0000036643

Transcript Exhibit(s)

T-01051B-03-0454

T-00000D-00-0672

PART 5 of 5

RECEIVED

2005 NOV -9 P 4: 08

AZ CORP COMMISSION
DOCUMENT CONTROL

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-15 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL TESTIMONY

OF

SCOTT A. MCINTYRE

QWEST CORPORATION

DECEMBER 20, 2004

TABLE OF CONTENTS

TOPIC	PAGE
I. IDENTIFICATION OF WITNESS	1
II. PURPOSE OF TESTIMONY	1
III. TESTIMONY OF MR. THOMAS REGAN	2
IV. TESTIMONY OF MR. TIMOTHY J. GATES	10
V. TESTIMONY OF MR. DON PRICE	16
VI. TESTIMONY OF MR. DEL SMITH	19
VII. TESTIMONY OF MR. ELIJAH O. ABINAH	30
VIII. SUMMARY OF REBUTTAL TESTIMONY	35

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND PLACE OF EMPLOYMENT.

A. My name is Scott A. McIntyre. I work for Qwest Services Corporation ("Qwest"). My title is Staff Director – Public Policy. My responsibilities include developing marketing and pricing strategies for Qwest and supporting these strategies in the regulatory arena. My business address is 1600 7th Avenue, Room 3214, Seattle, Washington 98191.

Q. HAVE YOU FILED TESTIMONY PREVIOUSLY IN THIS CASE?

A. Yes, I filed direct testimony on May 5, 2004.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to respond to the testimony of Mr. Thomas Regan for the Arizona Commission Staff, as it relates to Qwest's intrastate switched access rates. I will also address the testimony of Del Smith for the

Utilities Division, as it relates to service quality standards affecting the Residence Business Office access, Business Business Office access and Repair Center access. In addition, I will respond to the testimony of Timothy J. Gates for Time Warner Telecom of Arizona, LLC. as it relates to the pricing of Qwest's intrastate private line services, also known as special access. I will address portions of Mr. Don Price's testimony for MCI concerning switched access issues, and finally, I will address the proposal by Mr. Elijah O. Abinah for the Utilities Division of the Commission as it relates to increasing the credit to customers for special construction costs.

III. TESTIMONY OF MR. THOMAS REGAN

Q. WHAT IN MR. REGAN'S TESTIMONY WOULD YOU LIKE TO ADDRESS?

A. On page 35 of his testimony, Mr. Regan begins a discussion of Qwest's intrastate switched access service pricing. He concludes his analysis with a recommendation that Qwest reduce intrastate switched access rates by approximately $8.9 million.

Q. DO YOU AGREE WITH MR. REGAN'S ANALYSIS?

A. I agree with Mr. Regan that Qwest's intrastate switched access rates should be reduced. One of Mr. Regan's analysis techniques however, is based on a faulty premise and the other technique is arbitrary. As a result, Mr. Regan's final recommendation for rate reduction is essentially an arbitrary amount.

Q. WHAT FAULTY PREMISE DOES MR. REGAN RELY UPON IN HIS ANALYSIS?

A. On page 35 of his testimony, at line 22, Mr. Regan claims that Qwest's interstate switched access rates are artificially low. He bases his assertion on the concept that the interstate End User Common Line (EUCL) charge should be factored into switched access rates. This is clearly not the case. The EUCL charge is a rate element intended to provide revenue support for the local loop. It is not a switched access service and does not provide support for low switched access rates. Interstate switched access rates are above cost and need no support from any other service.

Q. WHY IS THE EUCL CHARGE ASSOCIATED WITH SWITCHED ACCESS AT ALL?

A. In years past, the revenue from the EUCL charge was collected through switched access rates. At that time, an implicit subsidy was inherent within switched access. The FCC recognized that support for the local loop was causing switched access rates to be artificially high and that this implicit subsidy should be removed. The FCC has done that over the past few

years, separating the EUCL charge from switched access and driving switched access rates toward cost.

Q. WHY SHOULD THE EUCL CHARGE BE SEPARATE FROM SWITCHED ACCESS?

A. Non-traffic sensitive costs, such as the loop, should be recovered in a non-traffic sensitive manner. The old architecture created a subsidy whereby long distance carriers were paying a portion of the loop charges in a traffic sensitive way. Carriers were charged switched access on a per-minute basis. They then passed these costs on to consumers in the form of long distance rates.

Q. HOW DID THE INCLUSION OF LOOP SUPPORT CREATE AN IMPLICIT SUBSIDY WITHIN SWITCHED ACCESS?

A. This was an implicit or hidden subsidy for two reasons. The first is that the true cost of the loop was not being paid for by the end users, who were the ones who created the cost. The cost was being paid by long distance carriers who did not create the cost at all. Even if the carriers passed these costs along to consumers in the form of higher long distance rates, these rates were not in proportion to the costs incurred and not in proportion to the use by consumers. Simply put, the end users who made few long distance calls were being subsidized by those who made many calls. While this concept was acceptable in a monopoly environment, it is not acceptable in a competitive environment. This is why The Telecommunications Act of 1996 and the FCC has sought to eliminate such implicit subsidies.

Q. WHAT IS THE SECOND WAY IN WHICH THE OLD RATE ARCHITECTURE REPRESENTED AN IMPLICIT SUBSIDY?

A. The cost of the loop is not sensitive to traffic volume. The cost of the loop is the same whether many calls are made or few calls are made. This requires a flat rated structure such as the EUCL charge. Every consumer should pay the same on an averaged basis, to cover the cost of the loop because the costs are the same, regardless of how much the customer uses it. The recovery of these costs through switched access rates means that high toll usage contributes more to overall loop costs than low usage. This again is a form of implicit or hidden subsidy. The costs were not being recovered in the same proportion as they were incurred.

Q. IF QWEST'S INTERSTATE SWITCHED ACCESS RATES ARE NOT ARTIFICIALLY LOW, AS MR. REGAN STATES, DOES THAT MEAN THAT QWEST'S INTRASTATE RATES ARE ARTIFICIALLY HIGH?

A. Yes. Qwest's intrastate switched access rates still contain an implicit subsidy that supports the loop cost of local service.

Q. DOES THIS MEAN THAT THIS SUBSIDY CAN BE EASILY ELIMINATED?

A. No, while the solution is simple, it is not easy. The costs are real and need to be recovered. The solution is to shift the cost recovery mechanism as the FCC has done toward the end user on a flat rated basis.

Q. WHY IS MR. REGAN'S SECOND ANALYSIS TECHNIQUE ARBITRARY?

A. Mr. Regan's second analysis technique is to compare Qwest's intrastate access rates in Arizona to Qwest's intrastate access rates in Qwest's other 13 state territory. Choosing an average rate may sound reasonable, but it does not address the public policy of each state to determine why the rates in each state are set where they are. Mr. Regan merely concludes that since this technique yields a number that is close to his first analysis result, it somehow validates his first analysis. Since the first analysis was based on a flawed assumption, this comparison may be interesting but it does not validate anything.

Q. HOW DO THE PUBLIC POLICIES IN ARIZONA OR QWEST'S OTHER STATES AFFECT THE PRICING OF SWITCHED ACCESS?

A. Intrastate switched access has long been a revenue support mechanism for local service. High switched access rates provide a revenue stream that helps maintain low basic exchange rates. This is the traditional thinking of many regulators across the nation. This public policy is changing. Many regulators recognize that these policy based subsidies cannot be sustained in a competitive marketplace. This is the main flaw with Mr. Regan's comparison of other Qwest state switched access rates. Such a comparison assumes that other states are in the exact same policy transition phase as Arizona. Mr. Regan's comparison would have been better had he only compared Arizona rates with states that are in a similar situation in terms of rate levels for switched access and basic exchange service as well as levels of competition across various sectors.

Q. ARE THERE STATES INCLUDED IN MR. REGAN'S AVERAGE THAT ARE CLEARLY IN A DIFFERENT PHASE OF POLICY TRANSITION WITH RESPECT TO LOCAL RATES AND SWITCHED ACCESS RATES?

A. Yes. As an example, Wyoming has lowered switched access rates dramatically, however rural residential rates are almost $70 in some areas. Wyoming has also instituted a state universal service fund to offset some of the impact to customers. The public policy on these issues is clearly different in Wyoming than in Arizona, so any rate comparison for switched access is merely interesting.

Q. DOES MR. REGAN'S AVERAGING OF OTHER STATE RATES ALLOW FOR SUCH DIFFERENT STATES AS WYOMING?

A. Averaging Qwest's other states assumes that Arizona's public policy on this matter should be an average of other state policies. Averaging other state rates may be convenient but it is not an appropriate way to set policy on this issue in Arizona.

Q. HOW SHOULD THE COMMISSION SET POLICY IN TERMS OF PRICING INTRASTATE SWITCHED ACCESS RATES IN THIS CASE?

A. The Commission should determine what is appropriate at this point in time for Arizona. While analyzing other specific states could provide insight, merely averaging other state rates will provide no help. The Commission has stated before that parity with interstate switched access rates is a "laudable goal".[1] Qwest has stated agreement with this goal in many state

[1] Commission Opinion and Order in Docket No. T-01051B-99-0105 et.al, page 12, lines 15-21, October 20, 2000.

dockets around the country. The Commission must balance this eventual goal with the current situation in Arizona however and determine the current state of progress toward this goal.

Q. WHAT ARE THE KEY FACTORS TO CONSIDER IN DECIDING THE MAGNITUDE OF SWITCHED ACCESS REDUCTIONS IN THIS CASE?

A. Reducing switched access requires a shift of this revenue stream to other products. This revenue represents the recovery of legitimate costs and it is needed to maintain financial health for Qwest. The FCC has shifted this revenue at the interstate level to the EUCL charge which is currently $6.50 for basic service customers in Arizona. While the Arizona state equivalent of such a charge would be much lower than the interstate rate, the Commission must decide if this approach is necessary at this time and how large a step toward the goal should be taken.

Q. DOES QWEST PROPOSE A SWITCHED ACCESS REDUCTION IN THIS CASE?

A. Yes. Qwest is proposing lowering switched access rates to reduce revenues by $5 million.

Q. IS THIS ESSENTIALLY THE SAME $5 MILLION REDUCTION THAT THE COMMISSION DETERMINED WAS NOT REQUIRED IN A PREVIOUS DECISION?

A. Yes. The Commission determined in Decision No. 67047, Dated June 18, 2004 that a $5 million reduction in switched access rates was not required. Qwest is essentially offering that reduction as part of this case.

Q. ISN'T THIS $5 MILLION JUST AS ARBITRARY AS MR. REGAN'S $8.9 MILLION NUMBER?

A. No. This $5 million has already been planned for in terms of the rate adjustments necessary to develop this revenue reduction. An additional reduction as suggested by Mr. Regan would require additional analysis and rate calculations. Any additional revenue reduction in switched access beyond this $5 million figure must be offset with an increase in other rates.

Q. WHAT WOULD QWEST PROPOSE AS THE OFFSET TO SWITCHED ACCESS REDUCTIONS?

A. The most logical method would be to institute a recurring monthly charge per line to offset the reduction in switched access rates, similar to the approach used by the FCC. This would accomplish the rate rebalancing that is essential to the elimination of implicit subsidies in a competitive market. This type of charge is commonly used by providers of local service in Arizona.

Q. IF QWEST BELIEVES THAT PARITY WITH INTERSTATE RATES IS AN IMPORTANT STEP TOWARD ACCESS REFORM, WHY IS QWEST NOT PROPOSING PARITY IN THIS CASE?

A. As part of any case in any other jurisdiction, Qwest has always stated that a revenue neutral shift of access revenues is essential to rate rebalancing. That rebalancing in Arizona may not be possible without changes in current policies concerning local service rates and/or universal service. As other Qwest witnesses will testify, the competition in Arizona is high and the opportunity therefore for Qwest to raise rates to offset access reductions is low. Raising Qwest's most competitive service rates would simply cost Qwest customers for those services and this would negate any rate rebalancing. Even if the Commission decided to raise basic exchange rates as an offset, competition may just increase for these customers and negate the attempt to balance revenues.

IV. TESTIMONY OF MR. TIMOTHY J. GATES

Q. WHAT ISSUES IN MR. GATES' TESTIMONY WOULD YOU LIKE TO ADDRESS?

A. Mr. Gates make made broad claims about special access being a monopoly service that are clearly in error.

Q. WHAT IS SPECIAL ACCESS SERVICE?

A. Special Access is the same service as private line service. If a toll carrier uses private lines for the express purpose connecting end users to the toll

carrier's switch, then they call this dedicated private line circuit "Special Access".

Q. FROM QWEST'S PERSPECTIVE WHY ARE THESE CIRCUITS ALL CALLED PRIVATE LINE?

A. Qwest (and other providers as well) provides a dedicated point-to-point circuit from one customer location to another. This circuit may carry data or voice traffic. Qwest has no control over the traffic on this circuit and has no way of knowing its nature. Even if the circuit is provided from an end user to a carrier's Point Of Presence (POP), Qwest still doesn't know how this circuit is being used. The carrier may connect this circuit to another dedicated channel transporting data to another customer location. In this scenario, the circuit continues to be considered a "private line". The carrier may however connect this circuit from their customer to the carrier's switch. In this application, the circuit can carry long distance traffic yet bypass Qwest's switched network and bypass Qwest's switched access charges. In this application, the private line becomes a "special" access circuit from the customer's perspective or the carrier's perspective. These circuits are referred to as "special" access because they bypass the public switched network and its associated switched access charges.

Q. DO CLECS NEED THESE CIRCUITS AS MR. GATES CLAIMS ON PAGE 5 OF HIS TESTIMONY?

A. No. They may like such circuits for the ability to bypass switched access charges but they can use the switched network to carry this traffic. Such

circuits provide a significant advantage over paying for switched access, but they are not a necessary element from a network perspective.

Q. ARE THESE CIRCUITS ONLY AVAILABLE FROM QWEST, AS MR. GATES CLAIMS ON PAGE 5 OF HIS TESTIMONY?

A. Certainly not. Private line has been highly competitive for many years. Long before local service competition there was competition in the private line arena. Many competitive service providers began offering private line service as their first market offering. This is because the private line market is easy to enter. There is no need for a ubiquitous network for private line. All that is needed is some facilities between two locations and you are in business.

Q. ARE INTRASTATE PRIVATE LINE SERVICES COMPETITIVE WITH INTERSTATE SERVICES?

A. Yes. Both interstate private lines and intrastate private lines are in the same market. Customers mix their interstate traffic with their intrastate traffic on the same circuits. Up to 90% of an interstate circuit's traffic may be intrastate in nature. There are no practical methods for policing the traffic on these circuits so customers purchase circuits on the basis of low price not jurisdiction.

Q. ARE QWEST'S RATES FOR INTERSTATE PRIVATE LINES LOWER THAN THEIR INTRASTATE COUTERPARTS?

A. Yes. This is why the majority of Qwest circuits are purchased out of the interstate tariffs.

Q. DO COMPETITIVE PROVIDERS OF PRIVATE LINES DISTINGUISH BETWEEN INTERSTATE RATES AND INTRASTATE RATES?

A. No. Competitive private line providers typically don't distinguish between interstate and intrastate jurisdictions in providing these circuits and price them the same.

Q. DO MANY PROVIDERS OFFER PRIVATE LINE SERVICE IN ARIZONA?

A. Yes. There are currently more than 25 providers in Arizona with tariffs offering private line (or special access) services.

Q. HOW DOES QWEST OFFER PRIVATE LINE SERVICES IN ARIZONA?

A. Qwest offers private line services through its Competitive Private Line Transport Service Tariff.

Q. HOW LONG HAVE THESE SERVICES BEEN CONSIDERED COMPETITIVE IN ARIZONA?

A. Qwest's Competitive Private Line tariff was established in 1997.

Q. IS PRIVATE LINE A WHOLESALE PRODUCT OFFERING?

A. No. Private line is a retail service.

Q. SHOULD RETAIL SERVICE PRICES BE REDUCED TO COST AS MR. GATES CLAIMS ON PAGE 5 OF HIS TESTIMONY?

A. No. Retail services are priced above cost to recover joint and common costs. If Time Warner wishes to purchase private line services for the provision of local service it should do so through an interconnection agreement or through Qwest's Schedule of Generally Available Terms (SGAT). If it wishes to purchase dedicated transport for long distance purposes, it should purchase special access/private line from Qwest or from any of a number of other companies that own their own facilities. An even more economical choice might be to build the facilities themselves.

Q. CAN TIME WARNER PROVIDE ITS OWN FACILITIES FOR PRIVATE LINE SERVICES?

A. Yes. In fact, Mr. Gates admits that Time Warner self provides these facilities. On page 17 of his testimony, Mr. Gates describes a situation where time Warner was denied access to a building in which it wished to place fiber optic cable. The building owner denied them access, but this was obviously Time Warner's first choice for reaching customers in that building.

Q. HOW DO COMPANIES SUCH AS TIME WARNER MAKE DECISIONS ON WHICH PROVIDER TO USE FOR PRIVATE LINE SERVICES?

A. Typically such companies will check their own networks first to determine if they have capacity in the locations needed. If they lack capacity or do not have facilities to a specific location, they will then check other providers in the area. Often they will seek facilities from Qwest as a last resort.

Q. IS FIBER THE ONLY TECHNOLOGY CURRENTLY USED FOR PRIVATE LINE CIRCUITS?

A. No. Fiber is a common technology today but other technologies include coaxial cable, copper wire, and microwave radio. In addition, infra-red systems and laser systems are available that can be set up quickly and inexpensively.

Q. DOES QWEST HAVE ANY ADVANTAGE WHEN IT COMES TO PLACING NETWORK FACILITIES FOR PRIVATE LINE SERVICES?

A. No. This is why the private line market is so competitive. Many providers have networks and it is reasonably easy to place facilities in metropolitan areas where the largest demand exists. Many municipalities have networks and offer excess capacity for resale. Qwest is actually at a disadvantage in many ways. Qwest employs wide spread networks. This approach has one advantage in that it reaches many customers but it has a pricing problem due to the need to file tariffs based on average costs. This results in the lower cost portions of the network being overpriced and the higher cost portions being under-priced. This motivates competitors to self provide where Qwest's costs (and theirs) tend to be low, but rely on Qwest's network where costs are high but Qwest rates are relatively low.

Q. IS THERE ANY JUSTIFICATION FOR MR. GATES' CLAIMS THAT SPECIAL ACCESS/PRIVATE LINE IS A MONOPOLY SERVICE?

A. No. These services are very competitive and Qwest has offered these services under the approved competitive classification for many years.

There are many other companies that offer these services with their own facilities, for example, Cox, Qwest's largest competitor, offers DS-1, DS-3, OC-3, OC-12, and OC-48 Special Access services in its Arizona tariff[2].

V. TESTIMONY OF MR. DON PRICE

Q. WHAT TESTIMONY DOES MR. PRICE PROVIDE FOR MCI IN THIS CASE THAT YOU WOULD LIKE TO ADDRESS?

A. Mr. Price discusses intrastate switched access rates in Arizona. He makes the claim that intrastate switched access should be priced at cost to avoid various market problems. He also claims that Qwest is not being consistent in this case with what Qwest has argued in other situations in other states.

Q. SHOULD SWITCHED ACCESS RATES BE SET AT COST?

A. No. Under the current mechanism for intercarrier compensation, switched access should not be set at cost. Switched access is one service of many that contributes to the overall rate design currently supported by all states and the FCC. There is no jurisdiction in the country that has endorsed the concept that switched access rates should be set at cost.

Q. SHOULD INTRASTATE SWITCHED ACCESS RATES BE SET AT INTERSTATE AS MR. PRICE SUGGESTS ON PAGE 3 OF HIS TESTIMONY AS THE NEXT BEST ALTERNATIVE?

[2] See Cox Arizona Telecom LLC Access Tariff, Tariff No. 2, Specialized Common Carrier Service, p. 51.

A. Under the right circumstances, yes. Qwest has presented arguments in other situations supporting that FCC rates constitute a valid surrogate for free market rates for switched access.

Q. MR. PRICE CLAIMS ON PAGE 45 OF HIS TESTIMONY THAT QWEST IS BEING INCONSISTENT IN THIS CASE WITH WHAT QWEST ARGUED IN A RECENT CALIFORNIA CASE. IS THIS TRUE?

A. No. The California case included an extensive industry-wide investigation of switched access rates and the issues that surround access reform. Under ideal conditions, Qwest would propose the similar resolutions to these issues as it did in California. The situation in Arizona is different and therefore Qwest's proposal in this case is different.

Q. WHAT WOULD IT TAKE FOR QWEST TO PROPOSE THE REDUCTION OF INTRASTATE SWITCHED ACCESS RATES IN ARIZONA TO INTERSTATE LEVELS?

A. It would require an industry-wide investigation that resulted in a competitively neutral rebalancing of intrastate switched access rates.

Q. WHY MUST SUCH REFORM INCLUDE ALL PROVIDERS?

A. True access reform involves much more than just access rates. Access reform will affect basic exchange rates which will require support from universal service funds. Competition will be affected because many providers use switched access to subsidize their local service offerings. In

order to encourage fair competition, the Commission must treat all providers in a fair and balanced manner.

Q. HOW DO YOU KNOW OTHER LOCAL SERVICE PROVIDERS USE SWITCHED ACCESS AS A SUPPORT MECHANISM FOR OTHER SERVICES/

A. It is fairly obvious from looking at different service rates. Cox Arizona Telecom, LLC, for example, charges switched access rates of four cents per minute for originating calls and four cents per minute for terminating calls. For a call from one Cox customer to another Cox customer, this amounts to eight cents per minute. Cox offers a long distance plan however, at three cents per minute. They also offer basic exchange service at rates lower than Qwest's rates. These disparities are evidence that many providers average rates together and use one service to support another. This is common in a competitive world, but it can cause some confusion for customers when comparing rates between providers.

Q. DOES THIS DOCKET DEAL WITH ALL PROVIDERS IN ARIZONA?

A. No. This Docket deals only with Qwest. This is why Qwest's proposal for switched access in this limited situation is different than it would be in an industry-wide investigation of access reform in Arizona.

VI. TESTIMONY OF MR. DEL SMITH

Q. WHAT TESTIMONY DOES MR. DEL SMITH PROVIDE IN THIS CASE?

A. Mr. Smith provides testimony on behalf of the Utilities Division of the Commission Staff. In his testimony Mr. Smith addresses some service quality issues and makes a recommendation that service quality measurements with some modification be continued as part of this proceeding.

Q. WILL YOU ADDRESS ALL ASPECTS OF MR. SMITH'S TESTIMONY?

A. No. Mr. Dennis Pappas for Qwest will address issues around held orders and out of service performance. I will address issues raised by Mr. Smith concerning access to Qwest's business offices and repair centers.

Q. WHAT DOES MR. SMITH RECOMMEND RELATIVE TO CALL CENTER ACCESS PERFORMANCE?

A. Mr. Smith recommends that the thresholds for service penalties be changed so that penalties are more likely under the new plan.

Q. WAS QWEST REQUIRED TO IMPLEMENT ONE TIME PAYMENTS TO CUSTOMERS UNDER THE OLD PLAN DUE TO LOW SERVICE QUALITY?

A. No. Qwest satisfied the requirements of the plan to prevent such payments.

Q. WHAT IS MR. SMITH'S OVERALL OPINION OF QWEST'S SERVICE PERFORMANCE DURING THE TERM OF THE CURRENT PLAN?

A. On page 15 of his testimony, Mr. Smith states: "Reviewing all of the performance data collectively, Staff concludes that Qwest service quality has not diminished, and overall has improved, during the initial term of the Price Cap Plan."

Q. THEN WHY DOES MR. SMITH RECOMMEND INCREASING THE OPPORTUNITY FOR PENALTIES?

A. One reason seems to be that he is concerned about a few periods of lower performance. He seems to believe that increasing the penalty will prevent such occurrences.

Q. WHAT MEASUREMENTS CREATED PENALTY PAYMENTS FOR QWEST DURING THE TERM OF THE CURRENT PRICE PLAN?

A. The only penalty payments were associated with customer access to the Residence Business Office.

Q. DO MR. SMITH'S RECOMMENDATIONS FOR INCREASED PENALTIES AFFECT ONLY THE RESIDENCE CALL CENTERS?

A. No. Even though residence center performance was the only measurement that resulted in penalty payments, Mr. Smith would have penalties increased for the Business centers and Repair centers as well. Meeting performance standards should not result in increased penalties for these other center operations.

Q. ARE MR. SMITH'S RECOMMENDATIONS WARRANTED?

A. No. Qwest does not concur with Mr. Smith's contention that narrowing the penalty and offset ranges for Residence, Business and Repair office access will encourage higher performance levels. As Mr. Smith's testimony plainly shows, Business and Repair office would pay the same penalty under this proposal as they did under the current methodology – **nothing**. Both these centers have maintained a high performance level throughout the period of the Price Cap Plan such that no penalties were incurred. Narrowing the ranges is an unnecessary and unwarranted step. Rather than tightening the ranges, the penalty requirement should be eliminated altogether. The penalty provision as an incentive to improve call center access is outmoded and has outlived its usefulness.

Q. WILL INCREASING THE PENALTY OPPORTUNITY IMPROVE SERVICE?

A. It is doubtful that narrowing the penalty and offset ranges would have any beneficial impact on customers. According to Mr. Smith's chart on page 14 of his testimony, complaints to the Consumer Services Section of the Arizona Commission have dropped dramatically from 2000 to 2004. In fact, Commission complaints on call handling are at some of the lowest levels since the start of the Price Cap Plan. Through October 2004, there had been only 69 complaints on call handling in Arizona, an average of only 7 complaints a month. Clearly customers are satisfied with business office and repair office access. The only effect of this proposal would have is be to

raise the penalty amount for the Residence office where greater call volumes make performance more vulnerable to volatility.

Q. ARE FLUCTUATIONS IN PERFORMANCE TO BE EXPECTED IN CALL CENTER OPERATIONS?

A. Yes. Call volumes to call centers are subject to extreme volatility. Call centers of any kind experience events that cause performance to dip at times. There are three key elements to manage in order to provide consistent customer hold times. These are: call volume, call duration and staffing levels. In order to staff appropriately, the call center manager must accurately predict how many calls will come into the center and how long these calls will take. Once these predictions are made, staffing levels must be adjusted.

Q. IS THERE MUCH HISTORY TO RELY ON FOR THESE PREDICTIONS OF LOAD?

A. Yes. There is significant history available, but it is history, not a crystal ball for the future. History predicts the likelihood of call volumes and durations, but this is not an exact science.

Q. WHAT TYPES OF PROBLEMS DOES QWEST ENCOUNTER WHEN STAFFING CALL CENTERS TO APPROPRIATE LEVELS?

A. It is well known that Mondays and days after holidays are the heaviest call

days and schedules are set to have the maximum number of consultants available on those days. But other things can impact call volumes, such as a news story, advertising, customer moving on the first of the month, school being out in the spring or just starting up in the fall. Repeat callers are an increasing factor in call volume, and they can be attributed both to low experience levels of the consultants, and to the increased complexity of the products and services now available to customers.

Q. ONCE PREDICTIONS ARE MADE IS IT ALWAYS POSSIBLE TO STAFF APPROPRIATELY?

A. No. Mondays loads, for example may be 50% higher than any other day in the week. It is nearly impossible to staff up by 50% for just one day. Employees like to work consecutive days. Since the centers are closed on Sunday, Monday is particularly problematic. Working Monday, Tuesday, Wednesday, Thursday, Friday is acceptable, but Monday, Wednesday, Thursday, Friday, Saturday is not. This schedule would give employees Tuesday and Sunday off. Any schedule that requires Monday in the schedule, but covers Saturday as well is a problem. Also, you cannot hire highly trained and skilled representatives to work just Mondays on a part-time basis. This type of part-time labor is not easily available.

Q. WHAT OTHER FACTORS IMPACT THE NUMBER OF CALLS THAT CAN BE HANDLED IN A DAY?

A. Different call types have varying call lengths. For example, a simple inquiry about the bill may take less than a minute, while an order for new service can take more than a half hour. Call length is impacted by the experience level of the consultant, and how many times he or she may need to seek help from a supervisor or more experienced employee, or how often and how many systems need to be accessed in order to complete the customer's request. As telecommunications services become more complex, they require more and longer explanations to customers.

Q. HAS QWEST EXPERIENCED ANY SIGNIFICANT PROBLEMS THAT HAVE AFFECTED CALL CENTER PERFORMANCE IN THE TIME PERIOD OF THE CURRENT PRICE PLAN?

A. Yes. In January 2004 there was a severe ice and snow storm that closed the offices in Seattle and Portland for two days. This created significant problems as the calls to these centers had to be routed to other centers.

Q. WERE ARIZONA CUSTOMERS AFFECTED BY THIS STORM?

A. Yes. Calls are routed to many centers around Qwest's region to balance the load. Since these centers in Seattle and Portland were closed it created overloads in other centers. This affected customer hold times across the entire region.

Q. DID OTHER EVENTS OCCUR THAT ALSO AFFECTED SERVICE RESULTS?

A. Yes. Qwest launched a new product in December 2002. This product was called Qwest Choice and it was very popular. In fact, this product was so popular that calls to Qwest business offices were twice what was expected. This example illustrates that even when Qwest offers an attractive product for customers, there is a danger of missing call center objectives if the popularity of the product is not predicted accurately. In this case, call center results would have been better if the product were less beneficial to customers.

Q. ARE THE CURRENT MEASUREMENTS APPROPRIATE FOR MEASURING BUSINESS OFFICE PERFORMANCE?

A. No. The real measure of any call center performance is overall customer satisfaction at the conclusion of the call. Customers want their issue resolved in an efficient and professional manner. How long they waited to talk to a representative is forgotten if that representative is professional; and handles the call to the customer's satisfaction.

Q. HOW WOULD THIS BE MEASURED?

A. The only way to really measure customer satisfaction is through surveys.

Q. DOES QWEST SURVEY CUSTOMERS ON SATISFACTION WITH BUSINESS OFFICE CONTACTS?

A. Yes. Qwest surveys customer and reports the results to the FCC. The FCC then generates Automated Reporting Management Information System

(ARMIS) reports. According to the latest (2003) ARMIS report, less than 2% of Qwest residence customers are dissatisfied with their business office experience.

Q. IS QWEST COMMITTED TO PROVIDING GOOD CUSTOMER ACCESS TO YOUR BUSINESS OFFICES?

A. Yes, and we believe we are providing good service for the majority of our customers. We must do this to meet the competitive challenge we are seeing in all areas of the business, and we must be able to accommodate growth with the good service that customers have come to expect.

Q. SHOULD THE ARIZONA PRICE PLAN INCLUDE MEASUREMENTS FOR CALL CENTER ACCESS?

A. No. Call center access is not an accurate measurement of customer service. Customers expect professional representatives to handle their calls efficiently and to the customer's satisfaction. This customer satisfaction cannot be expressed by a simple measurement of time spent on hold. The FCC ARMIS data and the lack of complaints to the Arizona Commission is evidence that customers are being well served by Qwest call centers. The current standard is cumbersome and unnecessary.

Q. IF THE PRICE PLAN MUST INCLUDE SOME SERVICE LEVEL MEASUREMENT FOR BUSINESS OFFICE OR REPAIR OFFICE ACCESS, ARE THE CURRENT STANDARDS APPROPRIATE?

A. No. If the Price Plan must include a service level measurement for Business office or Repair center access, it should use a 60-second average wait time instead of the current standard. Average wait time is a far better measurement for customer access to call centers than the current 80/20 measure. This metric measures the length of time a customer waits for a customer representative to respond once the customer has selected the last menu option of the automated response system. Average wait time not only better expresses the experience of all customers, it reflects how call centers are managed and therefore provides valuable data that call center managers can use to improve customer service. State commissions in Washington, New Mexico and Utah have already adopted the average wait time metric and it is being considered in Colorado and Montana rulemaking dockets.

Q. DOES AN AVERAGE WAIT TIME MEASUREMENT ALSO ENHANCE THE MANAGEMENT OF THE CALL CENTER?

A. Yes. An average wait time measurement delivers precise information to the call center manager that can be used to make decisions in real time on how to improve service. For the most part, call volume is controlled by circumstances. Qwest does not, for example, block incoming calls. Call volume is totally controlled by the customers making choices of when to call. Call duration is largely controlled by customers and the growing complexity of services. In order to provide good service, it is not advisable to cut conversations short just to answer the next call. This is a key reason why call access measurements are not the best measure of customer

service. Meeting access requirements by rushing conversations with customers helps meet access requirements but it reduces customer service. The key to managing call centers efficiently is to manage the personnel and shift people as needed.

The 80/20 standard makes it difficult to discover the true nature of any existing problem with answering calls. For example, if a call center is answering 75% of the calls within 20 seconds, the magnitude of the performance shortfall is still unknown. In this case there are 25% of calls that are not included in the metric that may be taking 21 seconds or 60 seconds to answer. The results become so clouded that the required shift in personnel cannot be accurately determined and staffing adjustments become more like guesses at the appropriate level. In contrast, if the average wait time is running 66 seconds and the objective is 60 seconds, it is clear that there is a 10% problem. If the work force can be augmented by 10% the average wait time will drop by 10% and the objective will be attained.

Another problem with the 80/20 measurement is that it has a very steep cliff from success to failure. For example, if a center is answering all calls in 20 seconds, it is meeting the 80/20 standard with 100% compliance. If call volume suddenly increases and the center slows to a 21 second answer rate for all calls, performance drops to 0% compliance. I realize that calls do not come in at a steady rate such as this, but it illustrates a situation

where service levels can drop by less than 2%, yet we go from 100% compliance to 0% compliance with the 80/20 standard.

Q. HOW DOES THE INCREASING COMPLEXITY OF SERVICES CONTRIBUTE TO THE PROBLEM?

A. Services that are increasingly complex and require more time to discuss with the customer. Many of our new services require some research into availability, either by wire center or loop characteristics. Also, there may need to be more discussion with the customer about what the service does and how it is billed. These new services add a layer of complexity that requires additional time, and it is even a bigger problem for newly trained employees.

Q. WHAT AVERAGE HOLD TIME WOULD QWEST RECOMMEND AS A STANDARD?

A. Qwest would recommend a standard of 60 seconds. The Commission should be setting minimum acceptable standards if they set any standards at all. These standards should be the same for all providers, not just Qwest. A 60 second hold time is reasonable at the present time. Customers experience hold time for many calls to many call centers in many industries. Waits of up to one minute do not create problems for most people. In fact, for many calls to many service centers a wait of only 60 seconds would be a welcome relief. I have been paying attention for the past few years to how long I wait when I call in to some service or sales center in various lines of

business. My experience has been waits of several minutes are not unusual.

VII. TESTIMONY OF MR. ELIJAH O. ABINAH

Q. WHAT ASPECTS OF MR. ABINAH'S TESTIMONY ARE YOU ADDRESSING?

A. Mr. Abinah proposes that the current $3000 special construction credit provided to customers in rural areas be increased to $5000.

Q. WHAT ARE SPECIAL CONSTRUCTION CHARGES?

A. Special construction charges occur when a customer requests a service that is unique, unusual or provides service specifically for one customer or group of customers. Special construction charges apply when the cost to provide these services exceed normal provisioning costs.

Q. WHY ARE SPECIAL CONSTRUCTION CHARGES APPROPRIATE?

A. Customers who choose to build in locations not served by telephone network facilities should not be subsidized for this choice by other rate payers of Arizona. A customer may wish to enjoy the privacy associated with living in a remote area, but this choice comes with appropriate additional costs. Other customers in Arizona should not have to pay higher rates for telephone service to pay for the lifestyle choices of a few.

Q. WHAT IS THE CREDIT DISCUSSED BY MR. ABINAH?

A. The credit amounts to a discount off of the total cost of providing service to the customer. For example, if the total cost to provide service is $10,000, the customer currently receives a $3000 credit. This means that the construction bill paid by the customer is only $7000.

Q. WHY IS THERE A CREDIT ALLOWANCE FOR SUCH SITUATIONS?

A. The credit dates back to a time when the desire to add customers to the network outweighed the problems with creating a subsidy for these customers. The cost of building new network in rural areas is typically higher due to the low densities and long distances involved. The credit was an attempt to support rural area customers because they typically were less affluent and needed more help.

Q. DOES THE CONCEPT OF POOR RURAL CUSTOMERS STILL HOLD?

A. No. Today, many people moving to rural areas are more affluent, not less. People moving to rural areas are those who can afford the transportation costs of getting to and from the cities. Rural family farms are declining and land is being divided up into ranchettes and country estates. These customers do not need subsidization and they should not receive it.

Q. IS THE CURRENT $3000 CREDIT APPROPRIATE?

A. No. The annual carrying charge for an investment of $3000 is approximately $863. This represents the depreciation cost, amortization including the cost of money, taxes and maintenance. The average expected revenues from a

1 residence customer are about $540 per year. This means that customers
2 who receive this credit are being subsidized by other rate payers in the
3 amount of approximately $27 per month. There is no reason to subsidize
4 these customers simply because of the lifestyle choices they make.

5 **Q. IS THE REVENUE FIGURE USED HERE A GUARANTEED NUMBER?**
6 A. No, not at all. The customer could easily choose to take service from
7 another provider. The new provider could be a reseller of Qwest's service in
8 which case the revenue would be reduced. The new provider could also be
9 one that utilizes its own facilities or some wireless technology. In such
10 cases, Qwest might receive no revenue at all. New facilities create costs
11 whether they are used or not. When Qwest must install new facilities, it is
12 committed to the cost but the revenue is definitely not guaranteed.

13 **Q. SHOULD THIS CREDIT BE INCREASED AS PROPOSED BY MR.**
14 **ABINAH?**
15 A. Certainly not. This credit is already too high in light of the current state of
16 telecommunications competition in Arizona. Raising the credit would
17 increase the subsidy already being received by this select group of
18 customers and result in a longer cost recovery period for Qwest.

19 **Q. HOW DOES THE $3000 CREDIT COMPARE TO THE AVERAGE LOOP**
20 **COST DETERMINED BY THE COMMISSION?**
21 A. The Commission has found that for wholesale pricing purposes, the
22 average cost of a loop in Arizona is $505. This means that while the

average loop cost is only $505, the Commission Staff wishes to allow almost ten times this amount to be credited to this special group of customers regardless of the actual costs to provide them service. In light of the telecommunications choices available to consumers today and the competitive market that exists in Arizona, it seems inappropriate to allow a credit this far above the Arizona average loop cost.

Q. WHAT WILL HAPPEN IF MR. ABINAH'S RECOMMENDED CREDIT INCREASE IS APPROVED BY THE COMMISSION IN THIS CASE?

A. The additional cost will be picked up by other rate payers in one form or another for the services they purchase from Qwest. Perhaps new services will be priced higher than they otherwise would. Perhaps discounts or promotions to other customers will be limited. Perhaps Qwest will be unable to pass along these costs due to competitive pressure and the only option is to cut operating costs which could adversely affect service levels.

Q. WHY CAN'T QWEST JUST ABSORB THE ADDITIONAL COST OF PROVIDING SERVICE TO THESE CUSTOMERS?

A. There is no such thing as "absorbing" the cost. The cost will be passed on to consumers in one way or another or the cost will be passed on to stock holders in the form of reduced earnings and a lower stock price. In any case, the increased cost of serving these special customers will have to be subsidized by others.

Q. IS THIS APPROPRIATE?

A. No. The telecommunications market is increasingly competitive. Competition cannot tolerate subsidies. One of the main focuses of The Telecommunications Act of 1996 and the FCC's interpretation of The Act has been the elimination of implicit subsidies. There is already such a subsidy in the current credit. Mr. Abinah would have that subsidy increased.

Q. DOES THIS CREDIT HAVE ANY EFFECT ON COMPETITON IN ARIZONA?

A. Yes, this credit is a detriment to competition. Forcing other rate payers to subsidize new customers and pay a portion of the cost to add customers to the network inhibits the ability of other providers to compete. If Qwest charges new customers less than the true costs of building new facilities, competitors must compete with a subsidized rate. This makes it difficult to build facilities to compete in the market. This is another case where a forced averaging of costs is detrimental to competition, especially in rural areas. Mr. David Teitzel also discusses this concept in his rebuttal testimony of Staff witness Matthew Rowell.

Q. WHAT SHOULD HAPPEN TO THIS CREDIT AMOUNT?

A. It should be eliminated completely. These customers are choosing to locate in areas that lack facilities. This means that Qwest must add facilities in a manner not planned for as part of efficient growth. This makes such additions more costly than efficient network growth would anticipate. If these new additions were average in nature then one could argue that the largest credit possible would equal the average loop cost which has been

determined to be approximately $505. Since these are not average situations and do not benefit from the economies of scale built into general network growth, the credit should be eliminated. These one-at-a-time, one-of-a-kind, construction efforts require specific analysis by Engineering. All of this effort should be paid for by the customer requesting service and no credit should be given at all.

VIII. SUMMARY OF REBUTTAL TESTIMONY

Q. WOULD YOU PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY?

A. Yes. Mr. Regan's testimony attempts to justify a reduction in Qwest's switched access rates by approximately $8.9 million. While Qwest agrees that some reduction in switched access is appropriate, Mr. Regan's analysis is flawed and creates no clear justification for the $8.9 million reduction. Qwest proposes that the $5 million reduction previously planned for is more appropriate given the policy issues and competitive levels in Arizona. The additional rebalancing of switched access rates is desirable but only if it can be accomplished in a revenue neutral manner that is consistent with the other policy issues applicable in Arizona.

Mr. Gates provides testimony that is misleading and inaccurate. His claim that Qwest is a monopoly provider of special access/private line services is

clearly baseless. There are many providers of private line service in Arizona, as is evidenced by the tariffs on file with the Commission. Qwest has offered these services under a competitive tariff since 1997. Mr. Gates' claims on this issue should not be given credence.

Mr. Price challenges Qwest's recommendations concerning switched access based on what he feels are needed changes in the industry. Qwest agrees that switched access reform should be addressed, but it should be addressed on an industry-wide basis. This Docket concerns only Qwest's rate plan and does not address other necessary components of switched access reform.

Mr. Smith recommends that penalties for Qwest should be increased even though he admits that service levels have improved. Mr. Smith's proposal is clearly unfair. Improvements in service should be rewarded, not penalized. Qwest must offer high quality service in order to compete in the telecommunications market. Mr. Smith clearly does not understand or appreciate the complexities of managing call centers that handle millions of calls per year. His analysis does not take into account the true value of service offered by Qwest's call centers and does nothing to balance his recommended expectations with real world expectations of customers. Mr. Smith's recommendation is just another example of micromanagement and over-regulation of Qwest. The CLECs in Arizona are not subject to the same service quality penalties as Qwest. Price Cap regulation was supposed to be an effort to simplify regulation. Mr. Smith seems to think it is an

opportunity to expand regulation in areas other than pricing. At best, the new price plan should not include service measurements at all. At worst, the penalties should remain the same, but the better standard of a 60 second average wait time should be adopted.

Mr. Abinah recommends that the subsidy already flowing to new customers requesting service should be increased. Increasing this subsidy is not only inappropriate; it is unfair to the other rate payers in Arizona. In this proceeding, while all rates are being examined for a reasonable design in an increasingly competitive market, the truly appropriate step would be to eliminate this credit completely.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF WASHINGTON)
) **ss** **AFFIDAVIT OF SCOTT A. MCINTYRE**
COUNTY OF KING)

Scott A. McIntyre, of lawful age being first duly sworn, deposes and states:

1. My name is Scott A. McIntyre. I am Staff Director – Public Policy for Qwest Corporation in Seattle, Washington. I have caused to be filed written rebuttal testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Scott A. McIntyre

SUBSCRIBED AND SWORN to before me this 14th day of December, 2004.

LORI L. WHITE
COMMISSION EXPIRES
NOTARY
PUBLIC
7-10-07
STATE OF WASHINGTON

Lori L. White
Notary Public

My Commission Expires: 7/10/07

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-16 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL TESTIMONY

OF

TERESA K. MILLION

QWEST CORPORATION

DECEMBER 20, 2004

TESTIMONY INDEX

EXECUTIVE SUMMARY i

IDENTIFICATION OF WITNESS 1

PURPOSE OF TESTIMONY 1

TESTIMONY OF MR. THOMAS REGAN 2

TESTIMONY OF MR. F. WAYNE LAFFERTY 12

EXECUTIVE SUMMARY

Current Responsibilities:

My title is Staff Director - Service Cost. My responsibilities include preparing expert testimony and testifying about the cost of service for all products and services that Qwest offers, including its traditional retail services and the more contemporary wholesale services.

Purpose of Testimony:

My testimony rebuts the testimony of Mr. Thomas Regan and Mr. F. Wayne Lafferty regarding Qwest's proposal for the Arizona Universal Service Fund ("AUSF"). In addition, my testimony rebuts Mr. Lafferty's testimony regarding the calculation of price floors based on Qwest's TSLRIC studies.

Summary of Testimony:

My testimony explains why Mr. Regan's interpretation of the AUSF rules, which assumes that no loop or port cost should be included in calculating the funding need, is incorrect. I also discuss the results of his "overall analysis" and provide the rationale for increasing the shortfall calculated in Zone 3 from $4.6 million to $19.6 million.

My testimony addresses Mr. Lafferty's concerns about the way that Qwest's TSLRIC studies have been developed in this proceeding and show why they result in costs that are exactly what Mr. Lafferty says they should be. Finally, I explain why Qwest proposed to use its fully allocated costs to calculate the AUSF funding amount instead of the direct TSLRIC costs as recommended by Mr. Lafferty.

IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Teresa K. (Terri) Million. My business address is 1801 California Street, Room 2050, Denver, Colorado 80202. I am employed by Qwest Services Corporation as a Staff Director, Service Costs, in the Public Policy Department. In this position, I am responsible for preparing testimony and testifying about Qwest's cost studies in a variety of regulatory proceedings.

Q. ARE YOU THE SAME TERESA MILLION WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony rebuts the direct testimonies of Messrs. Thomas Regan on behalf of the Staff of the Arizona Corporation Commission (ACC) and F. Wayne Lafferty on behalf of Cox Arizona Telcom regarding Qwest's proposal for the Arizona Universal Service Fund. In addition, my testimony rebuts Mr. Lafferty's testimony regarding the calculation of price floors based on Qwest's TSLRIC studies.

1 **Testimony of Mr. Thomas Regan**

2 **Q. DOES THE ARIZONA CORPORATION COMMISSION STAFF BELIEVE THAT**
3 **QWEST IS ENTITLED TO UNIVERSAL SERVICE FUNDING UNDER THE**
4 **ARIZONA CODE?**

5 A. No. According to Mr. Regan's analysis Qwest would not receive any AUSF
6 funding because in Staff's view the TSLRIC for basic local service should not
7 include any cost for the loop and the port. Mr. Regan reasons that because Qwest
8 already provides toll, access and vertical services the costs of loops and ports are
9 not additional costs of basic local exchange service. Thus, when Qwest's TSLRIC
10 costs (sans loop and port costs) are compared to the benchmark rates for local
11 service Qwest does not meet the test for receiving AUSF funding.

12 **Q. DO YOU AGREE WITH MR. REGAN'S ANALYSIS?**

13 A. No, I disagree with Mr. Regan's analysis on two levels. First, while it may be true
14 that the other major services listed by Mr. Regan are provided over Qwest's loop
15 and port facilities, they are not the reason for Qwest's decision to invest in those
16 facilities. Historically it is clear that the reason the telephone industry came into
17 existence in the first place was to provide people with basic local exchange
18 service. It was not until later that other services such as toll, access and vertical
19 services came into existence. Even in today's competitive marketplace Qwest's
20 decision to invest in additional loop and port facilities is based on the provisioning
21 of local dial tone to consumers. Mr. Regan's suggestion that the appropriate way
22 to calculate Qwest's TSLRIC cost for basic exchange service is to exclude the cost

of the loop and port entirely ignores this reality. His position is also counter to every other application where TSLRIC or TELRIC studies are used to calculate costs. For example, whether calculating price floors for retail services or UNE rates for unbundled elements Qwest's cost studies include the entire cost of the loop and the port in the cost of the service or element.

Second, if Mr. Regan is correct in eliminating the loop and port cost from Qwest's AUSF calculation, Qwest would never qualify for AUSF funds for the customers it serves in Arizona's high-cost areas, but then neither would any of Qwest's competitors who serve those same customers. This is because it would be a clear case of discrimination against Qwest if a different result was reached for CLECs who provide services to former Qwest customers over Qwest-owned facilities (i.e., the CLEC is allowed to receive funds based on the inclusion of loop and port costs in the calculation). Thus, Mr. Regan would be required to perform a similar analysis in determining a CLEC's eligibility for AUSF funding and based on the CLEC's costs being essentially the same as Qwest's the CLEC would also be denied AUSF funding. The result under Mr. Regan's interpretation is that the AUSF funds are never available to large LECs and are only available to small independent LECs. However, if that was the intent when the AUSF fund was established it seems as though the Administrative Code could have simply specified that the funds were not available to large LECs, rather than going to the trouble of describing how to determine the amount of AUSF support for large LECs

1 and at the same time writing the rules in such a way that they would never qualify
2 for funding.

3 **Q. WHY IS MR. REGAN'S INTERPRETATION A PROBLEM?**

4 A. If the CLECs are not able to receive AUSF funds for customers, particularly
5 residential customers, in Zones 2 and 3 where the combined loop and port costs
6 are high in comparison to the 1FR rates then competition is not likely to develop in
7 the affected areas. This result is directly counter to the Telecommunications Act of
8 1996 and previous findings of the Arizona Commission. In Decision No. 62753 the
9 Commission stated with regard to the relationship of deaveraged rates to retail
10 rates in an upcoming rate case that "it would be more appropriate to begin to
11 gradually make the [retail] rate structure more cost based. We believe such a cost
12 based movement is consistent with the objectives of the Act."[1] This is because, as
13 the Commission noted, "[t]he intent of the Act is to provide competitive choices to
14 all consumers, regardless of where they live in the state..." and further "[t]he
15 purpose of deaveraging of UNE rates is to minimize implicit subsidies."[2] However,
16 in spite of the fact that UNE rates have been deaveraged in Arizona since July of
17 2000, and cost differences among the zones have been recognized, the retail rate
18 structure in Arizona remains the same. As a result, implicit subsidies remain in the

[1] In the Matter of Investigation Into U S WEST Communications, Inc.'s Compliance With Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts, Docket No. T-00000A-00-0194, Phase I, Opinion and Order, July 25, 2000, pg. 6 ("Deaveraging Order").
[2] Id., pg. 7.

retail rates and the disparity between the retail rates and deaveraged UNE rates discourages competition in the high-cost zones.

Q. DO IMPLICIT SUBSIDIES PRESENT PROBLEMS FOR QWEST IN THESE HIGH-COST ZONES?

A. Yes. As competition for business customers and zone 1 residential customers increases it becomes more and more difficult for Qwest to continue with the current subsidies. The reason for this is two-fold. First, the subsidization of the high-cost zones is supported in part by the difference between business rates and residential rates in each of the zones. However, the cost to a CLEC of an unbundled loop and port is the same in any given zone regardless of whether they are used to provide service to a business or a residential customer. This allows the CLEC to capture Qwest's business customers by undercutting a cost that was originally set higher in order to subsidize residential customers, thereby eliminating one of Qwest's sources of residential subsidy. This would not be as much of a problem for Qwest if the CLECs were required to serve the same residential customers that Qwest does. However, because the CLECs do not face this requirement, if Qwest lowers its retail business price to meet the competition and keep the business customer it effectively gives up the remainder of the business subsidy it uses to subsidize high-cost residential customers.

Second, Qwest also relies on the prices it charges for features such as Caller ID, Last Call Return, Auto Callback and others to subsidize high-cost residential

service. However, the CLECs receive access to all of the features in the switch for one low TELRIC port charge. This allows them to undercut Qwest's prices for such services so that as competition for residential customers increases in low cost areas Qwest is left, again, with no ability to meet the lower price and less ability to subsidize the remaining customers in high-cost areas that it is required to serve. As the sources for subsidies available to support the high-cost customers Qwest serves dwindle it will become more and more difficult for Qwest to compete in the low-cost areas, and at the same time there is no incentive for the CLECs to compete for customers in high-cost zones where retail prices are kept low.

Q. HOW DOES QWEST'S AUSF PROPOSAL CHANGE THIS RESULT?

A. Qwest's AUSF proposal provides not only for the direct subsidization of service in high-cost zones as envisioned by the Telecom Act and this Commission, but it also provides incentive for CLECs to compete for all consumers, regardless of where they live in the state. By allowing both Qwest and qualifying CLECs to receive AUSF funding in high-cost zones the need to rely on implicit subsidies to serve the customers in those zones diminishes. This means that CLECs would be able to serve customers in all areas sooner because they would not first have to capture enough customers in low-cost zones in order to be able to subsidize a customer base in the high-cost areas. Qwest and the CLECs, alike, would have the ability to continue to serve and compete for customers in all areas of the state through the use of direct subsidies for those customers in high-cost zones.

Q. IF MR. REGAN IS CORRECT THAT THE ARIZONA ADMINISTRATIVE CODE CONTEMPLATES THE EXCLUSION OF LOOP AND PORT COSTS FROM QWEST'S AUSF CALCULATION IS THERE ANYTHING THE COMMISSION CAN DO TO ESTABLISH AUSF FUNDS FOR QWEST?

A. It is important to emphasize that Mr. Regan's conclusion that the loop and port costs should be excluded from the AUSF calculation cannot be correct because it doesn't make sense and it produces a discriminatory result. As I mentioned above, under Mr. Regan's interpretation the AUSF funds are never available to large LECs and are only available to small independent LECs. It does not make sense that the AUSF rules would be written to exclude the cost of the loop and port from the TSLRIC calculation used for large LECs, while at the same time including the loop and port costs in the embedded cost calculation used for small independent LECs. Nor does it make sense to exclude the loop cost when determining the high-cost areas under the AUSF rules, because the increased cost of the loop in rural and sparsely populated areas is what drives the price of service higher in the first place.

In the Midvale Order, establishing AUSF funding for Midvale Telephone Exchange, Inc., the Commission granted funding in part on the basis of Midvale's estimate of its cost to deploy facilities in order to serve previously unserved areas.[3] Although the Commission never specifically addresses the issue of loops and ports in its decision, presumably the "plant" used to provide service includes loops and ports.

[3] In the Matter of the Application of Midvale Telephone Exchange, Inc. for Authority to Increase Rates and for Disbursement form the Arizona Universal Service Fund, Docket No. T-02532A-00-0512, Opinion and

1 Allowing Midvale Telephone to receive AUSF funds on the basis of loop and port
2 costs, while disallowing those costs and denying AUSF funding for Qwest, would
3 be nothing short of discriminatory. Nevertheless, even if the Commission believes
4 that Mr. Regan's interpretation of the rules is correct, the Commission can allow a
5 waiver of the rules and grant Qwest's request for AUSF funds as a matter of public
6 interest just as it did for Midvale Telephone Exchange, Inc. in Decision No. 64011.[4]
7 In that case, the Commission determined that the "rules indicate that a company
8 must already be providing service to the area in which it is seeking AUSF funding
9 after applying for FUSF funding."[5] The Commission also noted that Midvale was
10 not serving any customers in the exchanges for which it was requesting AUSF
11 funds and could only estimate its costs because it had not yet built facilities in the
12 area. Nevertheless, because the Commission wished to encourage carriers to
13 invest in facilities to serve previously unserved areas, it allowed for a waiver of the
14 specific AUSF rules for Midvale in order to accomplish a competing goal that was
15 in the public interest. In this case, the Commission's competing goal is to provide
16 competitive choices for all consumers, regardless of where they live in the state.
17 By allowing Qwest to include the cost of the loop and port in its AUSF calculation
18 and granting its request for AUSF funding the Commission will be establishing a
19 mechanism whereby the correct incentives will be in place to encourage

---

Order, September 5, 2001, ("Midvale Order").
[4] Id., pg. 21.
[5] Id., pg. 21.

competition and the wide spread availability of basic telephone service in all areas of Arizona at reasonable rates.

Q. DOES MR. REGAN CONDUCT ANY ANALYSIS THAT SHOWS QWEST'S COSTS TO BE HIGHER THAN ITS REVENUES IN ANY OF THE ZONES?

A. Yes. Mr. Regan performs what he calls an "overall analysis" for AUSF in which he calculates a $4.6 million shortfall for Qwest in Zone 3.[6] This analysis compares Qwest's intrastate revenues to its intrastate costs for each zone. However, in spite of the fact that Mr. Regan's analysis shows Qwest's total annual intrastate revenues are below its total annual intrastate costs by more than $4.6 million, he determines that Qwest "does not need AUSF support" because overall its revenues exceed costs.[7]

Q. DO YOU AGREE WITH MR. REGAN'S OVERALL ANALYSIS AND HIS CONCLUSION?

A. No. To begin with, Mr. Regan's workpapers indicate that his analysis uses Qwest's fully allocated TSLRIC costs, except that for loop and port costs it uses Qwest's UNE loop and port rates. This does not make any sense. As I explain below in response to Mr. Lafferty, Qwest's TSLRIC studies use the Commission-determined investments underlying the UNE costs to develop retail rates. Except for the fact that a basic exchange study combines unbundled elements into a finished service, the only real difference between TSLRIC and TELRIC is the

[6] Regan Direct, Schedule TMR-3, pg. 2.

1 expense loadings that are applied. In the case of TSLRIC studies, Qwest
2 develops factors based on retail expenses, while TELRIC studies use factors
3 based on wholesale expenses. If the purpose of Mr. Regan's analysis is to
4 compare the retail revenues for a 1FR service to the TSLRIC costs for that service
5 then it should use the TSLRIC costs based on retail factors, not UNE rates that
6 were developed using wholesale factors.

7 In addition, Mr. Regan uses only, what he terms, the "intrastate portion" or 75% of
8 the loop and port cost in his analysis. He reasons that because the 1FR revenues
9 are intrastate in nature, then only 75% of the cost of the loop and port elements
10 should be included. However, this approach ignores that fact that when a carrier
11 makes a determination to invest in loop and port facilities it does not contemplate
12 placement of only three-quarters of a loop. Mr. Regan's use of the 75% factor
13 confuses cost (100%) with cost recovery (25% from interstate rates, 75% from
14 intrastate rates).

15 When the decision is made to provide dial tone to a customer for basic local
16 exchange service, the carrier bears the full cost of the loop and port facilities
17 whether other revenues are ever generated over that line or not. This is especially
18 true in a competitive environment where, as described in Mr. Teitzel's direct
19 testimony, consumers are turning to alternative technologies for service. For
20 example, with the advent of virtually free long distance services from wireless

[7] Regan Direct, pg. 34.

providers, it is entirely possible that a customer could use their wireline service strictly for local calling, while relying on their wireless service for long distance calls. In that case, the carrier incurs 100% of the cost of the loop but receives no contribution from interstate toll revenue to recover that cost. Nevertheless, the carrier does receive interstate revenue toward recovery of the loop cost in the form of the $6.50 end user line charge ("EUCL"). Mr. Regan uses the 75% to align intrastate costs with intrastate revenues, but ignores the fact that the AUSF calculation includes the interstate EUCL revenue. The correct way for Mr. Regan to align the costs in his analysis is to recognize that the $6.50 EUCL contributes to the partial recovery of the cost. Assuming the $6.50 in this way is conservative because it implies an average loop cost of $26 ($6.50/.25) and that second lines and business lines have higher EUCLs. Because the average loop cost in Arizona, as determined by the Commission, is far less than $26, the interstate EUCL provides more than adequate cost recovery for the interstate portion of the loop cost. Therefore, in order to properly reflect the costs Qwest incurs when it establishes service for a customer Mr. Regan should have used the entire cost of the loop and port in his analysis.

If Mr. Regan's analysis is adjusted to include the entire cost of the loop and port in the cost per line and the EUCL in the revenue per line, Qwest's shortfall in Zone 3 increases by $15 million to $19.6 million.

Finally, in spite of determining that based on his analysis Qwest experiences a $4.6 million shortfall in Zone 3, Mr. Regan concludes that Qwest is not entitled to AUSF funding. His conclusion completely ignores the purpose of universal service funding which is to help maintain affordable rates in high cost areas and at the same time eliminate implicit subsidies for high-cost service. By suggesting that Qwest has sufficient revenues in Zones 2 and 3 combined to cover the shortfall in Zone 3, Mr. Regan assumes that continuing subsidization of one group of customers by another is appropriate. Qwest believes that in order to encourage competition, eliminate implicit subsidies and at the same time maintain reasonable retail rates for the largest number of customers Qwest must be allowed to receive AUSF funding.

Testimony of Mr. F. Wayne Lafferty

Q. MR. LAFFERTY CLAIMS ON PAGE 37 OF HIS TESTIMONY THAT QWEST DID NOT BASE ITS TSLRIC STUDIES ON A UNE COSTING METHODOLOGY. IS HE CORRECT?

A. No. As I discussed in my direct testimony Qwest's TSLRIC studies utilize investments determined by the Commission for unbundled network elements (UNEs) in the wholesale cost docket (Docket No. T-00000A-00-0194). Those investments resulted from models and cost studies that were used to develop TELRIC, thus, UNE rates. As I also mentioned in my testimony there are many similarities between TELRIC and TSLRIC cost methodologies, the main difference being that TELRIC develops the cost of unbundled elements and TSLRIC

1 develops the cost of retail services. In addition, there are differences between the
2 expense loadings that are applied to determine retail costs versus those applied to
3 develop wholesale costs. Therefore, by using the underlying investments
4 established in the TELRIC docket, and applying retail expense loadings to
5 determine costs Qwest has effectively imputed the UNE costs into its TSLRIC
6 studies. This methodology does exactly what Mr. Lafferty says it should which is
7 to recover "the prices of the unbundled network elements that are utilized to
8 provision [ ] local exchange telecommunications service plus the long run
9 incremental cost of any other required network functions"[8] in Qwest's TSLRIC
10 costs.

11 **Q. ARE ALL OF QWEST'S TSLRIC COSTS BASED ON INVESTMENTS FROM**
12 **THE TELRIC DOCKET?**

13 A. No. There are some retail services that do not rely on investments from the
14 Commission-determined UNE costs either because there are not corresponding
15 unbundled elements that have been reviewed in a cost docket, or the wholesale
16 rates established by the Commission are not based on a discernable cost model.[9]
17 For example, in the case of Switched Access, Toll MTS, and Directory Assistance
18 Qwest has developed investments using its own retail models. It would be
19 impossible for Qwest to use a UNE costing methodology in its TSLRIC studies

[8] Lafferty Direct, pg. 38.
[9] For example, in Phase IIA of the cost docket the Commission set interim unbundled transport rates based on the results of an AT&T Arbitration for which there are no corresponding cost model or calculations available. Being unable to replicate the ordered transport rate Qwest used its current

where none exists. Thus the costs that result from these TSLRIC studies are based on the assumptions and TSLRIC principles discussed in my direct testimony.

Q. MR. LAFFERTY APPEARS TO BE CONCERNED THAT QWEST DID NOT PROVIDE TSLRIC STUDIES FOR ALL COMPETITIVE AND NON-COMPETITIVE SERVICES. DID YOU ADDRESS THIS IN YOUR DIRECT TESTIMONY?

A. Yes. In my direct testimony I posed the question "In this proceeding, is Qwest providing TSLRIC studies for all competitive and non-competitive services?" I went on to explain that in this proceeding I sponsored recurring cost results only for the services for which Qwest proposes to change prices or make other changes. For any of the services that Qwest does not propose to change the price, an analysis of costs would have already been undertaken in a previous proceeding when the service was introduced and should not be necessary here. I also pointed out that I was providing the cost results for the basic exchange products that are used in calculating the appropriate level of the AUSF funding need. Finally, I stated that I was providing cost results for Switched Access service and Message Toll Service (MTS) due to the consolidation of the Cost of Access Docket (Docket No. T-00000D-00-0672) with this proceeding. Beyond these studies it should not be necessary for Qwest to submit other cost information.

---

transport cost model to develop transport costs in its TSLRIC studies, including the Switched Access, Toll MTS and Basic Exchange services.

Q. MR. LAFFERTY DISAGREES WITH THE FULLY ALLOCATED COST THAT YOU USED IN YOUR AUSF CALCULATION. COULD YOU COMMENT ON THAT?

A. Mr. Lafferty believes that the "appropriate cost" under the Commission's rules for calculating AUSF is TSLRIC. As I explained in my direct testimony, the 'TSLRIC' in a TSLRIC study represents the direct costs of the service, but does not include the shared and common costs associated with the service. I do not disagree with Mr. Lafferty that the Commission rule describes the appropriate cost for purposes of determining AUSF support to be TSLRIC. However, the rule also says that the appropriate cost is the cost to provide basic local exchange telephone service "as determined by the Commission."[10] My testimony merely suggested to the Commission that it consider fully allocated TSLRIC cost as the appropriate cost for determining AUSF funding if one of its goals is to eliminate implicit subsidies. As I explained in my direct testimony the total cost to provide a retail service includes the direct cost of the service, as well as the costs that are shared among groups of services and a contribution to the common overheads of the corporation. If the AUSF support were calculated using an amount that recovered less than the total cost to provide the service, then the shared costs and the amount of contribution to common overheads from basic local exchange telephone service would be borne entirely by the lines located in Zone 1. Any necessary contribution not recovered from the Zone 1 lines would have to be recovered from Qwest's other retail services. This would result in an implicit subsidy of the business and residential

basic exchange customers in at least one zone by the customers in another zone. Because the purpose of a universal service fund is to help maintain affordable rates in high cost areas and at the same time eliminate implicit subsidies for high cost service Qwest believes that its fully allocated cost is the appropriate cost to use in calculating AUSF funding.

Q. DOES MR. LAFFERTY CALCULATE AN AMOUNT FOR QWEST'S AUSF FUNDING NEEDS USING TSLRIC COSTS?

A. Yes. Mr. Lafferty calculates that Qwest's AUSF funding requirement using TSLRIC-based costs is $24.5 million.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

---

[10] A.C.C. Rule 14-2-1202(A).

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-17 Admitted

BEFORE THE ARIZONA CORPORATION CO

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL TESTIMONY

OF

DENNIS PAPPAS

QWEST CORPORATION

DECEMBER 20, 2004

TABLE OF CONTENTS

	Page
INTRODUCTION	1
AVAILABILITY OF QWEST'S BHCP	4
BHCP DETAILS	6
ARIZONA SERVICE QUALIFY RULES	13
CONCLUSION	18

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Dennis Pappas. My business address is 700 Mineral Ave., Room MNH19.15 in Littleton, CO 80120.

Q. WHAT IS YOUR CURRENT POSITION?

A. I am a Director in Qwest's Public Policy organization representing Local Network Operations.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND AND EDUCATION.

A. I have worked in the telecommunications industry for 26 years. In December 2001, I accepted my current position as Director in Qwest's Public Policy group responsible for providing technical network expertise in the form of live and/or written testimony on a number of issues in State and Federal proceedings. For instance, following the issuance of the *Triennial Review Order*, I led a team developing a "batch hot cut" process ("BHCP"), which would provide CLECs with a process to undertake large quantities of UNE-P to UNE-Loop migrations at a reduced price and without lengthy outages for end user customers. Upon completion, I produced the BHCP testimony at both the State and Federal levels. Between 1996 and 2000, I was directly associated with Interconnection and Wholesale Product Marketing. My first responsibilities in this area were as State Interconnection Manager for Colorado and Wyoming, a position that involved project management of all collocation activity. I later became a team leader for

the Unbundled Loop and Collocation product teams. Subsequently, I became the Director of the Wholesale Product Marketing team and, during that time, led multiple groups in developing new products and processes for provisioning interconnection products and services for competitive local exchange carriers ("CLECs"). Subsequent to that assignment, I was the General Manager for Qwest Wholesale Emerging Diversified Markets and had responsibility for approximately 75 CLEC accounts. In late 2000, I left Qwest to accept a position as Vice President of Services at TESS Communications, which was a facilities-based CLEC in Colorado and Arizona that provided a suite of services, including telecommunications, data, long distance and CATV, to approximately 1,200 end users. In early 2001, I assumed the role of President of TESS with responsibility for the day-to-day operations of the company. I left TESS in that same year and returned to Qwest, where I again worked on the unbundled loop product team and began participating as a witness in a number of section 271 workshops.

Prior to the years worked in Wholesale Markets, I held multiple titles and positions requiring expertise in network operations, including Staff Manager and Regional Service Manager in the Local Networks Organization. In the 14 years prior to those assignments, I worked in Network as an Installation and Maintenance Technician (I&M Technician) and an Outside Plant Technician. I have my Bachelor's degree in Business Administration and a Masters in Telecommunications from the University of Denver.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My responsive testimony is two fold. In the first portion of my responsive testimony I respond to the claims made by Mr. Matthew Rowell on certain aspects of Qwest's current Batch Hot Cut Process ("BHCP") and update both he and this Commission on the progress that has been made with a number of CLEC customers since the BHC Forum was held and concluded nearly 12 months ago. In that short period of time, commercial agreements have been signed with a number of CLECs – some that had participated in the Forum and others who had not. The commercial agreement contains the BHC option whereby giving the CLEC the opportunity to migrate UNE-P customers to the CLEC's facilities should they choose to do so. The newly developed BHCP addresses each concern voiced by the FCC in their *Triennial Review Order ("TRO").* The newest provisioning option gives the CLECs the ability to convert large numbers of loops in a single day at a single office with little to no impact on the CLEC's end users while also reflecting a reduced non-recurring charge due to gains in efficiencies. Qwest's new BHC provisioning option successfully addresses each of these issues. Therefore, the request made by Mr. Rowell, in his testimony, for this Commission to intervene and compel the parties to meet again on the disputed issues is no longer needed.

Later in this testimony I provide comments on the assertions made by Mr. Del Smith as he asks for continuation and modifications to the Service Quality rules in Arizona. This portion of the testimony is intended to focus on held orders, out-of-service measurements and trouble report rates. As you will see, the testimony actually mirrors the same observations that Mr. Smith has made in his direct

testimony which is the fact that Qwest is performing well above each of the current thresholds documented in the rules and for those very reasons, there is no need for continuation of the Service Qualify measurements in an environment where competition weeds out those companies with the inability to meet the end user's needs.

II. AVAILABILITY OF QWEST'S BHCP

Q. BRIEFLY DESCRIBE THE CURRENT STATE OF QWEST'S BATCH HOT CUT PROVISIONING OPTION.

A. Today, Qwest has a fully develop BHC provisioning option available to any CLEC wanting to conduct migrations of existing customers to UNE-L in quantities qualifying as a batch. Exhibit DP-1 is the description of the provisioning option as it exists in Qwest's Product Catalog ("PCAT") today. The BHC provisioning option is available to CLECs either through commercially negotiated agreements or it can be ascertained as an amendment into an existing Interconnection agreement ("ICA"). Qwest currently offers the BHC option in its negotiations template agreement which is TRO and USTA II complaint. Complimentary to the BHC provisioning option is a set of electronic tools, which Qwest has successfully developed and deployed, that provides the CLECs with the ability to schedule their conversions on a central office by central office basis and gain insight into the status of each of their orders – is it pending, in jeopardy status for some reason or complete. These tools are commonly referred to as the Batch Scheduling Tool and the Batch Status Tool. Both tools were tested and made

available to those CLECs wanting to use the BHCP on or about October 18, 2004. I will discuss each of these tools later in this testimony.

Q. YOU MENTION TWO METHODS FOR CLECS TO UTILIZE THE BHC PROVISIONING OPTION. HOW MANY CLECS HAVE TAKEN ADVANTAGE OF THIS OPPORTUNITY IN THE PAST 12 MONTHS?

A. Qwest has negotiated and signed commercial agreements with 16 CLECs to date and is in the process of negotiating a deal with 1 additional CLEC. While the number of agreements may not seem significant, the companies that have signed the Commercial Agreement account for nearly 25% of the entire embedded UNE-P base in Qwest's 14 state territories – one CLEC accounts for nearly 80% of that amount. In addition to offering the BHCP as part of these commercial agreements, Qwest has also added this provisioning option into the template agreement which will allow those companies, not interested in a commercial agreement, to amend their Interconnection agreements ("ICA") and enjoy the benefits offered by the BHC option. As stated earlier, one CLEC has requested to amend their ICA.

Q. PLEASE COMMENT ON THE STRUCTURE OF THESE COMMERCIAL AGREEMENTS.

A. The basis for the commercial agreement was a new product offering known as Qwest Platform Plus or QPP. QPP allows the CLEC to retain their current customers on Platform Plus without the need for migrations off of the Qwest switching platform to a CLEC switching platform. The new product offering was in response to CLEC needs and perceived concerns over that transition of

customers from one platform to another. However, the CLECs still wanted to have an option available to them should they decide, at a later date, to migrate customers to their own switch – hence the inclusion of the BHCP in the commercial agreement.

III. BHCP DETAILS

Q. MR. ROWELL MAKES A STATEMENT IN HIS TESTIMONY THAT THE TRO FOUND THAT ILECS CANNOT HANDLE THE VOLUME OF MASS MARKET CONVERSIONS. PLEASE ELABORATE ON HIS STATEMENT.

A. Qwest provided documentation during the BHC Forum demonstrating the method of how it planned on meeting the 27 month migration schedule set forth in the TRO. Based on the embedded UNE-P volumes, Qwest had committed to perform more than 5,000 UNE-P to UNE-L conversion per day across its 14 state region. In order to perform this "labor intensive" work, as Mr. Rowell states, Qwest had committed to having teams of two central office technicians dedicated to central offices where migration activity was taking place. In order to validate this plan, Qwest conducted trials with McLeod USA to ensure that two central office technicians could actually perform the pre-wire and due date work within the 3:00AM to 11:00AM window. During this trial, McLeod and Qwest moved actual working customers from UNE-P to the McLeod switching platform. A readout on the trials can be found in the Hitachi Report which is attached to this testimony as Highly Confidential Exhibit DP-2.

Q. MR. ROWELL MAKES ASSERTIONS IN HIS TESTIMONY THAT QWEST NEVER COMPLETED THE BHCP. IS THAT TRUE?

A. No it is not true. Qwest used the information gained during the BHC Forum and the repeated trials with McLeod as the basis for its newest provision option. Even though the Forum itself concluded in January of 2004, the BHC development team continued work based on input from the CLECs and learnings from the actual hands on work that was taking place in the McLeod trial. Input from the CLECs assisted Qwest in successfully developing and introducing the BHC provisioning option which is available to CLECs today.

Q. BRIEFLY ELABORATE ON A FEW OF THE DETAILS OF THE BHCP ITSELF.

A. Batch applicability - Applies to the migration of existing service that does not require a field dispatch. In other words, the facilities need to be assigned to the end user customer and appear on the Qwest Customer Service Record (CSR).

Batch size - Qwest has committed to a maximum daily batch size is 100 lines per Qwest central office for all CLECs combined. The minimum batch size is 25 lines for one Qwest central office. These lines can be submitted by one CLEC on multiple LSRS for multiple end users. If the batch size drops to below 20 lines due to the inclusion of ineligible orders, before the QCCC "groups" the lines into a project, then the BHC will be rejected and all LSRs for that entire BHC project will be put into a Jeopardy status. The CLEC will then need to issue subsequent LSRs.

Batch interval - Once a valid LSR is received by Qwest the BHC orders will have a standard 7 business day interval. This interval falls in line with the time frames

currently set forth in the Service Interval Guide ("SIG") when a CLEC submits a large number of orders today. In fact, the SIG today offers due dates on an individual case basis for volumes exceeding the minimum batch numbers so under this new offering, the CLEC will be able to provide their end user with a standard interval.

Batch migration window - On the Due Date of the BHC project the Qwest work will occur between the hours of 3:00 am and 11:00 am.

Pre-wiring testing - Testing and verification of CLEC dial tone will be performed on this day (usually on day 2 or 3 of the 7 business day interval). If no dial tone is present the CLEC will be notified via the Batch Status Tool. The jumper will be run from the CLECs termination to the COSMIC frame where their current UNE-P customer resides.

Due date testing - On due date, the Qwest central office technician will once again test the CLEC dial tone, test the UNE-P line for activity and then perform the lift and lay. At this point, the line is tested one final time to validate the CLEC telephone number.

Batch scheduling tool - Qwest will create an electronic interface that allows the CLEC to schedule conversions on a central office by central office basis. This tool is currently available.

Batch status tool - Qwest will create an electronic interface that will allow the CLEC to get real time updates and order status including jeopardy notifications and completions. This tool is currently available also.

Q. PLEASE ELABORATE ON SOME OF THE MORE IMPORTANT ISSUES THAT QWEST AND THE CLECS WERE ABLE TO AGREE TO.

A. As mentioned in earlier testimony, Qwest worked with the CLECs to develop two electronic tools both focused on making conversion easier and quicker for the CLEC. The Batch Scheduling Tool allows the CLEC to electronically plan their migration schedule based on migration availability within a given Qwest central office. The Batch Status Tool allows the companies to communicate electronically on the status of the conversion whereby virtually eliminating the need for phone calls back and forth. Both parties viewed these electronic interfaces as one way to increase efficiency of the process and enhance the end user experience insofar as it reduces the amount of time until the end user's number is ported by the CLEC.

Another issue discussed during the BHC Forum was the request by the participating CLECs to include loops currently provisioned on IDLC as part of the batch. While the parties did not reach agreement on this issue during the Forum, we did arrive at a manner in which to provision these "types" of circuits during the commercial negotiations. Qwest has agreed to introduce a modified batch that will allow the conversion of UNE-P or QPP lines, which currently work on IDLC during normal business hours at volumes of 40 conversions per state per day. Qwest expects to have systems upgrade in place between 1Q05 and 2Q05 but until the systems updates are complete, have committed to handle requests for these types of conversions in a manual process. This process is documented in Qwest procedural Product Catalog or PCAT. Qwest and the CLECs also agreed

to include the conversion of Line Split to Loop Split loops as part of BHCP as long as certain rules are followed including some limitations on rewiring activity in the Qwest central office – this process is also defined in the Qwest Procedural PCAT and is included as Exhibit DP-3.

Q. WERE THERE ISSUES THAT THE PARTIES COULD NOT AGREE TO THAT ARE YET UNRESOLVED?

A. I would hazard a guess that during any session where this many issues were discussed that there are going to be a few items that parties can not/will not agree to – this Forum session was no different. However, several of the open issues have been closed in the past 12 months. It is important to note however, that some of the issues that went to impasse would have directly affected the cost (adversely) of the BHC option and for that reason alone, Qwest did not want to agree to something that would have negatively impact the non-recurring cost of the provisioning option – especially in light of the requirements set forth in the TRO language of more for less meaning more migrations for less money. It is also important to note that while a majority of the CLECs may have agreed to close an issue, one CLEC backed out of the Forum sessions and refused to participate so the larger group was not able to close these issues because of the single CLEC's absence.

Q. DO YOU AGREE WITH MR. ROWELL'S ASSESS OF THE UNE-P MARKET ON PAGES 57 AND 58 OF HIS TESTIMONY?

A. I do not. Qwest has been diligently working with a number of CLECs to address their concerns brought on by the Federal Communications Commission's ("FCC")

Interim Unbundling Order.[1] In response to these concerns, Qwest introduced a functionally equivalent product called QPP, as discussed earlier in my testimony. Once again, QPP allows the CLEC to retain existing customers or win customers without having to invest in any facilities or network equipment. Some of the larger UNE-P customers today have either entered into a Commercial agreement for QPP or are in the midst of negotiating such a Commercial agreement. As a member of the team that negotiated the Nation's first real QPP agreement with MCI, it appeared that the joint effort and subsequent agreement was beneficial to both parties – insofar as it allowed the CLEC to retain customers without migration concerns while allowing Qwest to recover more of its cost for the new service. As of October 31, 2004, in Arizona, CLECs have approximately 43,000 QPP lines in service.

Q. MR. ROWELL ASKS A QUESTION IN HIS DIRECT TESTIMONY ABOUT HIS REASON FOR UNE-L BASED COMPETITION NOT BEING MORE PREVALENT. PLEASE COMMENT ON HIS RESPONSE.

A. Mr. Rowell's comments about the ILECs not being able to handle the volume of UNE-L conversions has nothing to do with why UNE-L competition is not more prevalent. If he wanted the true answer to that, he would have to ask the number of CLECs in the State why they were only able to sell less than 30% of there embedded capacity. One only has to look at the total number of CLEC terminations in a state compare to the UNE-L customers the CLEC has taken in

[1] *In the Matter of Unbundled Access to Network Elements and Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313 and CC Docket No. 01-0338, Order and Notice of

order to understand the excess capacity that currently exists. His attempt to associate UNE-L competition and Qwest ability to handle a large number of conversions fails to make any point.

Q. MR. ROWELL ASKS IF THE STAFF BELIEVES THAT COMPLETION OF THE COLLABORATIVE PROCESS WOULD ENHANCE COMPETION. IN YOUR OPINION, WOULD IT?

A. That question is easily answered when you look at the work that Qwest has continued to conduct since the conclusion of the BHC Forum. We never slowed down in our efforts to develop an efficient process that met needs of the CLECs while also addressing those concerns set forth by the FCC in the TRO. Qwest believes that we HAVE completed the process and that the newly developed process adequately addresses the industry's needs. Today, any CLEC interested in participating in the offering can take advantage of the new BHC provisioning option.

Q. MR. ROWELL EXPRESSES SOME CONCERNS ABOUT COMPETITION IN ARIZONA AND THAT THE BHC MAY HAVE SOME IMPACT ON COMPETION. IS THIS CONCERN WARRANTED?

A. It is not. Qwest's introduction of QPP is a single indication of Qwest's interest in assuring that CLECs continue serving their customer base well into the future. Based on this actual contract with a number of CLECs across the region, this Commission should review in an attempt to understand the level of commitment that Qwest has with the parties.

Proposed Rulemaking (Released August 20, 2004)("*Interim Unbundling Order*").

IV. ARIZONA SERVICE QUALITY RULES

Q. STAFF WITNESS DEL SMITH IS RECOMMENDING THAT THIS COMMISSION CONTINUE THEIR SERVICE QUALITY RULES IN ARIZONA. PLEASE COMMENT ON HIS RECOMMENDATION.

A. In reading and reviewing Qwest's service qualify performance in Arizona it appears that the measures that were put in place in 1995 have served their purpose and while these rules may have been needed in 1995 to ensure improvements in the end user's experiences with the dominant telecommunications provider the landscape, not only in Arizona but across the nation, has changed drastically.

Q. PLEASE COMMENT ON WHAT PROMPTED THIS DRASTIC CHANGE?

A. The release on the 1996 Telecommunication Act changed the entire telecommunications landscape. It has allowed numerous resellers, UNE-Loop, UNE-Platform and facility based competitors into a market that was once considered impenetrable. In fact, in AZ, there are 119 ICAs in place. The Commission's own website lists over 130 competing local exchange providers from which customers may choose telecommunications service. CLECs have access to approximately 80% of all the loops in Qwest's network by establishing collocation in 69 of Qwest's 131 central offices. More than 200,000 end users get their service through either UNE-P or UNE-L with some additional consumers committing to the CLEC via resale arrangements. Now lump on top of this the number of cellular users that have replaced their landline phones with wireless

alternatives and it is clear that competition is alive and available to a majority of the subscribers in the state.

Q. MR. DAVE TEITZEL HAS ALREADY COVERED LOCAL COMPETITIONI THE STATE, WHY ARE YOU ALSO BRINGING IT UP?

A. The point I am trying to make is that it should be competition that regulates the market performance – not Commission fines and penalties. At this point in time, the biggest penalty any telecom provider can face is the loss of a revenue-producing subscriber. If a customer today cannot get services from one provider, they certainly have the option today to go with another provider. If the customer receives substandard service from one provider, they have the option, today, to simply go with another provider. If the service level of a provider goes below the expectations of the end user the customer will make the choice to change providers – customers have had that option since passage of the Telecommunications Act of 1996 and continue to exercise those options today. Commission-imposed incentives to provide satisfactory service via penalties in the form of customer credits and fee waivers is outmoded and outdated in light of the competitive environment that exists in Arizona today and should be eliminated.

Q. DOESN'T QWEST PROVIDE INDIVIDUAL BILL CREDITS TO CUSTOMERS FOR THE SAME SERVICE FAILURES THAT ARE COVERED BY THE SERVICE QUALITY PLAN PENALTIES?

A. Yes, Qwest believes that customer-specific remedies focus on the customer affected by the miscue and enable carriers to differentiate themselves in the competitive marketplace. Qwest offers automatic adjustments to a customer's bill

when it misses a service call to install or to repair service. If Qwest does not provide basic local exchange service within 30 days, Qwest provides the customer a choice of: a credit equal to one month of basic service for each month or partial month service was not provided, or a cellular voucher of $150.00 for each month/partial month beyond 30 days, or Qwest voice messaging or paging service. If Qwest does not restore an Out of Service condition in less than 8 hrs., it automatically provides a credit approximately equal to one day of the basic monthly service charge. Additional credits are paid if the outage extends beyond 48 hours. These credits are paid in addition to the penalties incurred for the same infractions, effectively overlapping the remedy coverage for held order and out-of-service failures.

Q. IS THE CONTINUATION OF THE $2.00 ADDITIONAL ONE-TIME CREDIT WARRANTED?

A. No, the provision that implemented the additional one-time credit of $2.00 for each residence and business access line has outlived its usefulness. The credit was to be paid to customers only if Qwest's performance deteriorated to such a degree that Service Quality Plan penalty payments were paid in two or more categories in one calendar year. To date, this credit has NEVER been paid. From the start of the Price Cap Plan throughout the entire initial term of the Plan, there was not even a hint of risk that the additional credit would ever be paid.

Staff's argument would lead one to believe that the additional credit provides a major benefit to customers and serves as an incentive for Qwest to provide higher quality service. Qwest disputes both of these notions. It is hard to imagine

customers getting terribly excited about a bill credit that is less than the cost of a single MacDonald's Happy Meal. Qwest's performance through the initial term of the Price Cap Plan, as shown in Mr. Smith's exhibits, is ample evidence that a "plug the tub" add-on penalty is unnecessary and should be eliminated.

Q. DOES QWEST'S CURRENT PERFORMANCE ON HELD ORDERS WARRANT THE CLOSURE OF THIS PERFORMANCE MEASURE?

A. One only has to review the held order exhibit submitted by Mr. Smith to respond to this question. It is very apparent that Qwest has been able to constantly reduce the number of held orders across the state in fact, for most of the past two years (January 2003-July 2004), held order numbers have been at or near zero. The significant improvement in held orders was well underway before the start of the Price Cap Plan and the imposition of penalties. This reduction is a direct result of Qwest's continued capital investment to meet the needs of new developments along with the fact that facilities have been freed up by the continued decline of wireline subscribers which have chosen to either use a wireless alternative instead of their landline connection or get their services from an alternate facility based provider.

Q. MR. SMITH RECOMMENDS THAT THE OUT-OF-SERVICE AND HELD ORDER PERFORMANCE MEASURES REMAIN UNCHANGED. DOES QWEST HAVE ITS OWN RECOMMENDATION?

A. We do. It would be our preference that this Commission allows the market (customer) to determine their own levels of quality and that the Service Quality Plan penalty enforcement provisions for out-of-service and held orders be

eliminated altogether. Out-of-service results have been on an improving trend since 2000 and, for the most part, results for individual months have been above the objective of eighty-five (85) percent. Held Order results demonstrate significant improvement also. Reporting at any level in this competitive environment is an unnecessary use of resources especially on these two aspects of the rules that have NEVER been triggered.

Q. ONE OTHER ASPECT REPRESENTED BY MR. SMITH IS QWEST'S TROUBLE REPORT RATE. PLEASE COMMENT ON HIS RECOMMENDATION.

A. Mr.Smith confirmed that Qwest has continually met the trouble report standard month after month. The wire center level of 8 reports per 100 lines has never been approached – in fact, Qwest reported a statewide average of 1.81 lines per 100 in 2003 which is down from a 3.09 average in the fourth quarter of 2000. It is significant to note that Qwest achieved and maintained this high level of service without any "penalty incentive" being attached to the trouble report rate standard.

Q. STAFF IS RECOMMENDING THAT THE TARIFF BE REVISED TO A TOTAL COMPANY OBJECTIVE OF NO MORE THAN 3.0 TROUBLE REPORTS PER 100 ACCESS LINES ACROSS ALL WIRECENTERS IN ARIZONA. PLEASE COMMENT ON THIS SUGGESTION.

A. Qwest fundamentally does not understand why the Staff is imposing an additional repair standard, when there are not significant problems with repair performance. A review of Commission complaints shows that complaints regarding repair are at a five-year low. Through October, 2004, there have been a total of only 29

Commission complaints on repair – an average of 3 complaints a month. Records show that there were **no** repair complaints **at all** in July of this year. Clearly, customers have found Qwest's repair efforts sufficient. Staff's recommendation to add yet another trouble report standard is inconsistent with the customer experience, will not provide additional benefit to consumers and is burdensome to Qwest.

Qwest would ask, once again, to let the market control the trouble report rate that an end user is willing to tolerate. Mr. Smith's testimony demonstrates that Qwest has continually decreased the trouble report rate from 2001 through 2003 but then goes on to state the following "such an objective would provide incentive to the Company to maintain the higher service levels it has achieved and thus provide ongoing benefit to customers." Qwest already has an incentive – the competitive forces in Arizona are the incentive for us to continue providing the high levels of service documented throughout Mr. Smith's testimony. In an era where regulation and reporting is supposed to be on a decline, this proceeding would be a good place to begin.

V. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	DOCKET NO. T-01051B-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	DOCKET NO. T-00000D-00-0672

REBUTTAL EXHIBITS

OF

DENNIS PAPPAS

QWEST CORPORATION

DECEMBER 20, 2004

INDEX OF EXHIBITS

DESCRIPTION	EXHIBIT
PCAT – Batch Hot Cut Process – V1.0	DP-1
Hitachi Report	Highly Confidential DP-2
PCAT - Loop Splitting – V19.0	DP-3

Batch Hot Cut Process - V1.0

History Log

Description

The Batch Hot Cut (BHC) Process permits you to migrate existing analog services (e.g., Qwest Retail, Unbundled Network Element - Platform (UNE-P), or Resale) to Unbundled Local Loops (2-Wire or 4-Wire analog voice grade) in a batch mode (quantities defined below) if the current facilities can be reused. The BHC Process is also available to convert a line splitting arrangement, using UNE-P or Qwest Platform Plus (QPP) lines, to a loop splitting arrangement. Refer to the Line Splitting PCAT or Section 9.21 of the Statement of Generally Available Terms and Conditions (SGAT) for the appropriate definition of line splitting.

Before submitting BHC requests, involving analog services to Unbundled Local Loops, you are responsible for identifying whether the request is eligible for the BHC Process. For this type of BHC migration the following is applicable:

- Reuse of existing facilities
- No field dispatch required
- Minimum of 25 lines per service provider per central office per day and a maximum of 100 lines for all service providers per central office per day
- Region wide (14 states) BHC migration volumes cannot exceed 2,500 lines per day for all service providers.

Before submitting BHC requests, involving Line Splitting to Loop Splitting, you are responsible for identifying whether the request is eligible for the BHC Process. For this type of BHC migration the following is applicable:

- Reuse of existing facilities
- No field dispatch required
- Data Provider and splitter equipment remain the same
- No additional line conditioning
- Line Splitting to Loop Splitting BHC requests are included in the minimum of 25 lines per service provider per central office per day and a maximum of 100 lines for all service providers per central office per day.
- Line Splitting to Loop Splitting BHC requests are included in the region wide (14 states) BHC migration volumes that cannot exceed 2,500 lines per day for all service providers

The BHC service interval can be found in the Service Interval Guide (SIG).

Integrated Digital Loop Carrier (IDLC) as a Modified Batch

Existing analog services provisioned over IDLC are not eligible for the BHC process because dispatch of a field technician is required. However, a modified batch process can be used to transition analog services currently provisioned over IDLC. A modified batch cut must be made up exclusively of lines currently provisioned over IDLC. Prior to issuing your request, the facility type should be verified by you via Loop Qualification and Raw Loop Data queries. The modified batch will consist of no more than 40 IDLC lines per state per day. This is a cumulative total for all IDLC cuts for all Competitive Local Exchange Carriers (CLECs). The

modified batch IDLC process is excluded from the Batch Scheduling Tool and the Statusing Tool.

Availability

BHC is available where facilities exist throughout Qwest's 14-state local service territory.

Terms and Conditions

To request a BHC, you will need to have your Interconnection Agreement (ICA) amended to include the BHC installation offering.

Technical Publications

Technical Publications section does not apply to BHC.

Back to Top

Pricing

Rate Structure

Recurring charges do not apply to the BHC option. However, they do apply to the Unbundled Local Loop. Refer to the Unbundled Local Loop - General Information PCAT for additional information.

Nonrecurring charges are comprised of the following rate elements:

- BHC Installation Option charges
- IDLC charges may apply

Nonrecurring charges for Batch Hot Cut are only billed for performed installation work and do not affect the recurring rates that are billed for all Unbundled Loops (UBLs).

Additional rate structure information can be found in the Statement of Generally Available Terms and Conditions (SGAT) or your Interconnection Agreement.

Rates

Rates are available in Exhibit A or the specific rate sheet in your Interconnection Agreement.

Tariffs, Regulations and Policies

Tariffs, regulations and policies are located in the state specific Tariffs/Catalogs/Price Lists.

Optional Features

Optional Features section does not apply to BHC.

Back to Top

Features/Benefits

Features/Benefits section does not apply to BHC

Back to Top

Applications

Applications section does not apply to BHC.

Back to Top

Implementation

Product Prerequisites

If you are a new CLEC and are ready to do business with Qwest, view Getting Started as a Facility-Based CLEC. If you are an existing CLEC wishing to amend your Interconnection Agreement or New Customer Questionnaire, additional information is located in the Interconnection Agreement.

Back to Top

Pre-Ordering

General pre-ordering activities are described in the Pre-Ordering Overview.

Requirements for pre-ordering are described in Local Service Ordering Guidelines (LSOG) Pre-Order.

Additional information regarding Appointment Scheduler functionality can be found in the IMA User's Guide.

Scheduling a Batch Hot Cut is accomplished through the use of the Appointment Scheduler Tool, which will provide a system generated Appointment Confirmation (APT CON) Number for your Local Service Request (LSR). You may request appointments for any normal business day through Appointment Scheduler. With the exception of the modified IDLC batch identified above, the BHC is restricted to scheduling a minimum of 25 lines per service provider per central office and a maximum of 100 lines for all service providers per central office per day with an overall maximum of 2,500 lines per day region-wide (14 states).

Volume limitations are controlled by the Appointment Scheduler Tool. Additional information regarding Appointment Scheduler functionality can be found in the IMA User's Guide.

Prior to issuing your BHC requests, the facility type should be verified by you via the Integrated Mediated Access (IMA) Loop Qualification and Raw Loop Data. In some instances, the facilities to be reused do not qualify for the BHC Process. These include:

- End-users served by IDLC, see the IDLC sub-section above
- End-users served by a Remote Switching Unit (RSU)
- End-users accounts that contain Line Sharing

Back to Top

Ordering

General ordering activities are described in the Ordering Overview.

BHC service requests are submitted using the following LSOG forms:

- LSR
- End-User (EU)
- Directory Listing (DL)
- Loop Service (LS)
- Loop Service Number Portability (LSNP)

Field entry requirements are described in the LSOG.

Service requests should be placed using Interconnect Mediated Access (IMA) Electronic Data Interchange (EDI), IMA Graphical User Interface (GUI), or faxed to (888) 796-9089.

A Design Layout Record (DLR) request is described in the IMA EDI Network Disclosure Document or the IMA User's Guide.

The Network Channel /Network Channel Interface (NC/NCI™) codes eligible for BHC are as follows:

Loop only, if the NC Code is	Then Available NCI Codes Are	
	Qwest CO-NI NCI	End-User EU-NI(SEC) NCI
LX--	02QC3.OOD	02LS2
	02QC3.OOB	02GS2
	02QC2.OOF	02NO2
	04QC2.OOF	04NO2
	02QC3.RVT	02RV2.O
	02QC3.RVO	02RV2.T
Loop with Loop Splitting NC Code is:		
LX-N	04QSM.LO5	02DUM.LS5

To request a BHC, the following information is required on the LSR:

- The REQTYP must be 'AB' (loop only), 'BB' (loop with number portability) or 'UB' (loop with loop Splitting)
- The ACT field must be 'V' or 'Z'.
- The DSPTCH field must be 'N' or blank.
- The CHC field must be 'B'.
- The APT CON field must contain the confirmation number presented by Appointment Scheduler.
- The NC field must be 'LX-' (loop only or loop with number portability) or 'LX-N' (loop with loop splitting).
- The Desired Due Date (DDD) field must equal the date associated with the APT CON presented by appointment scheduler.
- The TEST field must be 'N' or blank.
- The Expedite (EXP) field must be 'N' or blank.

For a modified IDLC batch to qualify, the following information is required on the LSR:

- Coordinated Hot Cut (CHC) = Blank or N
- Requisition Type (REQTYP) = AB or BB
- Activity (Act) = V or Z
- Dispatch Required (DSPTCH) = Y
- PROJECT = IDLCBHCXXX (XXX = to Customer Carrier Name Abbreviation (CCNA)
- Special Construction Authorization (SCA) = Blank or N
- Network Channel (NC) code = LX-
- Manual Indicator (MANUAL IND) = Y
- REMARK = IDLC Batch Hot Cut, Project Number (PRN) = IDLCBHCXXX (XXX= CCNA), Dispatch required, Installation option 1CRWT

Back to Top

Provisioning and Installation

General provisioning and installation activities are described in the Provisioning and Installation Overview.

The BHC Due Date (DD) work activities will be completed between the hours of 3:00 AM and 11:00 AM local time, Monday through Friday, excluding Holidays. The modified IDLC batch DD work activities will be done during Qwest's normal hours for installation - Monday through Friday, 8:00 AM to 5:00 PM local time, excluding holidays.

You may verify the current status of your request for a central office on an individual line by line basis via the IMA BHC Status Tool. You may use the central office and the date of the requested BHC to make your status request. The IMA BHC Status Tool will display the following:

- Status information for that specific central office
- Status information for all other central offices due to cut that day
- Initial and subsequent changes to order status
- An option to view details on a line by line basis:
    - Telephone Numbers (TNs)
    - Order numbers

- Related order numbers
- Connecting Facility Assignment (CFA)
- Purchase Order Number (PON)
- Event time stamp
- Message indicating status for each line
- Start time on the day of the cut
- Completion time on the day of the cut

You may also obtain status information in an Excel downloadable file. For more information regarding the IMA BHC Status Tool, refer to the IMA User's Guide.

You will need to have your dial tone present at your CFA by 12:00 AM. (midnight) on day one following LSR submittal. On day two or day three, Qwest will perform pre-wiring activities. These activities include dial tone verification and Automatic Number Identification (ANI). If no dial tone is detected during pre-wiring, you will be notified via the IMA BHC Status Tool of the no dial tone condition. You will need to have dial tone at the CFA by 3:00 AM on the DD. If CFA changes are required, you will need to submit a supplement (SUP 3) to your LSR by 12:00 PM. (noon) on day four. If dial tone is not found on the DD, your request will be placed in jeopardy status and it will be removed from the Batch. Other lines included on the same LSR will also be placed in jeopardy status and removed from the Batch due to the no dial tone condition. In this situation, you will need to follow standard jeopardy processes by submitting appropriate supplements.

For BHC migrations that include Line Splitting to Loop Splitting, a Sync Test will be performed on the DD at time of cutover. Qwest will not perform Sync Testing unless you sign up for this option. For more information regarding Sync Testing refer to /wholesale/pcat/collocation.html. If the Sync Test fails, your request will be placed in jeopardy status. Other lines included on the same LSR will also be placed in jeopardy status due to the Sync Test failure. In this situation, you will need to follow standard jeopardy processes by submitting appropriate supplements.

When the BHC DD work activities are initiated, Qwest will notify you via the IMA BHC Status Tool that those orders have been started. You will also have the option of identifying when a specific line migrated (referred to as "Trap and Trace"). Refer to your switch vendor for information regarding these capabilities. For more information regarding the IMA BHC Status Tool, see the IMA User's Guide.

When the BHC DD work activities are completed or put in jeopardy, you will also be notified of the change in status via the IMA BHC Status Tool. No response on an individual line, will be considered acceptance of that line and no further action is required by you.

When a line is shown as complete in the IMA BHC Status Tool, you will have two hours to respond if a problem is encountered. If you experience a problem and do not accept the cut, you may request to have the circuit cut back to its original state. To do this, you will need to email the Qwest CLEC Coordination Center (QCCC) at qcccbhc@qwest.com with the Subject Line stating: "CUT BACK". Include the following information in the Email:

- "Require cutback"
- Order #
- PON
- TN

The QCCC will respond via Email when the cut back is complete. Your order will be placed in jeopardy status and other lines included on the same LSR will also be placed in jeopardy status and cut back to their original state. In this situation, you will need to follow standard jeopardy processes by submitting appropriate supplements.

Back to Top

Maintenance and Repair

General maintenance and repair activities are described in the Maintenance and Repair Overview.

Back to Top

Billing

Customer Records and Information System (CRIS) billing is described in Billing Information - Customer Records and Information System (CRIS).

Back to Top

Training

Qwest 101 "Doing Business with Qwest"

Click here to learn more about this course and to register.

View additional Qwest courses by clicking on Course Catalog.

Back to Top

Contacts

Qwest contact information is located in Wholesale Customer Contacts.

Back to Top

Frequently Asked Questions (FAQs)

This section is being compiled based on your feedback

Back to Top

Last Update: October 18, 2004

Exhibit No. ____ (LB-2HC)
Docket No. UT-033044
January 23, 2004

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of Qwest Corporation to Initiate a Mass-Market Switching and Dedicated Transport Case Pursuant to the Triennial Review Order	*Docket No. UT-033044*

Report of Lorraine Barrick

HIGHLY CONFIDENTIAL
Pursuant to the Protective Order in UT-033044

Loop Splitting - V19.0

History Log

Product Description

Loop Splitting provides the Competitive Local Exchange Carrier (CLEC) or Data Local Exchange Carrier (DLEC) with the opportunity to offer advanced data service simultaneously with a new or existing Unbundled Local Loop by using the frequency range above the voice band on the copper loop. The advanced data service may be provided by the CLEC or DLEC or another service provider chosen by you. For purposes of this web page, CLEC will refer to the voice provider and DLEC to the advanced data service provider. Only one customer of record determined by the CLEC or DLEC partnership, can be identified to Qwest. The customer of record is the CLEC/DLEC that is billed for the Loop Splitting. The customer of record may designate an authorized agent to perform ordering and/or maintenance and repair functions.

A Plain Old Telephone Service (POTS) splitter must be inserted into the Unbundled Local Loop to accommodate establishment of the advanced data service. The POTS splitter separates the voice and data traffic and allows the copper loop to be used for simultaneous DLEC data transmission while you provide the voice service to the end-user. Additional information describing the POTS splitter configurations is available in Collocation - General Information.

The POTS splitter can be located in your collocation space in the Qwest Wire Center or in the Common Area Splitter Collocation in the Qwest Wire Center that serves the end-user.

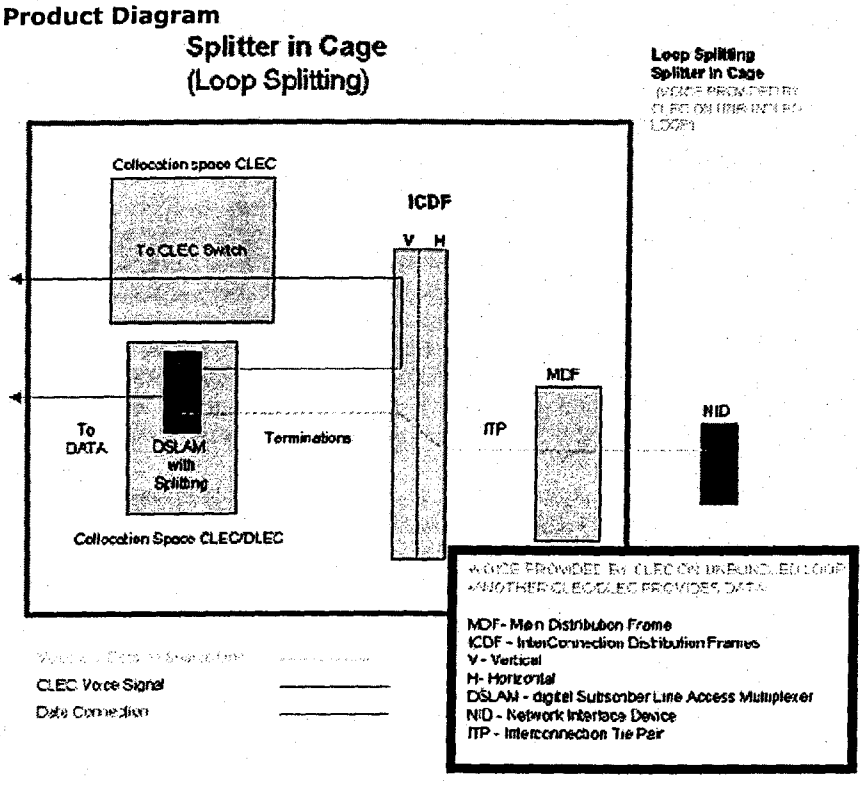
Either you or the DLEC must provide the end-user with all equipment required for them to receive separate voice and data services across a copper loop.

Enhanced Extended Loop (EEL) splitting is available and can be requested using the Special Request process.

Other alternatives for providing data service are as follows:

- If Qwest provides your voice service, you have the option of using Line Sharing/Shared Loop.
- If you have Unbundled Network Elements – Platform (UNE-P), you have the option of using Line Splitting.
- If you are interested in a Resale option, Resale - Qwest Digital Subscriber Line (Qwest DSL™).

Product Diagram



Availability
Loop Splitting is available where facilities exist throughout Qwest's 14-state local service territory.

Terms and Conditions
Loop Splitting is provided where existing compatible facilities are available and/or you have authorized construction per the terms and conditions in the Statement of Generally Available Terms and Conditions (SGAT) or your Interconnection Agreement. You are responsible for determining whether the physical characteristics of the facility are compatible with your data service. Technical Publication, Interconnection - Shared Loop, 77406 informs you which facilities are compatible with Loop Splitting.

All splitter collocation installations must be completed prior to submitting Loop Splitting requests.

Upon notification of a loss of an end-user account, it is the customer of record's responsibility to notify any other involved parties. The customer of record is the CLEC that is billed for the Loop Splitting. The customer of record may designate an authorized agent to perform ordering and/or maintenance and repair functions. Loss and Completion Reports are available and are based on loss and gain account activity. For more information about the reports, see the Provisioning and Installation Overview.

Technical Publications
Technical characteristics, including Network Channel/Network Channel Interface (NC/NCI™) codes are described in Technical Publication, Interconnection - Shared Loop, 77406.

Back to Top

Pricing

Rate Structure
Recurring charges for Loop Splitting are comprised of the following rate elements:

- Operational Support Systems (OSS)
- POTS Splitter Shelf Charge
- Two Interconnection Tie Pairs (2 ITPs), 1 for voice and 1 for combined voice/data, per connection
- Unbundled Local Loop

Non-recurring Loop Splitting are comprised of the following rate elements:

- Engineering Charge
- Installation charge, per circuit
- POTS Splitter Shelf Charge
- Reclassification Charge
- Splitter Tie Cable Connection Charge

Additional rate information is located in Exhibit A of the SGAT, or in your Interconnection Agreement.

Recurring charges bill on a month-to-month basis; term contracts are not available.

One-month minimum billing, contract termination liability and associated contract charges for the product from which the loop is being converted will apply, and will be assessed to the end-user as described in the Local Exchange Tariff for the applicable state.

Rates
Rates are available in Exhibit A or the specific rate sheet in your Interconnection Agreement.

Tariffs, Regulations and Policy
Tariffs, regulations and policies are located in the state specific Tariffs/Catalogs/Price Lists.

Optional Features
There are no optional features with Loop Splitting.

Back to Top

Features/Benefits

Features	Benefits
Carries data on the High Frequency Spectrum Unbundled Network Element (HUNE) above the voice band on the copper loop.	Enables CLEC/DLEC to offer data services through partnership with another CLEC/DLEC thus providing you with access to products without capital expenditure.

Provides access to facilities throughout Qwest's 14-state local service territory.	Allows CLEC/DLEC to order service using existing CLEC Unbundled Local Loops in areas where no facilities are available for new loops.

Back to Top

Applications

Loop Splitting enables a DLEC to create a business arrangement with a CLEC to provide data and voice service on an existing Unbundled Local Loop. Loop Splitting enables you to provide data and voice service to end-users that do not have spare facilities at their location or who do not desire to purchase an additional line.

Back to Top

Implementation

Product Prerequisites
If you are a new CLEC and are ready to do business with Qwest, view Getting Started as a Facility-Based CLEC. If you are an existing CLEC wishing to amend your Interconnection Agreement or New Product Questionnaire, additional information is located in the Interconnection Agreement.

Back to Top

Pre Ordering

General pre-ordering activities are described in the Pre-Ordering Overview.

Requirements for pre-ordering are described in Local Service Ordering Guidelines (LSOG) Pre-Order.

Qwest strongly recommends use of Pre-Ordering functionality to assist in achieving increased service request flow through and accuracy that will result in reduced service request rejects.

The loop qualification queries should be used prior to submitting a service request. Use of these queries can greatly reduce service request rejects by ensuring the types of facilities requested are available prior to placing a service request. The queries will enable you to verify the type of facility and the physical characteristics of the facility. Based on the physical characteristics you can determine if the facility needs to be conditioned, i.e., the removal of load coils or bridged tap, which will assist you in identifying the appropriate ordering intervals, described in the Service Interval Guide (SIG).

Some of these queries are available in IMA and others are web based. Loop qualification queries are available for you to access the physical characteristics of the Qwest loop facility and are based on data obtained from Qwest's underlying plant records. This is the same underlying data that Qwest utilizes for its retail product offerings.

The following applies to the loop qualification queries:

- The queries are for informational purposes only and do not restrict or imply that your service will or will not work on a given facility. This determination is your responsibility.
- Some of the queries offered include Qwest's evaluation of the recorded and calculated loop characteristic information.
- As mentioned, the physical characteristics provided are based on Qwest's plant facility database. If you encounter any inaccuracies in the information, please contact your Qwest Service Manager.

IMA qualification queries are:

- Loop Qualification Query
- Raw Loop Data (RLD) query

Wed based qualification queries is:

- Wire Center RLD

The Wire Center RLD query provides wire center specific information. This query provides the physical characteristics of the facilities for an entire wire center. The wire center raw loop data is presented as a comma delimited file and needs to be downloaded into a database or spreadsheet to analyze the individual facilities. Contact your Qwest Service Manager to request an ID, which will be required to obtain the digital certificate required to access this query. You will need to provide the names and telephone numbers of your employees that will be accessing the query. After your Qwest Service Manager has notified you that the necessary access permissions have been established, and provided you with your ID you may then initiate the digital certification process.

Information about the IMA based loop qualification queries is available in the IMA User's Guide. The IMA Loop Qualification and Raw Loop Data-CLEC Job Aid is a document designed to provide valuable information and instructions on how to use the IMA based loop qualification queries and interpret the information provided.

Performing a Central Office Splitter Search and Qualifying the Loop

Prior to ordering Loop Splitting, you will need to identify the end-user's Serving Wire Center (SWC) for the purpose of determining whether you have a POTS splitter in the SWC. Additionally, it is recommended that you qualify the end-user's loop.

Because Loop Splitting is provided on an Unbundled Local Loop and is a non-switched service, Qwest does not track this customer record by telephone number. You will not be able to qualify the loop or perform a Wire Center splitter search by telephone number. Instead, Qwest tracks this record by Common Language Serial Number Circuit (CLS). For that reason, you will need to determine the SWC and qualify the loop using the end-user's service address as follows:

- To determine the SWC, use the Address Validation function in IMA.
- To qualify the loop, use the Loop Qualification function in IMA.

The Pre-Order Process Section of the IMA User's Guide specifically details information applicable to address validation and loop qualifications functions.

If you do not have access to IMA, you will need to take the following steps to determine the SWC and qualify the loop:

1. Obtain a copy of the end-user's CSR by contacting the Customer Service Center.
2. Locate the LSO (Local Service Office) Field Identifier (FID) on the end-user's Unbundled Local Loop CSR. The LSO is six-digit numeric code identification for the physical switch and can be cross-referenced to a Wire Center by using the InterCONNection (ICONN) Database. You can then determine whether you have a splitter at that location.
3. If you do not have access to IMA, you can use the web-based Wire Center RLD query. At the digital certificate web page, click on "I Have A Digital Certificate" to gain access to the web-based Wire Center RLD query.

Back to Top

Ordering

General ordering activities are described in the Ordering Overview.

The Batch Hot Cut (BHC) Process permits you to migrate volumes of existing line split loops using UNE-P or Qwest Platform Plus (QPP) lines to a loop splitting arrangement. Detailed information and processes are described in the Batch Hot Cut (BHC) Overview.

Synchronization Testing is an option associated with your collocation space and Loop Splitting service requests. In order to receive notice of a failed Synchronization Test for Loop Splitting, you will be required to contact your service manager to sign up for Failed Synchronization Test PTA notification. For more information see the Synchronization Testing document in Collocation - General Information.

When Synchronization Testing is performed, the CLEC will be notified that there is a problem in their equipment if the test fails. The service request will be placed in a jeopardy status. For more information on Jeopardy Status refer to Provisioning and Installation Overview.

Loop Splitting orders are submitted using the LSOG forms:

- Local Service Request (LSR)
- End User (EU)
- Loop Service (LS)

Field entry requirements are described in the LSOG.

The Interconnect Mediated Access (IMA) User's Guide specifically details the information applicable to ordering functions.

Valid NC/NCI codes are required on all Loop Splitting requests. NC/NCI codes are located in Technical Publication, Interconnection - Shared Loop, 77406.

Loop Splitting requests are submitted using Circuit Identification numbers. Information describing Circuit Identification number format is available in Unbundled Local Loop General Information.

A Design Layout Report (DLR) request is described in the IMA EDI Network Disclosure Document or the IMA User's Guide.

The Basic Installation option is available for Loop Splitting. For an existing end-user, the Basic Installation option is the 'lift and lay' procedure. In this scenario the Qwest technician 'lifts' the loop from its current termination and 'lays' it on a new termination connecting to the CLEC. Test results are not provided to the CLEC. Detailed information about this option is located in the SGAT for the relevant state or in your Interconnection Agreement.

Service interval guidelines are found in the SIG or in Exhibit C of the SGAT for the relevant state.

Service requests should be placed using Interconnect Mediated Access (IMA) , IMA Graphical User Interface (GUI), or faxed to 888-796-9089. Loop Splitting should be ordered the same as Line Sharing/Shared Loop.

If no facilities are available, the service request will be rejected for a No Facilities reason. Reject notification information is described in the Ordering Overview.

Use of Universal Service Order Codes (USOCs) and Field Identifiers (FIDs) is described in the USOCs and FIDs Overview. Use of the USOC/FID Finder will assist you in identifying USOC and FID requirements.

The limitations when ordering multiple lines for Loop Splitting on a single service request are as follows:

- Qwest will accept multiple Loop Splitting requests on a single order if the Circuit Identification numbers are associated with the same end-user address. When you submit a service request requesting Loop Splitting for multiple Unbundled Local Loops from the same address, the quantity on the LQTY field on the LS of the service request must be equal to the number of Unbundled Local Loops to which Loop Splitting is being added.
- You are required to submit a separate service request for each Loop Splitting request when the Circuit Identification numbers terminate at a different end-user address.

In the Remarks Section of the LSR, provide the ZCID of the party who owns the splitter.

An Alternate Point of Termination (APOT) form is provided to the DLEC as part of the collocation hand-off process.

The splitter meet points for the Shared Loop are identified on the APOT form. Information contained on the APOT form is required on all Loop Splitting requests. The following table provides an example of Common Area Splitter Collocation format used to identify the splitter location.

Character Field Location	**Field Entry ***
Characters 1 through 3	vda
Characters 4 through 10	Floor and Aisle

Characters 11 through 12	Bay
Characters 13 through 14	Shelf
Characters 15 through 18	Unit

* vda.0010121.02.01-001 is an example of the Common Area Splitter Collocation format.

The following table provides an example of format used to identify the splitter location when the splitter is located inside your collocation.

Character Field Location	**Field Entry ***
Characters 1 through 3	vda
Characters 4 through 8	Cable Pair
Characters 9 through 11	Voice Pair

* vda.ALT06.201 is an example of Inside the Collocation Area format.

Loop Splitting, UBL Split and/or UBL Split with NP

In IMA you may see the UBL Split or UBL Split with NP options for requesting new Loop Splitting and UBL Split arrangements at the same time. If you are requesting new Loop Splitting and UBL services at the same time, you must select the UBL Split or UBL Split with NP option in IMA. Loop Splitting requests on an existing UBL services may be requested utilizing the Loop Splitting option in IMA.

Projects
If you relate 25 or more Purchase Order Numbers (PONs) and associate orders to a Project Identification Code in the PROJECT field on the LSR, the request will be handled as a project by the Center responsible for handling your account. The installation guidelines for the project are negotiated on an Individual Case Basis (ICB) based on the request. The main point of contact for your project will be your Qwest Service Manager.

Back to Top

Provisioning and Installation

General provisioning and installation activities are described in the Provisioning and Installation Overview.

Provisioning information and design requirements are available in Technical Publication Interconnection – Shared Loop, 77406.

Firm Order Confirmation (FOC) intervals are available in the SIG.

For Loop Splitting, the Migration activities will not exceed forty five (45) minutes. For more information on migrations and conversion, see the Migrations and Conversions Procedural PCAT.

A jeopardy occurs on a service request order if a condition exists that threatens timely completion. Jeopardy notification information is described in the Provisioning and Installation Overview.

Loss and Completion Reports are based on loss and gain account activity. Completion notification, including Loss and Completion Reports, is described in the Provisioning and Installation Overview.

Loop Splitting is provided where existing facilities are available. If no facilities can be found, and there is No Planned Engineering Job, the service request will be rejected for a No Facilities reason and the order cancelled. Contact your Qwest Sales Executive if you wish to authorize construction per the terms and conditions of your Interconnection Agreement. Information regarding reject codes is available in the Ordering Overview. Refer to SGAT, Section 9.19, which addresses options available to you when facilities are not available or refer to your Interconnection Agreement.

Qwest will install and maintain the splitter if it is installed using Common Area Splitter Collocation. You have the options either to purchase POTS splitters then provide them to Qwest, or to have Qwest purchase them on your behalf, subject to full reimbursement of costs incurred. All splitter collocation installations must be completed before Loop Splitting requests can be processed.

New Loop Splitting, UBL Split and/or UBL Split with NP options for Loop Splitting may be provisioned on a 2-Wire Non-Loaded Unbundled Local Loop. Loop Splitting (request on a UBL service) may also be requested on an existing 2-Wire Non-Loaded or ADSL Compatible Loop. When requesting Loop Splitting on an existing ADSL Compatible Loop Qwest will convert the loop to a non-loaded loop type. This is performed by changing the NC/NCI code combinations.

Directory Listings are not part on the Loop Splitting product offering.

Back to Top

Maintenance and Repair

General maintenance and repair activities are described in the Maintenance and Repair Overview.

Qwest will work with the customer of record to resolve trouble impacting voice services provided through Loop Splitting, as well as for the physical line between the demarcation point at the end-user premises and the demarcation point in the Qwest SWC. You and/or the DLEC are responsible for repairing data services provided using Loop Splitting. Each service provider is responsible for maintaining their own equipment; the party in control of the POTS splitter is responsible for its maintenance.

Qwest will perform Synchronization Testing on Loop Splitting repair reports upon CLEC request in the CO;s where Qwest Digital Subscriber Line (DSL) service is provided. To obtain a list of

Qwest CO's that have Qwest Rate Adaptive Digital Subscriber Line (RADSL) or its successor, refer to Network Disclosures.

When the CLEC issues a repair report, the CLEC will need to provide Qwest with the appropriate protocol, for additional information see Customer Electronic Maintenance & Repair (CEMR) On-line Help to test (i.e., DMT-T1.413, DMT-G.LITE, DMT-G.DMT, or CAP), as well as the setting for Rate Limiting and Auto Sync (On or Off). Refer to the CEMR On-line Help Section 10.7.8 for information regarding requesting a synchronization test.

In CO's where Qwest DSL is not provided, Qwest will test for electrical continuity involving Loop Splitting in response to trouble initiated by you. If the trouble ticket is not in Qwest's network, a Trouble Isolation Charge will be assessed. If the testing equipment has been installed at the SWC, Qwest will perform an electrical continuity test on the data side of the splitter upon your request. You may also request that Qwest perform additional testing. If the testing uncovers a problem in the portion of the network that Qwest is responsible for, you will not be charged for the testing. However, if the additional testing uncovers a problem in the portion of the network you are responsible for, an Additional Testing Charge will be assessed. Rates are specified in the SGAT, Exhibit A, for the relevant state or in your Interconnection Agreement.

Back to Top

Billing

Recurring and nonrecurring charges for Loop Splitting, OSS, Basic Installation, ITPs, Trouble Isolation, and Additional Testing are billed in Customer Records and Information System (CRIS). Detailed information regarding the CRIS Summary Bill, Inquiry and Disputes is described in the Billing Information – Customer Records and Information System (CRIS). web page.

Nonrecurring charges for Splitter Shelves, Splitter TIE Cable Connections, Engineering, and Reclassification are billed Billing and Receivable Tracking (BART) System. Detailed information regarding the BART Bill, Inquiry and Disputes is described in the Billing Information – Billing and Receivable Tracking (BART).

Recurring charges for Splitter Shelves and Splitter TIE Cable Connections will be billed in Integrated Access Billing System (IABS). Detailed information regarding the IABS Bill, Inquiry and is described in the Integrated Access Billing System (IABS).

Back to Top

Training

Qwest 101 "Doing Business With Qwest"

- This introductory instructor-led training course is designed to teach the CLEC and Reseller how to do business with Qwest. It will provide a general overview of products and services, Qwest billing and support systems, processes for submitting service requests, reports, and web resource access information. Click here for Course detail and registration information.

Unbundled Network Element - Switching (UBS)

- This is a self-directed, web-based training course that provides you with an overview of the Unbundled Network Element- Switching (UBS) product and its features. Click here to learn more about this course and register.

Unbundled Loop Elements (ULE)

- This is a self-directed, web-based training course that provides you with an overview of the Unbundled Loop Elements (ULE) product and features. Click here to learn more about this course and register.

Unbundled Dedicated Interoffice Transport (UDIT)

- This is a self-directed, web-based training course that provides you with an overview of the Unbundled Dedicated Interoffice Transport (UDIT) product and its features. Click here to learn more about this course and for registration information.

Unbundled Loop (UBL)

- This instructor-led process and systems training course is designed to introduce and teach the Unbundled Loop (UBL) products, instructing CLECs on how to request service for service for Unbundled Loops. This course will provide an overview of the current UBL products, and address the PreOrder, Order, Post-Order, Provisioning, Billing and Customer Electronic Maintenance & Repair (CEMR) On-line Help unique to the UBL product. Click here to learn more about this course and to register.

IMA "Hands On"

- This introductory instructor-led training course teaches you how to use Qwest's IMA Graphical User Interface (GUI) to order wholesale products. You will experience interactive software demonstrations and participate in hands-on practice sessions to familiarize yourself with the IMA GUI system. Click here to learn more about this course and to register.

View additional Qwest courses by clicking on Course Catalog.

Back to Top

Contacts

Qwest contact information is available in Wholesale Customer Contacts.

Back to Top

Frequently Asked Questions (FAQs)

1. Who installs and maintains the POTS splitter in the Common Area of the Qwest Central Office?
Qwest will install and maintain the POTS splitter if it is installed using Common Area Splitter

Collocation. You have the option to purchase POTS splitters and provide them to Qwest, or have Qwest purchase them on your behalf, subject to full reimbursement for cost incurred.

2. Where can we access our Loop Splitting loops?
You can access your loops at the point where the combined voice and data circuit is connected to the POTS splitter.

Back to Top

Last Update: October 18, 2004

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	DOCKET NO. T-01051B-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	DOCKET NO. T-00000D-00-0672

STATE OF COLORADO)
) ss AFFIDAVIT OF DENNIS PAPPAS
COUNTY OF LARIMER)

Dennis Pappas, of lawful age being first duly sworn, deposes and states:

1. My name is Dennis Pappas. I am Staff Director – Public Policy for Qwest Corporation in Denver, Colorado. I have caused to be filed written rebuttal testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Dennis Pappas

SUBSCRIBED AND SWORN to before me this 20th day of December, 2004.

Notary Public

My Commission Expires: 9-22-07

NOTARY PUBLIC
SUSAN HARDMAN
STATE OF COLORADO
My Commission Expires 09.22.2007

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-18

Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL TESTIMONY

OF

HARRY M. SHOOSHAN III

ON BEHALF OF QWEST CORPORATION

December 20, 2004

TABLE OF CONTENTS

I. IDENTIFICATION OF WITNESS 1

II. PURPOSE AND SUMMARY OF REBUTTAL TESTIMONY 1

III. THE CHANGES IN THE BASKET STRUCTURE PROPOSED BY STAFF AND RUCO ARE CONTRARY TO THE ORIGINAL INTENT OF THE PRICE-CAP PLAN, ARE UNWARRANTED AND DO NOT PROVIDE THE NECESSARY DEGREE OF REGULATORY FLEXIBILITY 2

IV. STAFF'S AND RUCO'S RELIANCE ON CONCENTRATION RATIOS IS UNWISE SINCE SUCH RATIOS HAVE LIMITED VALUE IN DETERMINING THE EXTENT OF EFFECTIVE COMPETITION. 8

V. THERE IS NO NEED FOR AN "X" FACTOR IN THE PRICE-CAP PLAN AND IT IS INAPPROPRIATE TO CONSIDER NATIONWIDE DATA ON PRODUCTIVITY GROWTH IN SETTING THE PRICE CAPS IN ARIZONA. 11

VI. CONTRARY TO THE POSITION OF STAFF AND RUCO, WIRELESS SERVICE IS AN EFFECTIVE SUBSTITUTE FOR WIRELINE SERVICE. 20

VII. MCI'S CALL FOR "REAL DEREGULATION" GOES FAR BEYOND THE SCOPE OF THIS PROCEEDING AND, AS A RESULT, IS A "RED HERRING." 26

VIII. SUMMARY AND CONCLUSION. 29

I. IDENTIFICATION OF WITNESS.

Q1. ARE YOU THE SAME HARRY M. SHOOSHAN III WHO PROVIDED DIRECT TESTIMONY IN THIS PROCEEDING?

A1. Yes.

II. PURPOSE AND SUMMARY OF REBUTTAL TESTIMONY.

Q2. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS PROCEEDING?

A2. The purpose of my rebuttal testimony is to respond to some of the positions taken by Staff witnesses Matthew Rowell and Armando Fimbres, by Ben Johnson on behalf of RUCO and by Don Price for MCI.

Q3. WHAT ISSUES RAISED BY THOSE WITNESSES DO YOU ADDRESS IN YOUR REBUTTAL TESTIMONY?

A3. In this rebuttal testimony, I disagree with retaining a revenue cap on Basket 3 services. There is no reason to treat Qwest's Basket 3 services differently than the comparable offerings of its competitors. I also argue against proposals to create a series of sub-constraints in the baskets and

against radically restructuring the baskets. I further argue that the productivity gains that Dr. Johnson claims could be attained by Qwest are unrealistic to expect in light of conditions in Arizona. I also discuss the flaws in reliance upon static measures of market concentration, and suggest instead that the Commission consider the ability of Qwest's competitors to expand capacity. Further, I reject the suggestions that wireless service is only a complement and not a substitute for Qwest's wireline services. Finally, I recommend that the Commission not be distracted by MCI's call for "real deregulation."

III. THE CHANGES IN THE BASKET STRUCTURE PROPOSED BY STAFF AND RUCO ARE CONTRARY TO THE ORIGINAL INTENT OF THE PRICE-CAP PLAN, ARE UNWARRANTED AND DO NOT PROVIDE THE NECESSARY DEGREE OF REGULATORY FLEXIBILITY.

Q4. STAFF PROPOSES RETAINING THE REVENUE CAP ON BASKET 3 DUE TO FAIR VALUE CONSIDERATIONS. ROWELL AT 12. HOW DO YOU RESPOND?

A4. I do not agree. In the first place, where competitive services are concerned, I do not believe that the Commission is required to base rates strictly on fair value considerations. Indeed, by their nature, competitive

services must be "priced to market" and based on conditions in the marketplace. Second, it is the overall price-cap plan and all of its component parts—not any particular element of it—that must meet the fair value standard. Further, in regulating the competitive services of CLECs and IXCs, the Commission does not cap the revenues from those services, while the Staff seeks to continue to cap revenue from the same category of services offered by Qwest. Qwest proposes to end this disparate treatment in this proceeding.

Q5. STAFF ALSO RECOMMENDS THAT PACKAGES OF SERVICES IN BASKET 3 THAT CONTAIN ANY BASKET 1 SERVICES BE "HARD-CAPPED" SUCH THAT THE PACKAGE PRICE DOES NOT EXCEED THE À LA CARTE PRICES OF THE INDIVIDUAL SERVICES IN THE PACKAGE. ROWELL AT 13. HOW DO YOU RESPOND?

A5. I disagree. It is contrary to the original intent of Basket 3 which was to give Qwest flexibility in pricing services and packages of services which had either been found to be competitive or which are discretionary in nature. I believe that requiring the Basket 1 service that is included in a Basket 3 package to be made available as a stand-alone offering—as the existing plan and Qwest proposed plan do—provides adequate protection for consumers. Additionally, it is difficult to understand why a firm,

1 particularly one in a competitive market, would price a bundle of services
2 above the sum of the individual service prices. There is no benefit to the
3 consumer to purchasing such a bundle. Instead of trying to write a rule for
4 every imagined "harm," I think Staff should recognize the need for market
5 forces to replace regulation and for the same consumer protection rules
6 that govern other non-regulated industries to apply in telecommunications.
7
8 **Q6. ON A RELATED MATTER, STAFF PROPOSES THAT SERVICES IN**
9 **COMPETITIVE ZONES BE CAPPED AT CURRENT LEVELS BECAUSE**
10 **"COMPANIES GENERALLY DO NOT COMPETE BY RAISING**
11 **PRICES." ROWELL AT 23. HOW DO YOU RESPOND?**
12 **A6.** This is a bad idea. In the first place, it is at odds with other aspects of the
13 Staff's proposed price-cap plan. The Staff has suggested that Qwest be
14 given "headroom" in Basket 3 to offset reductions in access charges and
15 to make up what the Staff has determined to be a $3.5 million revenue
16 deficiency. However, by hard-capping Basket 3 services that are offered
17 in competitive zones as well as hard-capping packages that contain
18 Basket 1 services, the Staff is limiting Qwest's ability to utilize that
19 headroom and renders that headroom largely illusory. In the second
20 place, the Staff's premise is incorrect. Firms in competitive markets adjust
21 prices continually—both raising them and lowering them—to reflect both

competitive conditions at a particular time and prevailing economic conditions (e.g., inflation, labor costs). By reaching into Basket 3 with a variety of sub-constraints, Staff is undermining the Commission's intent in establishing that Basket in the first place which was to give Qwest the maximum flexibility in setting its prices.

Q7. IN WHAT OTHER WAYS WOULD STAFF MODIFY QWEST'S PROPOSED TREATMENT OF BASKET 3?

A7. Staff would retain the revenue cap on Basket 3 and require annual reports and annual adjustments in the quantities of services in Basket 3. As I stated in my Direct Testimony, elimination of a cap on Basket 3 is warranted by competitive pressures which have served during the term of the existing plan to keep the aggregate prices of services in Basket 3 in check. Shooshan Direct at 16. I would also re-emphasize a point I made in my Direct Testimony. Regulation should be designed to act as a substitute for competition. Where, as in Arizona today, competition is pervasive, regulation of Basket 3 is a waste of the Commission's (and other parties') resources. *Ibid.*

Q8. ON BEHALF OF RUCO, DR. JOHNSON PROPOSES THAT THE CURRENT RATIONALE FOR THE THREE BASKETS BE SCRAPPED

AND THAT BASKETS BE COMPLETELY REDESIGNED BASED ON WHAT HE CALLS "THE INTENSITY OF COMPETITION CURRENTLY BEING FACED BY QWEST." JOHNSON AT 168. HOW DO YOU RESPOND?

A8. I disagree with Dr. Johnson's recommended approach. In the first place, when I recommended the current basket structure as a consultant to the Staff, I stated that it represented a progressive approach in that it separates wholesale and retail services into separate baskets. Since prices for wholesale and retail services are set very differently, I continue to believe that it is appropriate to retain that structure. In addition, I believe Dr. Johnson's approach, recommending such granular regulation of Qwest's services, is contrary to the spirit of price-cap regulation. Finally, I believe that the current basket structure which separates basic retail service from other retail services adequately reflects competitive considerations.

Q9. WILL YOU PLEASE ELABORATE ON THE PROBLEMS YOU SEE WITH DR. JOHNSON'S APPROACH?

A9. Yes. While Dr. Johnson's premise—that services should be divided into baskets "primarily on the basis of the intensity of competitive pressures currently being faced by Qwest"—has a superficial appeal, the devil is in

1 the details. When Dr. Johnson discusses the steps needed to implement
2 his approach, his real objective becomes clear—he wants to superimpose
3 a complex and cumbersome process that will frustrate any reasonable
4 efforts by Qwest to price its services in an economically efficient manner.
5 To Dr. Johnson's credit, he reveals his bias when he discusses at length
6 why he does not "believe" that there is any need for rate rebalancing and
7 why he opposes any restructuring of basic local exchange rates and
8 intrastate access charges. Johnson at 192-194.
9 Before granting Qwest any additional pricing flexibility, Dr. Johnson
10 proposes that the Commission should conduct a "broad examination of the
11 status of competition in general." The Commission should then examine
12 market conditions for each type of service for every wire center. Finally,
13 the Commission should perform a service-by-service analysis also on a
14 geographically specific basis.
15 Dr. Johnson certainly understates it when he acknowledges that his
16 approach is "somewhat more complex" than the approach suggested by
17 Qwest for evaluating services by competitive zones. In my opinion, Dr.
18 Johnson's approach is offered to throw sand into the wheels of progress in
19 Arizona. Indeed, his proposed approach could presumably lead to
20 services that are deregulated today being re-regulated when they are
21 passed through Dr. Johnson's screen.

Qwest's proposal to retain the existing price-cap plan basket structure and rationale while permitting greater degrees of pricing freedom is far preferable to the radical revisions suggested by Dr. Johnson.

Q10. WOULD YOU SUMMARIZE YOUR CONCERN ABOUT A PRICE-CAP PLAN THAT DOES NOT AFFORD QWEST ADEQUATE FLEXIBILITY?

A10. Yes. All parties concur that competition has intensified since the adoption of the existing price-cap plan. In a competitive environment, it is important that all providers have the flexibility to adjust their prices to take advantage of opportunities in the marketplace. If the Commission fails to provide Qwest with that flexibility in the way that it structures the price-cap baskets and sets the price caps, it will be simply bestowing what amounts to an "entitlement" on Qwest's many competitors. This is especially true to the extent that the Commission imposes sub-constraints on any service or group of services. In the long run, too, handicapping Qwest will harm consumers.

IV. STAFF'S AND RUCO'S RELIANCE ON CONCENTRATION RATIOS IS UNWISE SINCE SUCH RATIOS HAVE LIMITED VALUE IN DETERMINING THE EXTENT OF EFFECTIVE COMPETITION.

Q11. BOTH MR. FIMBRES AND MR. ROWELL RELY ON CONCENTRATION RATIOS ("HHI") TO ASSESS THE COMPETITIVENESS OF LOCAL EXCHANGE MARKETS IN ARIZONA. DR. JOHNSON ALSO RELIES ON HHI CALCULATIONS TO "MEASURE" COMPETITION AT EACH OF QWEST'S WIRE CENTERS. DO YOU BELIEVE THIS IS THE CORRECT APPROACH?

A11. Concentration ratios can certainly be considered, but they have shortcomings that the Staff witnesses and Dr. Johnson fail to acknowledge. As a result, they give concentration ratios more weight than they deserve.

Q12. WHAT ARE THE PITFALLS ASSOCIATED WITH USE OF HHI AS A MEASURE OF COMPETITIVE EFFECTIVENESS?

A12. First, it is important to consider the introduction of measurement bias that arises from utilization of number listings (as opposed to actual usage) in measuring a concentration index. By way of illustration, in the United Kingdom, where BT is the "incumbent" telephone company, BT still has about 80 percent of all lines, but only handles about *40 percent* of calls.[1] Using number listings or lines as the appropriate measure of actual and

[1] *See* Table 15 ("Summary call volumes by type"), *Fixed Telecoms Market Information*, Ofcom (May 2004).

potential *productive capacity*—the truly economically relevant measure for gauging competition—clearly understates true competitive effectiveness. Relatedly, please note that even usage measures are likely biased downward to the extent that they, too, *understate* the actual ability of existing firms to expand output and new firms to enter and do likewise. They merely measure the share that firms have managed to achieve at a particular point in time, *not* what they are capable of doing in response to a price increase. This hypothetical capability to respond is, *in fact,* the way in which the U.S. Department of Justice actually gauges market power—*not* the HHI which is merely a summary statistic that is used as an initial screen in evaluating proposed mergers and consolidations.

Q13. WHAT IS A MORE APPROPRIATE ECONOMIC MEASURE OF COMPETITIVE EFFECTIVENESS?

A13. The elasticity of supply is the best economic summary measure of competitive effectiveness.[2] A high elasticity of supply necessarily implies a high elasticity of demand and the absence of any genuine market power. That is, in such a market, many firms are poised to deploy new facilities or use existing facilities to satisfy growing demand as quickly as possible. In a market characterized by supply elasticity, many firms,

[2] *See*, for example, Paul Samuelson, *Foundations of Economic Analysis* (Harvard University Press, 1947).

rather than just the largest or most-established firm, have a reasonable opportunity to obtain new customers regardless of their current market share or the concentration level of the industry. Thus, a firm with a high market share in a highly-concentrated industry (i.e., high HHI) would find it difficult to exercise *any* market power under the assumption of a high elasticity of relevant supply.

With the effective removal of legal entry barriers to competition in local telecommunications, implementation of the market opening provisions of the 1996 Telecommunications Act, the ready availability of Qwest's retail services and network elements for resale and repackaging, and the proliferation of other means of expanding call-handling capacities (e.g. cable systems, wireless providers and VoIP), the elasticity of supply of telecommunications services has incontrovertibly become very high indeed, implying the absence of market power in the economically relevant sense.

V. THERE IS NO NEED FOR AN "X" FACTOR IN THE PRICE-CAP PLAN AND IT IS INAPPROPRIATE TO CONSIDER NATIONWIDE DATA ON PRODUCTIVITY GROWTH IN SETTING THE PRICE CAPS IN ARIZONA.

Q14. DO YOU AGREE WITH DR. JOHNSON'S PROPOSAL THAT THERE BE AN X FACTOR AND THAT IT SHOULD BE SET ON THE BASIS OF NATIONWIDE DATA ON PRODUCTIVITY GROWTH?

A14. No. As I stated in my Direct Testimony, I believe it is consistent with the evolution of price-cap regulation for Qwest to propose elimination of the X factor. Shooshan Direct at 8-9. A number of states—including Iowa, Colorado and Minnesota in Qwest's region—no longer use X factors in their basic baskets. *Id.* at 9. Also, I note that the Staff supports removal of an X factor in this proceeding. Rowell at 12.

Even if one were to retain an X factor, I also do not believe that it is appropriate to use nationwide productivity data to establish it.

Q15. WHY NOT?

A15. A fundamental requirement of a price-cap plan is to give the company the opportunity to recover its costs, including the cost of capital. Dr. Johnson acknowledges this point himself: "When rates are controlled in this manner (regardless of whether this is accomplished through traditional rate base regulation or through an alternative system), there will be an equitable and efficient balance between the interests of the utility and its investors on the one hand, and those of its customers on the other hand." Johnson at 79-80.

Unfortunately, Dr. Johnson's proposal does not necessarily satisfy this fundamental requirement. The rate of productivity growth varies geographically. Consequently, nationwide data cannot possibly establish that a plan with a particular X factor would allow Qwest to recover its costs, including the cost of capital, in Arizona. Additionally, the appropriate X factor depends on the sub-constraints in the price-cap plan. Nationwide data obviously provide no insights whatsoever in this regard.

Q16. WHAT DETERMINANTS OF PRODUCTIVITY GROWTH DOES DR. JOHNSON DISCUSS?

A16. He discusses technological progress and scale economies.

Q17. WHAT IS YOUR OPINION OF THE EFFECTS OF THESE DETERMINANTS AND DR. JOHNSON'S DISCUSSION THEREOF?

A17. Dr. Johnson is certainly correct that technological progress is a key determinant of productivity growth in telecommunications. For over a century, it has led to improvements in service and reductions in real cost. In contrast, scale economies are a much lesser source of productivity growth. Generally speaking, the populous urban areas of the United States long ago achieved efficient scale in telecommunications. While Arizona has experienced high increases in its population in recent years, it

is unlikely that further increasing Qwest's output or customer base would provide a source of substantial productivity growth. Further, new residents and businesses in Arizona need not select Qwest as their local telephone service provider. In fact, as Mr. Teitzel testifies, the number of access lines that Qwest serves has decreased at the same time that Arizona's population has grown. Teitzel Rebuttal at 5-6. Qwest can hardly be expected to obtain any economies or productivity growth from this population expansion in Arizona given these circumstances. Increasing scale economies are therefore not a source of substantial productivity growth, either.

Q18. ARE THERE OTHER DETERMINANTS OF PRODUCTIVITY GROWTH THAT WERE NOT DISCUSSED BY DR. JOHNSON?

A18. Yes, there certainly are.

Q19. WHAT ARE THESE OTHER DETERMINANTS?

A19. I believe that the two most important determinants are improved pricing efficiency and the growth of competition.

Q20. PLEASE EXPLAIN WHAT YOU MEAN BY "IMPROVED PRICING EFFICIENCY."

A20. It is generally accepted—except by Dr. Johnson, I might add—that economic efficiency is increased by the combination of lowering prices of usage and vertical services toward long-run marginal costs ("LRMCs") and raising the price of basic local service to allow the regulated firm to cover its costs, including the cost of capital. To be sure, regulatory commissions have concerns that go beyond economic efficiency. Nevertheless, there can be little doubt that economic efficiency is maximized by pricing in the way I just described. To the extent that commissions have chosen to pursue an alternative pricing policy, they are sacrificing economic efficiency in the hope of achieving other social goals. Improving the economic efficiency of pricing means moving from "socially engineered" prices toward this ideal of economically efficient pricing

Q21. PLEASE EXPLAIN HOW IMPROVING ECONOMIC EFFICIENCY OF PRICING AFFECTS PRODUCTIVITY GROWTH.

A21. As demand for usage and vertical services is stimulated, the value of the additional output exceeds the value of the additional inputs used to produce it. The difference shows up as an increase in productivity. It decreases (and may entirely eliminate) the X factor to which the regulated firm can commit, while still covering its costs, including the cost of capital.

This effect on productivity growth has had far more than theoretical significance for the telecommunications industry. Beginning in the 1980s, the FCC substantially restructured access charges to improve economic efficiency. The outcome was enormous productivity growth for the industry. This productivity growth allowed AT&T to remain profitable—indeed, prosperous—although its market share was rapidly declining and retail prices were falling. At the same time, local exchange carriers substantially benefited from the stimulation of carrier access minutes.

Q22. DO THE PRODUCTIVITY GAINS FROM IMPROVING PRICING EFFICIENCY VARY GEOGRAPHICALLY?

A22. Yes. To be sure, the gains from the FCC's policies apply throughout the country. But the policies of state commissions have varied considerably. Thus, the productivity gains from improved efficiency of *intrastate plus interstate* pricing also vary considerably.

Q23. HOW DOES THE STRUCTURE OF A PRICE-CAP PLAN AFFECT THE GAINS FROM IMPROVED PRICING EFFICIENCY?

A23. If a price-cap plan (like the current price-cap plan in the U.K.) has no sub-constraints, the firm can be expected to restructure prices so as to improve economic efficiency. I should point out that the firm's ability to

improve economic efficiency may, however, be limited by sub-constraints in the price-cap plan. In particular, hard constraints on specific prices prevent any progress whatsoever with respect to those prices. There may or may not be good policy reasons for these sub-constraints. Regardless, the sub-constraints have the effect of reducing the productivity gains from improved pricing efficiency.

Q24. HOW DO THESE CONSIDERATIONS RELATE TO ARIZONA?

A24. The sub-constraints in the current Arizona price-cap plan severely limit Qwest's ability to improve the economic efficiency of pricing and achieve the corresponding gains in productivity. In particular:

- A sizable portion of Qwest's total revenues comes from services that are subject to hard constraints.
- The basket structure prevents precisely the type of rate restructuring that would be most likely to improve economic efficiency; namely, lowering rates in Basket 3 toward their LRMCs and using the headroom to increase prices in Basket 1. Such pricing benefits consumers and is not anti-competitive, so long as prices in Basket 3 remain above their LRMCs.

Q25. HOW DO THESE CONSIDERATIONS RELATE TO DR. JOHNSON'S PROPOSAL TO SET THE X FACTOR ON THE BASIS OF NATIONWIDE DATA?

A25. These considerations expose the flaw in Dr. Johnson's logic. Qwest cannot reasonably be expected to achieve the same level of productivity gain in Arizona as could be achieved in a state where the price-cap plan has less severe sub-constraints or where the state has made more progress towards permitting economically efficient pricing by other means (i.e., by explicit rate rebalancing).

Q26. HOW DOES THE GROWTH OF COMPETITION AFFECT THE PACE OF PRODUCTIVITY GROWTH?

A26. In unregulated markets, competition generally increases the pace of productivity growth. Competition sharpens incentives to improve efficiency. By improving efficiency, the firm can attract customers by offering them better services at lower prices without losing money in the process. Unregulated competition also affords strong incentives for firms to price efficiently.

Much the same applies under price-cap regulation with no sub-constraints. Under such regulation, the firm can price the same as unregulated firms in competitive markets. At the same time, the overall price-cap constraint

limits the prices of services in less competitive markets. As before, consumers benefit, and the pricing is not anti-competitive so long as prices remain above LRMCs.

The effects of competition are, however, quite different if the price-cap plan has sub-constraints that limit price increases of services with relatively less elastic demand. In that case, the regulated firm has to price competitive services well above their LRMCs in order to cover total costs, including the cost of capital. Such pricing provides an umbrella under which inefficient competitive entrants can prosper. But regardless of whether the entrants are efficient, the productivity growth of the incumbent declines. Its production of competitive outputs declines without a commensurate reduction in the value of the inputs it uses. It may also suffer from under-utilized capacity and stranded investment.

More generally, sub-constraints in a price-cap plan reduce the efficiency and productivity growth of the regulated firm. Competition magnifies these efficiency losses. As competition becomes more intense, sub-constraints are more and more likely to be counterproductive. In any event, their downward pressure on efficiency and productivity growth must be considered in developing an appropriate price-cap formula. It is wholly inappropriate to set the X factor on the basis of nationwide data, as proposed by Dr. Johnson, without consideration of these state-specific reductions in efficiency and productivity.

VI. CONTRARY TO THE POSITION OF STAFF AND RUCO, WIRELESS SERVICE IS AN EFFECTIVE SUBSTITUTE FOR WIRELINE SERVICE.

Q27. MR. FIMBRES CONCLUDES THAT WIRELESS SERVICE IS NOT AN EFFECTIVE SUBSTITUTE FOR SERVICES OFFERED BY QWEST. DO YOU AGREE?

A27. No. Although Qwest has elected not to rely on the presence of wireless service in its competitive zone criteria, I believe that wireless service is an effective substitute for Qwest's basic local exchange service. I reach this conclusion by examining more closely the same evidence that Mr. Fimbres has offered as well as that offered by Mr. Teitzel in his Direct Testimony. *See* Teitzel Direct at 56-58. In short, I think Mr. Fimbres has gathered most of the right evidence, but then chooses to "look the other way" when considering it.

Q28. WILL YOU PLEASE ELABORATE?

A28. Yes. In order for an alternative offering to be an effective substitute, it must be widely available. Mr. Fimbres' own evidence suggests that wireless service is available from many providers. Fimbres at 32.

An effective substitute must also perform the same primary function. In this case, both wireline and wireless service permit users to make and receive local and long-distance calls. This is not to say that the alternative offering has to function in precisely the same manner. If it did, it would be precisely the same product.

The design of many wireless calling plans, coupled with the functionality of the service, makes them effective substitutes for basic local exchange service. These plans typically include various-sized "buckets" of minutes that can be used for "any distance calling" (i.e., local and long distance) coupled with unlimited minutes for certain time periods (e.g., nights and weekends). Wireless plans usually include numerous vertical features such as Caller ID and Call Waiting as part of the standard package.

Additionally, a substitute has to be priced comparably. Nationally, I observe that the prices for wireless service have fallen rapidly in recent years, driven down by increased competition. Wireless phones are now offered "free" with many plans and many carriers no longer require long-term contracts. Others are offering pre-paid plans that are attractive for occasional users or those without an adequate credit history. The price differences one observes between wireline and wireless service offerings are, for the most part, superficial. When one makes a true "apples-to-apples" comparison, taking into account all of the vertical features, larger

1 local calling areas and, in some cases, long-distance calling allowances
2 built into wireless plans, the price points are quite comparable. Also, in
3 order to make an "apples-to-apples" comparison, one has to consider the
4 additional value from features such as portability and immediate activation
5 inherent in wireless service.

6 Mr. Fimbres concedes as much but then curiously goes on to state that
7 "[f]or some users, however, the cost of wireless phones, as high as
8 several hundred dollars, and monthly fees that can be $50 and above may
9 present barriers." Fimbres at 25. I would point out that a number of
10 wireless providers are offering free phones and service packages that are
11 far less than $50 and within the range of basic local exchange prices in
12 Arizona. *See* Teitzel Direct at 56-58. Finally, there has to be evidence
13 that consumers view the product in question as a substitute. Mr. Fimbres
14 concedes this point too, noting the growth in the number of wireless
15 phones relative to wireline phones, the changes in usage patterns and the
16 fact that (nationally at least) some consumers are actually "cutting the
17 cord" and using their wireless phones as their only phones. This is
18 "complete" line substitution rather than merely the use of wireless by
19 consumers to replace "second" phone lines, a trend which Mr. Fimbres
20 also documents in Arizona. Fimbres at 33.

It is also important to consider the extent of what I call "usage substitution." There is ample evidence that consumers are shifting more and more of their calls to wireless phones even when they retain a wireline connection in their residence or business. I have overseen survey research that documents this trend in several states. The fact that consumers are using their wireless phones to make and receive calls at home or at work is additional evidence that consumers view wireless service as a substitute for wireline service.[3]

What is important here—and most relevant to an analysis of market power—is whether consumers *perceive* that wireless is a substitute, not, as Mr. Fimbres suggests, the number that have actually chosen to disconnect or not connect wireline service.

Q29. DR. JOHNSON SUGGESTS THAT YOU AND MR. TEITZEL ARE WRONG AND THAT WIRELESS SERVICE IS NOT "A COMPETITIVE ALTERNATIVE" TO WIRELINE SERVICE BECAUSE THE TWO SERVICES DO NOT SHARE PRECISELY THE SAME ATTRIBUTES. JOHNSON AT 177-179. HOW DO YOU RESPOND?

[3] In these surveys, a significant percentage of consumers give out their wireless phone number as their primary phone number while others give out both their wireless and wireline numbers.

A29. Not surprisingly, I strongly disagree with Dr. Johnson. To be considered substitutes, services or products do not have to be identical, functionally equivalent or even of equal quality. For example, cable television, satellite television and free-over-the-air television may differ in one or more of these respects and in the delivery technology, but can certainly be said to be in the same product market.[4] As long as the services are alike in "substance" (that is, they permit the same primary function to be performed), they are comparable for determining if there is effective competition. In this case, it is clear that wireless and wireline service are enough alike in their primary function to be considered substitutes.

It is also interesting to note that some of the differences in attributes cited by Dr. Johnson do not even relate to basic local exchange service, but to the customer premises equipment and inside wiring arrangements that customers elect on their own and that have long been deregulated (e.g., type of phone, the ability to have extensions of the same line, etc.).

Q30. WHAT IF A PARTICULAR CUSTOMER OR SET OF CUSTOMERS DOES NOT CONSIDER THE OFFERINGS OF WIRELESS PROVIDERS AS SUBSTITUTES FOR QWEST'S BASIC EXCHANGE SERVICES?

---

[4] *See Cable Holdings v. Home Video, Inc.*, 825 F.2d 1559, 1563 (11th Cir. 1987).

A30. For an analysis of market power, it is sufficient that many, if not all, customers perceive that substitutes exist. To determine which products or services are in the same market, it is not necessary for *all* customers to view the services as completely interchangeable. Rather, services are competitive substitutes if they "have the ability—actual or potential—to take significant amounts of business away from each other."[5] For a firm to exercise market power, it must be able to raise prices *profitably.*[6] If a substantial number of customers are aware of alternatives and would substitute a CLEC offering or wireless service for Qwest's basic exchange service should Qwest increase the price, Qwest cannot *profitably raise its prices* because it would risk losing those customers.[7] As a result, the fact that many customers have substituted—or *would substitute*—away from Qwest's basic exchange services protects those customers who may not view a CLEC's or wireless provider's offering as a "perfect substitute" based on their particular preferences.

---

[5] *SmithKline Corp. v. Eli Lilly & Co.*, 5757 F.2d 1056, 1063 (3d Cir.), cert. denied, 439 U.S. 838 (1978).

[6] Michael L. Katz and Harvey S. Rosen, *Microeconomics*, Second Edition (Boston: Richard Irwin Inc., 1994) at 417-420, where the price-making and profit-maximizing behavior of a firm with market power is discussed.

[7] These customers tend to be the most "valuable" precisely because they are more sophisticated and are higher volume users.

VII. MCI'S CALL FOR "REAL DEREGULATION" GOES FAR BEYOND THE SCOPE OF THIS PROCEEDING AND, AS A RESULT, IS A "RED HERRING."

Q31. MCI HAS CALLED FOR "REAL DEREGULATION." HOW DO YOU RESPOND?

A31. MCI's call for "real deregulation" goes well beyond the scope of this proceeding. Qwest is not asking for complete deregulation at this time, but rather is seeking modifications to the existing price-cap plan. Thus, MCI's call for "real deregulation" is nothing but a red herring.[8]

Q32. DO YOU DISAGREE WITH MR. PRICE'S STATEMENT THAT "ANY COMPANY CLAIMING TO ESPOUSE PRICING FLEXIBILITY OR DEREGULATION SHOULD AS PART OF THAT ASSUME THE RISK THAT GOES ALONG WITH BEING A COMPETITIVE OPERATION"? PRICE AT 44.

A32. No, as a general matter, I do not. However, in this case, the Commission is not being asked to deregulate Qwest. Quite to the contrary, even if

---

[8] A "red herring" is defined as something that draws attention away from the central issue. The idiom alludes to dragging a smoked herring across a trail to cover up the scent and throw off tracking dogs. *See The American Heritage® Dictionary of Idioms* by Christine Ammer (Houghton Mifflin Company, 1997).

Qwest's proposed plan is adopted as filed, the company would continue to be regulated in ways its competitors (including MCI) are not.

Q33. HOW DO YOU RESPOND TO MR. PRICE'S ASSERTION THAT "THE NEW ENVIRONMENT REQUIRES THAT THE COMMISSION ACTIVELY DISMANTLE THE NUMEROUS ARTIFICIAL PROTECTIONS THAT QWEST CONTINUES TO ENJOY AS A RESULT OF ITS HISTORY AS A REGULATED ENTITY"? IBID. (EMPHASIS IN THE ORIGINAL).

A33. In the first place, it is unclear to me what the "numerous artificial protections" are to which Mr. Price is referring. Apart from his concern about the level of access charges, he does not enumerate those protections. And, to the contrary, I would argue that Qwest bears regulatory "burdens" that its competitors do not. For example, the Commission continues to treat Qwest as the carrier of last resort throughout its service territory. Also, as anyone reading the record in this proceeding—and especially RUCO's filing—is aware, Qwest is subjected to a degree of regulatory scrutiny in the pricing and packaging of its services with which none of its competitors has to contend. In theory, I would not argue with Mr. Price's call for total deregulation and an end to all subsidies, but this price-cap renewal proceeding is not the right time or place for such sweeping reforms.

Q34. WHAT IS YOUR VIEW ABOUT MR. PRICE'S RECOMMENDATION THAT INTRASTATE ACCESS CHARGES BE REDUCED?

A34. In principle, I agree. Indeed, as a consultant to the Staff at the time the existing price-cap plan was developed, I recommended phased reductions in intrastate access charges. However, unlike Mr. Price, I believe that those reductions should be offset by some compensating provision. Since the "subsidies" embedded in access charges that Mr. Price complains about were established under traditional regulation, it is only fair that they are eliminated and rates are set at economically efficient levels *before* there is total deregulation.

In the existing plan, the reductions in access charges were offset by providing Qwest with additional "headroom" in Basket 3. As Mr. Price notes, Mr. McIntyre on behalf of Qwest mentions one possible offset—an intrastate subscriber line charge. Qwest is not seeking such a charge at this time and suggests instead that the Commission hold off further changes until the FCC completes its revamping of inter-carrier compensation generally.[9] This is not an unreasonable position given so much is at stake.

[9] The FCC is expected to issue a *Notice of Proposed Rulemaking* shortly that will embody a range of far-reaching reforms.

VIII. SUMMARY AND CONCLUSION.

Q35. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A35. The Commission should approve the renewed price-cap plan as proposed by Qwest in this proceeding. The Commission should discontinue the cap on revenues of Basket 3 services so that Qwest competitive services may be treated in the same manner as its competitors' services. The creation of additional sub-constraints in the baskets undermines the incentives for achieving greater economic efficiency, which an appropriate price-regulation plan can provide. The renewed plan need not include a productivity-inflation adjustment mechanism. The sources of productivity gains that Dr. Johnson cites are unlikely to be realized in Arizona. Further, although Qwest does not rely on wireless competitors to make its case, wireless service is an effective substitute for Qwest's wireline services, contrary to Mr. Fimbres' assertion. Finally, the Commission need not consider the implications of deregulating Qwest in this proceeding, as Mr. Price challenges the Commission to do. Such steps are not contemplated and can be considered in a subsequent proceeding (if at all).

Q36. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?

1 **A36.** Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF NEW MEXICO)
) **ss** **AFFIDAVIT OF HARRY M. SHOOSHAN**
COUNTY OF SANTA FE)

Harry M. Shooshan, of lawful age being first duly sworn, deposes and states:

1. My name is Harry M. Shooshan. I am a principal in Strategic Policy Research, Inc. located in Bethesda, Maryland and am appearing on behalf of Qwest Corporation. I have caused to be filed written rebuttal testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Harry M. Shooshan

SUBSCRIBED AND SWORN to before me this 14th day of December, 2004.

Notary Public

My Commission Expires: 11/22/07

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-19

Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL TESTIMONY

OF

DAVID L. TEITZEL

QWEST CORPORATION

DECEMBER 20, 2004

TESTIMONY INDEX

		Page
Executive Summary		i
I.	Identification of Witness	1
II.	Structure of Rebuttal Testimony	1
III.	Staff	2
	a. Competitive Issues	4
	b. Competitive Zones Proposal	21
	c. Arizona Universal Service Fund Proposal	31
	d. Specific Service/Pricing Proposals	44
IV.	Department of Defense	47
V.	Cox Communications	50
VI.	Time Warner	55
VII.	RUCO	65
VIII.	Conclusion	72

EXECUTIVE SUMMARY

My rebuttal testimony focuses on issues raised in this docket in the testimonies of Staff, RUCO, Department of Defense ("DOD"), Time Warner and Cox Communications. A primary overarching theme in the testimonies of witnesses for each of these parties is that there is limited competition in the local exchange telecommunication markets in Arizona, but that competition is not yet sufficient to justify additional regulatory flexibility for Qwest, such as is represented by Qwest's Competitive Zones proposal for the greater Phoenix and Tucson markets. Staff further suggests to the Commission that the Competitive Zones concept has merit and regulatory relief may be warranted in certain limited circumstances, but that the volume of evidence submitted thus far in this docket is insufficient to support such a finding. Qwest disagrees on both counts. As shown in my direct testimony, Arizona is one of Qwest's most robustly competitive states (the Phoenix and Tucson markets are particularly competitive) and competition continues to grow in the state. In addition to traditional CLEC-based competition, intermodal competition in the form of wireless and Voice over Internet Protocol ("VoIP") service is creating increasing pressures on Qwest's retail access line base. While the Arizona population, CLEC access lines, wireless subscribers and VoIP services are all enjoying strong growth trends, Qwest's retail access line base has declined by nearly 600,000 lines from December 2000 to December 2003 (with the preponderance of the reduction occurring in the highly competitive Phoenix and Tucson markets). In other words, Qwest is experiencing a declining share of a growing

overall market in Arizona. I have provided a significant level of detail regarding the scope of telecommunications competition in Arizona that is certainly sufficient to support a finding that the Phoenix and Tucson markets are now competitive to a degree that warrants approval of Qwest's Competitive Zones proposal in those markets. The competitive paradigm in Arizona is rapidly changing, and regulatory guidelines must be updated to afford Qwest an opportunity to fairly compete.

Both Staff and RUCO contend that Qwest's proposal to utilize Arizona Universal Service ("AUSF") funding as an explicit subsidy to support, on a competitively neutral basis, the cost of providing local service in high cost areas in Arizona is not warranted. In particular, both parties claim that existing revenue flows, in the net, are sufficient to allow Qwest to recover the high cost of providing local exchange services in Cost Zones 2 and 3 in the state. However, their position is based on an underpinning of continued implicit subsidies, which is neither sustainable nor appropriate in the competitive Arizona telecommunications market. Traditional implicit subsidy flows, which were established in the "monopoly" era of telecommunications in Arizona, were provided from Qwest services such as long distance, optional calling features and business services. Subsidy flows from each of these services are being rapidly eroded as intramodal and intermodal competition capture an ever-increasing share of the market. Additionally, as I discuss in my rebuttal testimony, there is currently scant competition in the high cost areas of the state, since competitors generally prefer to focus on densely populated areas where operating margins can be optimized. With Qwest's AUSF proposal, however, explicit subsidies are made available equally to

Qwest and its competitors to improve the economic attractiveness of serving high cost areas. Qwest's proposal is in harmony with the Commission's duty to remove implicit subsidies and improve the prospects for growth in competitive telecommunications alternatives in all areas of the state. The Commission should reject parties' appeal for a continuation of the antiquated and competitively inappropriate system of implicit subsidies.

Finally, with the exception of Qwest's Competitive Zones proposal, AUSF plan (which includes elimination of the existing Zone Increment pricing structure) and Qwest's proposed elimination of the current free Directory Assistance call allowance,[1] parties generally do not dispute the retail pricing proposals outlined in my direct testimony. These retail pricing proposals include elimination and consolidation of certain service packages and deregulation of Qwest's Voice Messaging and Billing and Collection services, and Qwest requests these proposals be approved as filed. With regard to the Directory Assistance free call allowance, Qwest's proposal is in alignment with a focus on elimination of implicit subsidies in this docket and represents one source of incremental revenue toward Qwest's revenue requirement. As discussed in my direct and rebuttal testimonies, Directory Assistance is a competitive service and was previously ordered by the Commission to be placed in Basket 3. Consumers now have a range of options in obtaining directory information, including internet DA services, wireless DA services, dial-around DA providers (such as MCI and AT&T) and printed directories. Qwest's proposal will properly position its Directory Assistance service in the competitive marketplace by removing the existing

implicit subsidy and will align the structure of the service with competing services such as that offered by AT&T, which does not currently provide a free DA call allowance.

Each of Qwest's retail service proposals, including its Competitive Zones, AUSF, deregulation and retail price adjustment proposals are reasonable and are in appropriate alignment with the realities of the competitive telecommunications market in Arizona. I respectfully request the retail service proposals outlined in my direct testimony be approved as filed.

[1] RUCO does not oppose Qwest's proposal to eliminate the existing Directory Assistance free call allowance.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is David L. Teitzel. I am employed by Qwest Corporation ("Qwest") as Staff Director-Public Policy. My business address is 1600 7th Avenue, Room 3214, Seattle, WA, 98191.

Q. DID YOU SUBMIT DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes. I filed direct testimony in this docket on May 20, 2004 regarding the competitive landscape in Arizona telecommunications markets, Qwest's proposal to establish competitive zones in the Phoenix and Tucson markets, Qwest's proposal to utilize the Arizona Universal Service Fund ("AUSF") on a competitively-neutral basis to defray the cost of providing local exchange telephone service to customers in rural areas of Arizona and Qwest's proposals for various pricing changes in its range of retail services in the state.

II. STRUCTURE OF REBUTTAL TESTIMONY

Q. HOW IS YOUR REBUTTAL TESTIMONY STRUCTURED?

A. My rebuttal testimony is generally organized around issues raised by intervening parties, then by witness representing the parties regarding proposals outlined in my direct testimony. For example, various witnesses presented direct testimony on behalf of Staff, and my rebuttal in the section devoted to Staff will focus on issues raised by Staff witnesses Fimbres, Rowell and Regan. I will also address issues raised by Dr. Ben Johnson on behalf of RUCO, Richard Lee on behalf of DOD, Tim Gates on behalf of Time Warner and Wayne Lafferty on behalf of Cox Communications.

III. STAFF

Q. WOULD YOU BRIEFLY SUMMARIZE THE MAJOR CONTENTIONS RAISED BY STAFF REGARDING THE ISSUES YOU PRESENTED IN YOUR DIRECT TESTIMONY?

A. Yes. The following list reflects the general themes raised collectively by Staff's witnesses in regard to elements of my direct testimony:

1. While telecommunications competition is present in Arizona, it is not yet sufficient to warrant the pricing flexibility proposed by Qwest.
2. Intermodal telecommunications competition, such as that represented by wireless services and Voice over Internet Protocol (VoIP) services, does not represent significant competition to Qwest local exchange services.

3. Only facilities-based competition should be considered "real" competition in determining whether and where Qwest should be granted pricing flexibility.
4. Qwest's competitive zones proposal should be set aside for further investigation in a separate docket and not ruled upon in this proceeding. Whether or not the competitive zones proposal is addressed in this proceeding, competitive zones should be defined geographically by zip codes, not Qwest wire centers.
5. Qwest is earning a sufficient margin to fund the provision of local exchange service to customers in high-cost areas, and Qwest's proposal to utilize AUSF funding to serve such customers should be denied. In conjunction with this recommendation, Qwest's current Zone Increment structure should be retained.
6. Qwest's proposal to deregulate Voice Messaging and Billing and Collections services should be approved, but its proposal to discontinue the monthly free call allowance for Qwest Directory Assistance should be denied.
7. Qwest's proposal to eliminate certain retail service packages should be approved.

In my rebuttal testimony that follows, I address these general contentions as well as specific witness statements regarding each such contention that requires further discussion.

a. Competitive Issues

Q. STAFF, PRIMARILY THROUGH THE TESTIMONY OF MR. FIMBRES, EXAMINES THE CURRENT LEVEL OF COMPETITION IN QWEST'S SERVICE TERRITORY AND CONCLUDES THAT COMPETITION IS ACTUALLY FAIRLY TEPID IN ARIZONA. WOULD YOU COMMENT?

A. Yes. Mr. Fimbres apparently studied telecommunications competition in a different Arizona than the one addressed in my direct testimony. Remarkably, in the second paragraph of his executive summary, he states:

> "Some of Qwest's ILEC service areas have several forms of competition (resale, UNE-L, UNE-P and facilities bypass) but the competitive gains in the nearly 9 year window since the 96 Telecom Act was passed highlight slow progress with little to support that acceleration is imminent."

Mr. Fimbres' conclusion that competitive growth in Arizona has been slow is entirely unsupported by the facts in this docket. In fact, Arizona is one of the most robustly competitive states in Qwest's 14 state service territory.

Q. HAVE YOU PROVIDED CLEAR EVIDENCE OF THE IMPACTS OF COMPETITION ON QWEST'S CUSTOMER BASE IN ARIZONA?

A. Yes. In my direct testimony filed on May 20, 2004 in this docket, beginning at P. 3 and ending at P. 62, I provided extensive information regarding the effects of traditional CLEC competition on Qwest's customer base in Arizona and also discussed the rapidly escalating impact of intermodal (e.g., wireless and Voice over Internet Protocol) services in the market.

Q. WHAT PARTICULAR EVIDENCE DO YOU BELIEVE IS VITAL FOR THE COMMISSION TO HAVE IN MIND AS IT CONSIDERS QWEST'S PROPOSALS IN THIS DOCKET?

A. Arizona continues to enjoy one of the strongest population growth rates in the country. At P. 3 of my direct testimony, I highlighted the fact that Arizona had the second highest population growth rate in the U.S. in 2003. As another point of reference, the U.S. Census Bureau reports that Arizona's population is expected to increase by 432,000 from 4,798,000 in July 2000 to 5,230,000 in July 2005.[2] Consistent with this population growth trend, the volume of certain communications services has increased sharply. For example, the number of high speed internet subscribers in Arizona increased by 382,965 from 153,500 in December 2000 to

[2] http://www.census.gov/population/projections/state

536,465 in December 2003.[3] It must be noted that each of these subscribers is a potential customer for VoIP services offered by an ever-expanding array of providers in Arizona. Similarly, the number of wireless subscribers in Arizona grew from 1,855,115 in December 2000 to 2,843,061 in December of 2003.[4] Regarding the growth in the wireline CLEC customer base in Arizona, it is noteworthy that the number of White Pages directory listings associated with CLEC end user access lines increased by over 450%, from ***confidential*** in December 2000 to ***confidential*** in September 2004.[5] Clearly, CLEC competition has grown dramatically in the state in a relatively short period of time, contrary to Mr. Fimbres' conclusion.

Q. HAVE YOU PROVIDED EVIDENCE REGARDING TRENDS IN QWEST'S RETAIL ACCESS LINE BASE IN ARIZONA THAT CONTRASTS TO THE TRENDS DISCUSSED ABOVE?

A. Yes. At P. 5 of my direct testimony, I reported that Qwest's retail access line base in Arizona has declined from 2,950,483 in December 2000 to 2,373,577 in December 2003, a <u>reduction</u> of over 576,000 Qwest access lines. I note that Qwest access line base in Arizona in October 2004 declined further to ***confidential***. Qwest continues to experience strong competitive pressures in Arizona. This fact, coupled

[3] FCC Report on High Speed Access for Internet Services, Table 8, June 8, 2004.
[4] FCC Local Telephone Competition Report, Table 13, released June 2004.

with the strong growth in the Arizona population and rapid market growth of competitive alternatives represented by CLEC, wireless and VoIP services clearly shows that Qwest is experiencing a declining share of a growing market.

Q. WHAT EFFECT HAS COMPETITION HAD ON QWEST'S SHARE OF THE ARIZONA COMMUNICATIONS MARKET?

A. As is noted by Mr. Fimbres, development of a granular view of market share of the communications market in Arizona is not a straightforward task, since much of the required data is proprietary to carriers who may be lightly regulated or deregulated and are reluctant to divulge information regarding the number of customers they serve. However, a research entity entitled TNS Telecoms conducts regular, standardized studies on a quarterly basis in each of the 50 states to assess the approximate shares of each competitor in the residential communications market. In its study, TNS collects actual bills from a statistically-reliable sample of customers in each state[6] and tabulates, in Arizona for example, the number of residential customers subscribing to Qwest service (wireline, DSL or wireless), AT&T, Cox, MCI, Verizon Wireless, T-Mobile, etc. and uses that data to calculate "shares of customer connections" (excluding video connections) for each service provider. In second Quarter 2000, TNS reported Qwest's share of residential communications

[5] Source: Qwest white pages listings database. It should be noted that, since customers often elect not to have all access lines listed in the white pages, the white pages listing counts understate the actual number of CLEC access lines in service.

connections as 70% in Arizona. In second Quarter 2004, Qwest's share of residential communications connections declined to 37%.[7] This independent view of the competitive communications market in Arizona considers all forms of telecommunications services now available to Arizonans and reflects the rapidly increasing impacts of intramodal and intermodal competition on Qwest's share of the overall market in the state.

Q. ARE THERE SPECIFIC CONTENTIONS IN MR. FIMBRES' TESTIMONY TO WHICH YOU WISH TO RESPOND?

A. Yes. At P. 3, Mr. Fimbres touts white pages directory listings as "highly accurate" for purposes of assessing the scope of local exchange competition. His testimony on this point is misleading. I agree that white pages listings data is accurate for its intended purpose, which is listings information for publication in a directory and used by directory assistance providers. However, customers often elect not to list all lines, and it is not accurate to suggest that white pages listings are equivalent to access lines. White pages listings do provide helpful information regarding competitive growth rates by comparing the increase in CLEC end user directory

[6] In Qwest's 14 state territory, the TNS sample is drawn strictly from exchanges within Qwest's service area footprint and does not include data from Independent service territory.

[7] TNS Telecoms ReQuest Consumer Survey, 11/2004. As stated at P. 7 of my rebuttal testimony above, the TNS "connections share" values are a quantification of all types of telecommunications connections within Qwest service territory in Arizona, including Qwest local service, CLEC local service and intermodal services (such as cable broadband, wireless and VoIP), based on actual customer bills.

listings over time, but the raw number of CLEC listings should not be interpreted as being equivalent to the number of access lines.

Similarly, Mr. Fimbres contends at P. 3, that the Local Exchange Routing Guide (LERG) contains "highly accurate" data. Again, for its intended purpose, which is to provide network switching and routing information to enable carriers to accurately program their switches to facilitate proper routing of end user calls between carriers, the LERG data is accurate. It is not generally useful, however, for determining whether a particular CLEC is serving a given wire center or similar geographic area, since the lowest geographical serving unit identified in the LERG is a rate center, which can encompass multiple wire centers. It is possible, for instance, that a CLEC may have a local switch located in a rate center consisting of wire centers A, B and C, but is only providing local service in wire center A.

Q. DO YOU HAVE OTHER CONCERNS WITH THE ACCURACY OF MR. FIMBRES' TESTIMONY?

A. Yes. At P. 4, Mr. Fimbres contends that neither wireless services nor VoIP can be considered realistic substitutes for Qwest's local exchange services and suggests that these services should not be considered as substitutes until they are "accepted on a widespread basis" as alternatives to traditional wireline service. By his

generalization, Mr. Fimbres apparently seeks to dismiss these services as competitive factors in Arizona.

In my direct testimony, at pages 56 through 68, I provided substantial evidence that both forms of these intermodal services are now widely available to Arizona customers and I won't repeat that evidence here. However, several publicly-available pieces of information are enlightening. First, in its 7th Annual CMRS Competition Report (FCC 02-179), the FCC stated that approximately 3% - 5% of wireless subscribers had "cut the cord" (disconnected traditional landline service in favor of wireless service). In its recent 9th Annual CMRS Competition Report (FCC 04-216), the FCC reported that the number of wireless subscribers who had "cut the cord" had increased to 5% - 6%. Other independent research suggests the rate of wireless substitution is even higher. In January 2004, Advanis released a study showing 11.5% of wireless users are willing to substitute wireless service for traditional landline service.[8] Another study by the Yankee Group found that "nearly 64% of U.S. households have both a wireless phone and a landline phone" and "40% of U.S. households with both wireless and landline phones expect their wireless phones to completely replace their landline phones."[9] Additionally, in Qwest's Arizona Service Quality Plan tariff[10] as approved by the ACC, the tariff

[8] Mobile Metrics: Wireline to Wireless Displacement Study (Advanis: January, 2004).
[9] The Success of Wireline/Wireless Strategies Hinges on Delivering Consumer Value (Yankee Group, October 2004).
[10] Qwest Corporation Service Quality Plan Tariff, Section 2.4.3(B)(2), P. 18, effective 8/29/01.

provides an option of a cellular service alternative to customers for whom Qwest is unable to furnish local exchange service within 30 days of customer's application date for service. In this instance, the ACC has recognized that wireless service can be used, at least temporarily, as an alternative to Qwest wireline service when standard local exchange service is not available. By any measure, wireless substitution is a present and increasing competitive factor in Arizona and must be considered in a balanced assessment of telecommunications competition in the market.

In regard to Voice over Internet Protocol (VoIP) service in Arizona, this market is highly dynamic and the number of VoIP providers is expanding rapidly. In my direct testimony at P. 63, I identified four VoIP providers in Arizona: Five Star, Vonage, Packet 8 and AT&T. Since the time of filing of my direct testimony in May 2004, at least two additional VoIP providers have begun offering service in Arizona, Verizon[11] and Lingo[12] (a subsidiary of Primus). As Mr. Fimbres states at P. 6 of his direct testimony, "VoIP is able to utilize any broadband network based on wireline or wireless technology." As stated earlier in my rebuttal testimony, the number of customers in Arizona with broadband internet connections was over 536,000, and this rapidly growing figure excludes customers using wireless "hot spot" broadband

[11] http://www.verizon.com/voicewing
[12] http://www.lingo.com

connections. All of these customers are now potential candidates for VoIP service. The Wall Street Journal estimates that 800,000 customers in the U.S. will be using VoIP services by the end of 2004, and that number is expected to grow to 17 million by 2008,[13] an exponential rate of growth. The FCC has recently ruled that VoIP service is an interstate information service and is essentially deregulated at the state level. This light regulatory treatment will help ensure the VoIP growth forecasts are realized. Clearly, VoIP is now a significant competitive factor in the telecommunications market and is driving a paradigm change. It cannot simply be rationalized away by Staff. In fact, in response to Qwest data request Set 7, No. 2, Mr. Fimbres stated:

> "I believe VoIP telephone service is now available from at least three separate providers to Arizona customers with a broadband internet connection but I cannot be sure of the terms, conditions or geographic coverage of such services."

In other words, even Mr. Fimbres recognizes that every customer with a broadband internet connection is a potential VoIP subscriber. This pool of Arizona customers is very significant and is increasing in size very rapidly.

Q. ARE YOU AWARE OF OTHER RESEARCH FINDINGS THAT ARE CONTRARY TO MR. FIMBRES' ASSERTION THAT WIRELESS SERVICES ARE NOT ACTUAL SUBSTITUTES FOR WIRELINE LOCAL EXCHANGE SERVICES?

[13] Telecom Turnaround, Wall Street Journal, P. 46, November 10, 2004.

A. Yes. A recent study by Dr. Stephen Pociask, president of TeleNomic Research, Inc., examined the issue of substitution of wireless services for traditional wireline local exchange service.[14] In his study, Dr. Pociask defines product substitution as follows:

> "Two goods are considered to be substitutes when consuming one good leads to less consumption of the other good. Substitute goods can have different prices and levels of quality, differences consumer preferences can sort out. While substitutes need not be identical products, they do need to serve overlapping markets, provide similar consumer benefits, and sometimes be sold in a similar unit of measure." [15]

Dr. Pociask captures the essence of this issue: wireless service need only provide a similar function as standard wireline service to be considered a substitute, and individual consumer preferences with regard to price and quality will dictate the actual level of substitution of one for the other. As the FCC and independent researchers have found, a significant number of customers have already compared these service alternatives and have elected to discontinue wireline service in favor of wireless service.

Further, Dr. Pociask concludes:

> "Wireless services are functionally equivalent to wireline services. Besides providing local and long distance calling, wireless phones offer

[14] *Wireless Substitution and Competition: Different Technology but Similar Service - Redefining the Role of Telecommunications Regulation,* December 15, 2004. This study is publicly available at: http://www.cei.org/gencon/025,04329.cfm

[15] *Id.*, P. 3.

> many of the same features, including voice mail, caller ID, speed dialing and return call. In addition, like wireline telephone, wireless service offerings include measured service and flat rate service plans, as well as access to the Internet. Wireless telephone services are, therefore, functionally comparable to wireline telephone services. In fact, with the ability of wireless telephones to send pictures and text messaging, as well as programming and broadband services, wireless telephones may provide more capabilities than plain old telephone services."[16]

Dr. Pociask also concludes that "wireless and wireline prices are converging. If $10 per month were added to wireline prices to compensate for the many free features available with wireless service (such as Caller ID, and speed calling), it is possible for wireless services to be cheaper than wireline services."[17] This continuing price convergence, as well as the convergence in functionality described above, is clearly a driver of the increasing rate of substitution of wireless service for wireline service by consumers.

Finally, and especially relevant to the Commission's consideration in this docket of the efficacy of intermodal services as competition for Qwest services, Dr. Pociask developed empirical models to test the cross elasticity between wireless and wireline services driven by price changes. His analysis concluded that "the models estimate that a one percent increase in wireline prices would result in a nearly 2 percent increase in wireless demand. In other words, if wireline carriers were to increase

[16] *Id.*, P. 5.
[17] *Id.*, P. 6.

their prices, wireless service providers would gain a substantial number of subscribers."[18] This finding illustrates that, at least for a significant number of subscribers, wireless service is an actual substitute for traditional wireline service.

Q. HAS ANY PRECEDENT BEEN ESTABLISHED AT THE FEDERAL LEVEL IN REGARD TO HOW INTERMODAL COMMUNICATIONS COMPETITION SHOULD BE VIEWED IN THE CONTEXT OF APPLICTIONS FOR REGULATORY RELIEF?

A. Yes. Such a precedent has been set with respect to regulation of the cable television industry. Under Section 623(a)(2) of the Communications Act of 1934, as amended 47 U.S.C. §543(a)(2), an incumbent cable television operator may be relieved of rate regulation if the FCC finds that the cable system is subject to "effective competition" in the local franchise area in question. Satellite video systems, which represent "intermodal" competition to cable television systems, are factors considered in an assessment of effective competition.

Q. IS THE FEDERAL CRITERIA STRINGENT FOR A CABLE TELEVISION OPERATOR TO DEMONSTRATE THAT SATELLITE VIDEO COMPETITION REPRESENTS "EFFECTIVE COMPETITION?"

A. No. In fact, under the requirements of 47 U.S.C. § 543(1), the cable television provider need only demonstrate that at least two unaffiliated multichannel video

[18] *Id.*, P. 15.

programming distributors ("MVPDs"), offering at least 12 channels, are capable of serving at least 50 percent of the households in the cable provider's franchise area[19] and are actually serving at least 15 percent of the households in that area. If these minimal criteria are met, the incumbent cable television provider's services are removed from federal, state and local rate regulation.

There are several key parallels between the FCC's guidelines and the issues before the ACC in this docket:

* Intermodal service alternatives need only be providing a similar, not identical, function to cable television service to be considered an actual and viable form of competition.

* The intermodal service alternative need not precisely overlay the incumbent cable television operator's entire franchise area before the cable television operator is granted regulatory relief.

* The market share captured by the intermodal competitors can collectively be as low as 15 percent within the cable television operator's franchise area to trigger relief from rate regulation for the cable operator.

In contrast, in this docket, parties suggest that intermodal competition should not be considered actual competition for Qwest's services since it isn't precisely the same as Qwest service and that Qwest should not receive additional pricing flexibility until it loses 50 percent or more of its local exchange market. These suggestions simply

[19] Since the coverage areasof major satellite television providers, such as DirectTV and Echostar, is virtually the entire United States, this criteria is easily met.

do not square with the precedent established by federal regulations for the cable television industry.

Q. AT PAGE 9, MR. FIMBRES SUGGESTS THAT UPCOMING FCC DECISIONS REGARDING THE TRIENNIAL REVIEW ORDER MAY UNDERMINE COMPETITION THAT RELIES ON THE AVAILABILITY OF UNE-P. WOULD YOU COMMENT?

A. Yes. At P. 8, Mr. Fimbres discussed his finding from the LERG that "21 CLECs have 45 digital switches, those typically used by wireline providers for end-offices, with 279 NPA-NXXs statewide." In other words, CLECs have deployed many digital switches to provide local exchange services in Arizona. Essentially, this is the primary reason the FCC found that the BOCs should no longer be required to provide local switching (and the UNE-P wholesale service that includes local switching) as an unbundled network element at TELRIC-based prices. However, Qwest has made available a replacement product, entitled "Qwest Platform Plus" ("QPP") for CLECs that wish to continue to utilize elements of Qwest's network as a finished wholesale package. This service is commercially available at prices slightly higher than the UNE-P rates, and major CLECs, including carriers such as MCI and Z-Tel, have already signed contracts with Qwest for this service. Contrary to Mr. Fimbres' implication, the FCC decision regarding UNE-P does not sound the death knell for competitors choosing to utilize Qwest's network.

Q. IF MCI HAS SIGNED A CONTRACT TO OBTAIN THE QPP PRODUCT FROM QWEST, WHY DOES MR. FIMBRES STATE AT PAGE 9 THAT MCI AND AT&T HAVE ABANDONED THE MASS MARKET?

A. Mr. Fimbres' reasoning is unclear and he is incorrect. In fact, both AT&T and MCI are continuing to serve their existing mass market customer bases and simply announced that they were temporarily halting marketing efforts to attract new residential and small business wireline customers. With respect to MCI, they now have at least two tools[20] to support service to mass market customers: the QPP platform they have now endorsed as well as the VoIP service they have deployed. AT&T has launched its CallVantage VoIP product and is actively marketing it to mass market customers. Far from "abandoning" the mass market, these carriers are simply in the process of revising their strategies and tactics for serving that market.

Q. AT P. 12, MR. FIMBRES IDENTIFIES COX AS THE SOLE COMPETITOR THAT PROVIDES SERVICE TO RESIDENTIAL CUSTOMERS IN A WAY THAT ALLOWS FOR SERVICE DIFFERENTIATION AND SUGGESTS THAT COMPETITION BASED ON FULL FACILITIES BYPASS SHOULD BE THE ONLY FORM OF COMPETITION CONSIDERED IN THIS DOCKET? WOULD YOU COMMENT?

[20] In addition to other available options, such as resale or use of MCI-owned circuit switches and/or loop facilities.

A. Yes. Mr. Fimbres' full quote is as follows:

> "Only Cox appears to be committed to wide-spread, residential, facilities-based competition, the only form of local exchange service provisioning that allows for full local exchange service differentiation."

This quote simply conveys Mr. Fimbres' opinion, and it is not based upon facts. Earlier in his testimony, he discussed the large number of CLECs in Arizona with CLEC-owned local switches. Any of these CLECs may use their switches in concert with UNE loops purchased from Qwest to deliver local exchange service that is fully differentiated from Qwest's retail services. Even CLECs utilizing UNE-P or QPP as a platform for delivering service to their end users can differentiate their services from Qwest's. For example, Z-Tel integrates an enhanced voice messaging service, supported by Z-Tel owned hardware, into its residential service currently provided via UNE-P. Other CLECs utilizing UNE-P can develop service packages with an entirely different set of features than those offered in Qwest's retail packages, since over 100 feature options are available to the CLECs in the UNE-P and QPP service platforms,[21] and can also integrate their own long distance products into their packages. In terms of intermodal competition, both wireless and VoIP providers offer services that are fully differentiated from Qwest local exchange services. Mr. Fimbres' attempt to narrow the focus of this docket to an assessment of wireline CLECs utilizing CLEC-owned loops to compete with Qwest ignores market realities and should be rejected.

Q. AT P. 16, MR. FIMBRES INTRODUCES THE NOTION OF UTILIZING THE HERFINDAHL-HIRSCHMAN INDEX ("HHI") AS A MEANS OF ASSESSING MARKET CONCENTRATION IN ARIZONA. IS THIS ANALYSIS USEFUL?

A. No. This mechanism is one that is used on occasion to examine markets, but it is not useful in this docket.[22] As discussed in my direct and rebuttal testimony, Qwest's local exchange markets, especially those in the Phoenix and Tucson areas, are competitive. In regard to Mr. Fimbres' discussion of HHI, he makes two interesting points at pages 16 and 17: markets with an HHI of 1,800 and over are considered to be "highly concentrated" and that, for Qwest's HHI to drop below 1,800, its market share "would have to drop below 43 percent." Mr. Fimbres goes on to state that, by his calculations, Qwest's current market share is above 70%. In other words, his position is that Qwest should be required to lose <u>at least</u> an additional 27% of its market before the Commission should grant Qwest's request for pricing flexibility. This is nonsense, completely ignores the effects of intermodal competition and demonstrates why the HHI model is not relevant to this docket. In fact, as discussed in the rebuttal testimony of Qwest witness Phillip Grate, since Qwest's cost structure is characterized by high fixed costs, driven in large part by its investment in its network and switching facilities, it is unlikely that Qwest's financial

[21] As discussed in the rebuttal testimony of Ms. Million, CLECs utilizing UNE-P or QPP can obtain all vertical features available in a Qwest local switch at a very low cost of approximately $2.00 per line per month.

condition could remain sufficient to support its retail and wholesale services at satisfactory levels with only a 43% market share (as calculated by Mr. Fimbres). It is clearly not in the interest of Arizona customers or Qwest's shareholders that Qwest continue to be regulated as a "monopoly" provider by denying it pricing flexibility necessary to effectively and fairly compete until it has lost 57% of the market.

b. Competitive Zones Proposal

Q. BOTH MR. FIMBRES, AT PAGE 43, AND MR. ROWELL, AT PAGE 15, SUGGEST THAT COMPETITIVE ZONES IN ARIZONA SHOULD BE GEOGRAPHICALLY DEFINED BY ZIP CODE RATHER THAN QWEST WIRE CENTER BOUNDARIES. WOULD YOU COMMENT?

A. Yes. The Competitive Zone proposal outlined in my direct testimony is designed to afford Qwest the flexibility in the Phoenix and Tucson markets to effectively compete. All of Qwest's network and billing systems are structured around the wire center and exchange concepts, and revising those processes to accommodate a zip code-based Competitive Zone structure would be a massive, lengthy and costly undertaking involving reprogramming of Qwest's billing systems, training sales and support personnel in a service structure that is inconsistent with structures in other

[22] Additionally, the HHI is not used as a criteria by the FCC in establishing the presence of "effective competition" in cable television markets, as discussed earlier in my rebuttal testimony. In that instance, a minimal "market share" criteria of 15% is used as a trigger for regulatory relief.

Qwest states, etc. In effect, this would provide Qwest no near term relief at all to fairly compete.

Q. DOES STAFF CONTEND THAT A ZIP CODE GEOGRAPHIC DEFINITION OF COMPETITIVE ZONES MAKES SENSE FROM A MARKET PERSPECTIVE?

A. Yes. For example, at Page 27, Mr. Rowell states:

> "Designating Competitive Zones at the zip code level will provide Qwest with a great deal of competitive flexibility and will allow for a comparison of all types of competition. Additionally, consumers are familiar with the concept of zip codes..."

Mr. Rowell mixes two issues here. Staff's proposal represents a means for Staff to analyze the competitive market at a level of granularity they believe to be appropriate. Mr. Rowell then goes on to suggest that, since customers are familiar with zip codes, they should understand the concept of Competitive Zones as defined by zip codes. However, he offers no evidence to support his opinion. In fact, establishment of competitive zones by zip code (which could literally number in the hundreds) would be much more confusing to customers than Qwest's proposal, especially since actual geographic zip code boundaries are not known by the typical Arizona resident. In addition, Qwest's competitors typically enter markets (as characterized by a broader geographic area such as wire center, exchange, city or

MSA) and not individual zip codes.[23] There is no doubt that Staff's proposal supports Staff's view that competitive data should by analyzed at a more granular level than the data presented by Qwest, but it is certainly not a more "market friendly" means of defining competitive zones.

Q. IF STAFF STRONGLY BELIEVES THE ASSESSMENT OF COMPETITION BY ZIP CODE IS AN EFFECTIVE MEANS OF DETERMINING WHERE RELIEF SHOULD BE GRANTED, IS THERE A MIDDLE GROUND BETWEEN STAFF'S PROPOSAL AND QWEST'S THAT COULD BE CONSIDERED?

A. I believe Qwest could produce data by zip code regarding elements of its network that are being utilized by its competitors to provide service to their end users. To the extent competitors utilizing their own loop facilities could be induced to provide data on the same basis, and presuming relevant data regarding intermodal competition could be similarly obtained, it would be possible to examine the degree of market competition by zip code. However, defining and implementing competitive zones by zip codes would remain highly problematic for Qwest. To the extent a zip code comprises all (or most) of a particular wire center, and if competition in that zip code is found to be sufficient to justify relief for Qwest, I recommend that the competitive zone be defined as the wire center. Similarly, if a wire center consists of two zip codes and one zip code is found to contain a high level of competition while the

[23] It should be noted that any CLEC utilizing Qwest's network on a wholesale basis has access to all customers within the

other is found to have a moderate level of competition, I recommend that the entire wire center be classified as a competitive zone. This proposal allows for use of zip codes in analyzing competition while affording Qwest an opportunity to utilize existing systems and processes to implement competitive zones.

Q. TO THE EXTENT STAFF REMAINS CONCERNED THAT WIRE CENTERS MAY NOT APPROPRIATELY DEFINE A COMPETITIVE MARKET, CAN YOU SUGGEST ANOTHER ALTERNATIVE THAT MAY ALLOW FOR STAFF'S DESIRED LEVEL OF GRANULARITY IN ITS ANALYSIS, YET BE LOGICAL TO THE MARKET?

A. Yes. Another means of defining Competitive Zones could be by Qwest prefix in an area subject to competition. Customers are certainly familiar with telephone prefixes and know their Qwest local exchange and related services are associated with the Qwest prefix assigned to them. It is possible to assess competition in the zip codes encompassed within the area served by a Qwest prefix. If competition in this collection of zip codes is viewed to be sufficient, Qwest services served by that prefix could then be classified as competitive. This alternative would represent a compromise between Staff's desire to assess competition at a granular level and a Competitive Zones structure that is workable in the market.

---

geographical boundaries of any Qwest wire center in which the CLEC chooses to operate.

Q. AT P. 17, MR. ROWELL SUGGESTS THAT QWEST'S COMPETITIVE ZONES PROPOSAL DOES NOT DEFINE HOW MAXIMUM RATES SHOULD BE ESTABLISHED FOR SERVICES IN COMPETITIVE ZONES. HOW SHOULD MAXIMUM RATES BE DETERMINED?

A. I suggest the Commission set maximum rates for services in Competitive Zones that are double current rates. This will allow Qwest to move rates as the competitive market dictates between the price floor and whichever level the competitive market will sustain. Since markets for services within Competitive Zones are, by definition, subject to competition, the presence of competition, not regulation, will determine the appropriate rate levels for those services.

Mr. Rowell, at P. 23, also suggests that prices for services in Competitive Zones should be capped at current levels. This is contrary to free market economics. At the same time, Mr. Rowell suggests that Qwest recover $10 million of its revenue requirement through Basket 3 increases, knowing that the reason services are in Basket 3 is because they have previously been found by the ACC to be subject to competition. Mr. Rowell knows that general price increases to Basket 3 services aren't sustainable in a competitive market, and in effect, his suggestion denies Qwest the opportunity to recover the $10 million he identifies.

Q. AT P. 21, MR. ROWELL COMPLAINS THAT IT IS UNCLEAR THAT QWEST WILL HAVE PROVIDER OF LAST RESORT OBLIGATIONS WITHIN COMPETITIVE ZONES. IS HE CORRECT?

A. No. This is largely an issue of legal interpretation, but Qwest believes that the Competitive Zones proposal has no effect on Qwest's Provider of Last Resort (POLR) obligations in Arizona.[24] In fact, if the Commission finds it appropriate to classify a particular area as a Competitive Zone, that finding can only be based on the presence of a sufficient number of competitive alternatives in that market. In such markets, no carrier should have POLR obligations since service alternatives are readily available.

Q. MR. ROWELL MAINTAINS AT P. 30 THAT ANY DISCOUNTS ON QWEST SERVICES WITHIN COMPETITIVE ZONES SHOULD REMAIN IN EFFECT FOR AT LEAST ONE YEAR. DO YOU AGREE?

A. No. To the best of my knowledge, none of Qwest's competitors are bound by such a requirement. Qwest's competitors are free to enter or exit markets, such competitors can introduce specific services in selected markets and the mix of competitors (and their associated services) varies geographically. None of Qwest's competitors is subject to a requirement that any discount remain in effect for one

[24] In response to Qwest data request Set 18, Nos. 1 and 2 to Staff, Mr. Rowell was asked to identify Qwest's POLR duties as well as any Arizona statute or rule defining such duties. Mr. Rowell was unable to identify any relevant Arizona statute or rule in his responses.

year. Mr. Rowell's suggestion would unfairly discriminate against Qwest's ability to fairly compete in markets where robust competition is shown to exist.

Q. BOTH MR. FIMBRES AND MR. ROWELL SUGGEST THAT, WHILE THE NOTION OF COMPETITIVE ZONES HAS MERIT, THE EXAMINATION OF COMPETITION IN COMPETITIVE ZONES AND DESIGNATION OF SPECIFIC AREAS AS COMPETITIVE ZONES SHOULD BE DEFERRED TO A STAND-ALONE DOCKET. DO YOU AGREE?

A. No. Local exchange competition, especially in the Phoenix and Tucson areas, is entrenched and widespread. I have presented extensive evidence of such competition, at the wire center level, in my direct testimony and believe that there is more than sufficient evidence available upon which the Commission can assess Qwest's proposal in this docket. If this issue is deferred to a separate docket, Qwest is very concerned that the deferral will create a significant delay in the investigation and ultimate approval of specific competitive zones, further harming Qwest's ability to compete. It should be noted that, in exchange for Basket 3 pricing flexibility under the existing Price Cap plan, Qwest agreed to forego recovery of its revenue requirement under traditional rate of return regulation. A further delay in consideration of Qwest's Competitive Zones proposal in essence means that Qwest will continue to be hindered in its ability to compete at the same time it is not realistically able to recover its revenue requirement (in view of the fact that

1 competitive Basket 3 services cannot generally be increased to generate revenue
2 sufficient to recover the revenue requirement since competitive forces won't allow
3 such increases).
4
5 **Q. AT PAGE 42 OF HIS TESTIMONY, MR. ROWELL SUGGESTS THAT QWEST BE**
6 **REQUIRED TO MAKE A SEPARATE FILING TO SHOW THAT ADDITIONAL**
7 **PRICING FLEXIBILITY IS WARRANTED IN SPECIFIC ZIP CODES AND THAT**
8 **STAFF "WILL MAKE ITS RECOMMENDATIONS TO THE COMMISSION WITHIN**
9 **120 DAYS" OF RECEIPT OF QWEST'S FILING IN THIS SEPARATE DOCKET.**
10 **WOULD YOU COMMENT?**
11 A. Mr. Rowell's presupposes that zip codes represent the correct means of defining
12 geographic areas for purposes of pricing flexibility (a premise with which Qwest
13 disagrees) and his offer is nothing more than a commitment to make a Staff
14 recommendation to the Commission within four months. After such a
15 recommendation, which would likely be contentious and would draw intervention
16 from other parties, much as Qwest's current Competitive Zones proposal has done,
17 the Commission would likely be compelled to establish a docket and related
18 procedural schedule to examine the issues. Realistically, this procedural process,
19 which would extend beyond the date upon which the Commission received the
20 proposed Staff recommendation, would encompass numerous months with
21 resolution likely not final until late 2005.

As I have stated earlier in this testimony, the competitive telecommunications market in Arizona is evolving at a much faster pace, and Qwest continues to lose an ever-increasing share of its market to intramodal and intermodal competitors. It is not reasonable that Qwest continue to be constrained in its ability to fairly compete in Arizona while the issues around the scope of local exchange telecommunications competition are deferred, analyzed and litigated on an ongoing basis well into the future.

Q. AT PAGES 33 AND 34, MR. ROWELL SUGGESTS THAT GIVEN QWEST'S "MARKET DOMINANCE," THE PRICING FLEXIBILITY GUIDELINES OUTLINED IN COMMISSION RULE R-14-2-1108 (RULE 1108) SHOULD BE STRICTLY APPLIED IN ASSESSING QWEST'S COMPETITIVE ZONES PROPOSAL. WOULD YOU COMMENT?

A. Yes. It appears that, in conjunction with Mr. Rowell's and Mr. Fimbres' preference for a zip code competitive zones definition, Mr. Rowell is proposing an application of Rule 1108 that would, as a practical matter, be nearly impossible to satisfy. In effect, Mr. Rowell's suggestion would require Qwest, as the petitioning party, to demonstrate the market share of <u>each competitor</u> for <u>each service</u> in each <u>zip code</u> prior to a grant of an area as a competitive zone. This high standard would actually require Qwest to utilize information not in its possession, such as proprietary

customer line counts for the specific services of its competitors at the zip code level. This level of detail, while having some analytical interest in theory, is not reasonable in practice.

Q. HAS QWEST IGNORED RULE R14-2-1108(B) IN THIS PROCEEDING?

A. No. What Qwest has provided, pursuant to rule R14-2-1108(B), is a detailed description of the conditions within the relevant market that many telecommunications services are competitive. In my direct testimony, consistent with subsections (1), (2), (3), (5) and (6) of the Rule, I provided a description of the general economic conditions that exist which make the relevant market competitive; estimates of the alternative providers of the services, an estimate of the market share of various providers, the ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions and descriptions of the ease of entry and exit and other competitive factors. Although Qwest is proposing new standards for the designation of competitive zones, it has provided the majority of the information required by rule R14-2-1108(B) for use by the Commission in determination of its request.

1

2 **c. Arizona Universal Service Fund Proposal**

3

4 Q. **STAFF WITNESSES REGAN (BEGINNING AT P. 3) AND ROWELL (BEGINNING**
5 **AT P. 46) BOTH CONTEND THAT QWEST SHOULD RECEIVE NO AUSF**
6 **FUNDING TO DEFRAY THE COST OF SERVING CUSTOMERS IN HIGH COST**
7 **AREAS OF ARIZONA. WOULD YOU COMMENT?**

8 A. Yes. Mr. Regan bases his position largely on his view of the relationship of costs (as
9 he defines them) of serving customers in high cost wire centers while Mr. Rowell
10 bases his position on his opinion that, even though Qwest's AUSF proposal is
11 competitively neutral, it may not induce increased competitive entry in rural areas of
12 Arizona. Mr. Regan focuses very narrowly on Qwest's cost structure and virtually
13 ignores costs faced by Qwest's competitors in serving high cost wire centers that
14 currently represent a disincentive to competitive entry there. Ms. Teresa Million, on
15 behalf of Qwest, provides rebuttal testimony of the cost issues argued by Mr. Regan,
16 while I will discuss flaws in Mr. Rowell's testimony.

17

18 Q. **WOULD YOU BRIEFLY SUMMARIZE THE PURPOSE OF THE AUSF?**

19 A. Yes. The AUSF exists to defray the extraordinary costs of providing local exchange
20 services to customers in high cost areas of Arizona, such as UNE Cost Zones 2 and
21 3, and is intended to ensure that customers in these areas have local exchange

services available at prices commensurate to those available to customers located within low cost, urban areas.

Q. HAS THE ACC PREVIOUSLY ISSUED DECISIONS INDICATING THE USE OF AUSF IS IN ALIGNMENT WITH QWEST'S PROPOSAL IN THIS DOCKET?

A. Yes. Prior ACC decisions have addressed the purpose of the AUSF and show that the objective of the fund is in alignment with Qwest's request in this proceeding. In Decision 59623, released April 24, 1996, the Commission stated: "Pursuant to A.A.C. R14-2-1113 of the Competitive Telecommunications Rules, the Commission should establish an intrastate universal service fund which shall assure the continued availability of basic telephone service at reasonable rates," and "The AUSF is the funding mechanism through which surcharges are collected from consumers of telecommunications services and support is paid to eligible providers of basic local telephone exchange service in areas where the cost of providing the service exceeds the rate authorized to be charged." In Decision 65472, released December 19, 2002, the ACC stated: "Pursuant to Decision No. 56639, dated September 22, 1989, the AUSF was established to maintain statewide average rates and the availability of basic telephone service to the greatest extent reasonably possible."

Q. HAS THE ACC ISSUED DECISIONS AUTHORIZING USE OF AUSF FUNDS BY INCUMBENT TELEPHONE COMPANIES IN ARIZONA FOR PURPOSES DEFINED IN YOUR PREVIOUS RESPONSE ABOVE?

A. Yes. For example, on July 17, 2000, Midvale Telephone Exchange, Inc. ("Midvale") filed with the ACC an application for a general rate increase as well as a disbursement from the AUSF to commence serving two communities, Millsite and Silver Bell, that were unserved areas at that time. This request resulted in an investigation in Docket No. T-02532A-00-0512, and ultimately in Decision No. 64011 which was released by the ACC on September 5, 2001. In its decision, the Commission noted at P. 21 that Midvale's request did not conform with Commission rules "that a company must already be providing service to the area in which it is seeking AUSF funding after applying for FUSF funding." However, the Commission determined that a waiver of this requirement was appropriate in the interest of ensuring customers in the rural communities of Millsite and Silver Bell were provided access to Midvale's local exchange telephone service at affordable rates. In its findings at P. 21, the Commission stated:

> "We wish to make clear that we strongly encourage Midvale, as well as other similarly situated carriers, to invest in facilities that will enable the provision of telephone service to remote areas that are not served by any other carrier. Accordingly, we will allow a waiver of our rules and grant Midvale's request for AUSF. Midvale is therefore authorized to draw $71,651 per year from the AUSF beginning with the commencement of service to Millsite and Silver Bell."

Clearly, in this instance the Commission determined that the public interest would be served by supporting affordable telephone service in these high cost areas with AUSF funding rather than requiring Midvale to subsidize these high costs via revenues received from its existing customer base.

Q. AT PAGE 45, IN SUPPORTING HIS CONTENTION THAT QWEST'S AUSF PROPOSAL IS UNLIKELY TO DRIVE INCREASED CLEC ENTRY IN RURAL AREAS, MR. ROWELL DISCUSSED CLEC DATA REQUEST RESPONSES TO STAFF DATA REQUEST 2-1 INDICATING THAT THE MAJORITY OF CLECS ARE NOT CURRENTLY RECEIVING USF SUPPORT IN OTHER STATES, ALTHOUGH CLECS INDICATED THAT THEY ARE RECEIVING FUNDING IN SOME INSTANCES IN TEXAS, PENNSYLVANIA, ILLINOIS, WYOMING, NEBRASKA AND KANSAS. WOULD YOU COMMENT ON MR. ROWELL'S ASSESSMENT?

A. Yes. Mr. Rowell's discussion of the current status of USF funding for CLECs in other states does nothing to undermine the pro-competitive aspects of Qwest's AUSF proposal in this proceeding. The CLECs' responses to Staff's discovery in this docket show only that CLECs' business models have focused to date predominantly on markets where the greatest concentrations of customers and profits can be found, which are typically in low cost wire centers where customers are highly

concentrated.[25] Staff's discovery did not ask whether CLECs have sought or are now actively seeking USF funding to enable them to profitably serve new markets, nor did Staff's discovery ask whether CLECs agreed that Qwest's AUSF proposal would enhance the financial attractiveness of serving additional Arizona markets for the CLECs. In other words, Staff's discovery question was retrospective and does not reveal the degree to which CLECs believe Qwest's AUSF proposal is beneficial to the CLECs' current and future business opportunities in the state.

Q. DOES STAFF RECOGNIZE THAT QWEST'S INTRASTATE REVENUES FALL SHORT OF COVERING ITS INTRASTATE COSTS IN CERTAIN AREAS OF THE STATE?

A. Yes. In fact, in Mr. Regan's Schedule TMR-3 at P. 2, he identifies an intrastate negative margin for Qwest in Zone 3 of $(4,633,799), when comparing revenues of all Qwest intrastate services against intrastate costs of providing those services. This is noteworthy in view of Mr. Regan's extraordinarily conservative assumptions about how intrastate costs should be viewed. This shows that, at a bare minimum, an AUSF funding need of at least $4.6 million exists for Qwest, and that amount is likely significantly higher depending upon cost methodology assumptions determined by the ACC to be reasonable.

[25] Staff's discovery also does not address the additional administrative effort and expense the CLECs must bear in

found in the significant reduction in access minutes of use that has been driven in part by wireless long distance substitution.[29] That erosion is found in the packaging of basic service with features that is common in the business today. Qwest optional features that are generally priced from $2.00 to $7.00 in Arizona are made available by Qwest's competitors either at no charge or at extremely low rates. For example, the Cox "Simply 3" package in Arizona is currently priced at $19.95 per month, and includes the basic line, Caller ID, Call Waiting and Voice Mail.[30] Cox's ala carte prices for these optional features respectively are $5.95, $6.95 and $6.95, for a total of $19.85. Deducting the $11.75 price of the access line from the Simply 3 package price of $19.95 yields a discounted rate for the three optional features of $8.20. In other words, the packaged features are discounted from the stand-alone feature rates by $11.65. From an intermodal services perspective, for example, Vonage provides free voice messaging, Caller ID, call waiting, call forwarding and three way calling[31] to its customers while Cricket (which presently offers flat-rated wireless service in the greater Phoenix and Tucson areas) provides free voice messaging,

---

[29] As a point of reference, Qwest's Arizona intrastate Switched Access minutes of use declined from ***confidential*** in June 2000 to ***confidential*** in June 2004. This trend is consistent with national research findings. For example, the Yankee Group reports that "more than 36% of local calls and 60% of long-distance calls have been replaced by wireless." (*The Success of Wireline/Wireless Strategies Hinges on Delivering Consumer Value, P. 7,* The Yankee Group, October 2004). Additionally, at the Regional Oversight Committee ("ROC") in September 2004, Western Wireless' CEO John Stanton reported "increasing numbers of consumers have "cut the cord" or are primarily using their wireless phone for their telecommunications needs," and estimated the proportion of consumers engaging in such substitution now exceeds 5% and is expected to increase to 30% by 2008.

[30] http://www.cox.com/phoenix/telephone

[31] http://www.vonage.com/products_basic

Caller ID, three way calling and call waiting with its service.[32] Virtually every intermodal competitor currently operating in Arizona now offers such free or deeply discounted features.

The higher price for business service than residential service has traditionally been used to recover the loop cost as well. The erosion in Qwest's business market is the highest. It is the first market that CLECs have selected and the one that has the most competitors and the most customer choice. The high margins for long distance, access charges, vertical features and business services, which were once available for loop cost recovery under Staff's traditional rate case approach, are no longer available.

Staff's approach to high loop cost recovery is first that Qwest has not strictly followed the Commission's rules that were established long before the current competitive market. Next, Staff pretends that Qwest continues to have the ability to realize the high margins from certain services to recover its costs "on average." The Staff is presenting a fantasy to the Commission that it should not believe. The reality is that competition has limited Qwest's ability to recover its costs.

[32] http://www.mycricket.com/about_who

Qwest's AUSF proposal resolves all three of these problems by making available funding that has the net effect of driving the retail revenue received from services in rural areas above the cost of providing those services.

Q. HAS THE ACC PREVIOUSLY RECOGNIZED THAT THE UNE LOOP PRICES IT ORDERED INTO EFFECT CREATE A PRICING CONFLICT WITH QWEST'S RETAIL RATE STRUCTURE?

A. Yes. In Decision No. 62753 in Docket No. T-00000A-00-0194, released July 25, 2000, in which the ACC addressed the rate levels and structure of Qwest's unbundled network elements in Arizona, the Commission recognized that the Qwest wholesale structure was in misalignment with Qwest's retail rate structure and invited Qwest to submit a proposal to "deaverage" its retail rates to address this issue. In its discussion, the Commission stated that all parties in his proceeding were in general agreement that "the intent of the Telecommunications Act of 1996 ("Act") is to provide competitive choices to all consumers, regardless of where they live in a state."[33] Further, in its analysis, the Commission stated:

> "We concur with U S WEST that the Commission policy in setting retail rates needs to be taken into consideration in setting geographic deaveraged UNE rates. To do otherwise, U S WEST could have retail rates which may not be cost based but would have to compete with wholesale rates which would be cost based."[34]

[33] *Id*, P. 3.
[34] *Id.*, P. 5.

Qwest's current retail pricing structure, which is largely averaged, is in disharmony with its wholesale UNE loop rate structure, which is aligned into three discrete cost zones. Rather than proposing a massive rate rebalancing to align the retail and wholesale rate structures, Qwest proposed its AUSF concept as a means to make explicit the subsidies supporting retail local exchange rates in high cost areas.

Q. WOULD QWEST NOW BE WILLING TO CONSIDER IMPLEMENTING A RETAIL RATE DEAVERAGING STRUCTURE FOR ITS BASKET 1 LOCAL EXCHANGE SERVICES, AS SUGGESTED BY THE ACC IN DOCKET NO. T-00000A-00-0194, IN LIEU OF ITS AUSF PROPOSAL IN THIS PROCEEDING?

A. Qwest would be willing to consider such a rate deaveraging proposal as an alternative to its pending AUSF proposal. However, it is likely that such a deaveraging proposal would not entirely resolve the wholesale/retail rate misalignment, especially in Zone 3 wire centers, since the UNE loop rate there is $36.44 and full alignment would entail a very significant retail rate increase. In this instance, a modified proposal involving some retail rate deaveraging and a scaled-back AUSF structure may be appropriate.

d. Specific Service/Pricing Proposals

Q. AT P. 34, MR. ROWELL OPINES THAT QWEST'S CURRENT ZONE INCREMENT RATE STRUCTURE SHOULD BE RETAINED, ESPECIALLY IF THE ACC DENIES QWEST'S REQUEST FOR AUSF FUNDING IN HIGH COST AREAS. WOULD YOU COMMENT?

A. As I stated at P. 86 of my direct testimony, the current Zone Increment structure, consisting of a $1.00 Zone 1 charge and a $3.00 Zone 2 charge, is based on a mapping process that is administratively cumbersome for Qwest and the Commission and is confusing to our customers.[35] The Zone Increment charges are rendered moot if the ACC accepts Qwest's AUSF proposal. However, if the ACC denies Qwest's AUSF proposal, the current Zone Increment structure must remain in place until an alternative means of funding local exchange service in high cost areas can be set in place.

Q. STAFF MAINTAINS THAT QWEST'S PROPOSAL TO ELIMINATE THE EXISTING ALLOWANCE OF ONE FREE DIRECTORY CALL PER MONTH SHOULD BE REJECTED. WOULD YOU COMMENT?

[35] The Commission rejected this distance deaveraging method and adopted the wire center deaveraging method for UNE loop rates in Docket No. T-00000A-00-0194, Decision No. 64922, pp 27-29.

A. Yes. Staff's consultant, Mr. Regan, suggests that Qwest should continue to provide free directory assistance calls based on his view that the Qwest Directory Assistance ("DA") product is marginally profitable.[36] However, his conclusion is based on his narrow range of assumptions regarding Qwest's cost structure and is made in isolation of other factors in this docket. Directory Assistance is a stand-alone, competitive retail service in Arizona, and Qwest incurs a cost in fulfilling each request for directory information. Clearly, Qwest receives no revenue for DA calls provided within the existing free call allowance, and the cost of those calls must be subsidized by DA calls for which a fee is charged. In other words, the current free DA call allowance is an example of an implicit subsidy, which the ACC is tasked with eliminating as all telecommunications services in the state continue to become robustly competitive. Additionally, for Qwest's interstate DA service that is regulated by the FCC, there is no free call allowance. This is consistent with the directory assistance offerings of Qwest competitors such as AT&T, which also does not provide a free call allowance for its competitive DA service. The existing free local DA call allowance is a remnant of the regulated monopoly era in Arizona, when certain services could be provided free or at artificially low rates and could be subsidized by revenue flows from other sources.

[36] Regan direct testimony, P. 41.

1 Directory Assistance is a discretionary service readily available from a variety of
2 sources, including dial-around providers (such as AT&T and MCI), wireless
3 providers, the internet (where directory listings information is typically provided at no
4 charge) and standard telephone directories. Qwest has proposed elimination of the
5 current free call allowance in the context of aligning this service with its National DA
6 service and the manner in which directory assistance is generally provided in the
7 competitive market. In this proceeding, Qwest has demonstrated a need for
8 additional revenues, and the DA proposal is an element of the range of adjustments
9 Qwest has proposed to generate revenue. Mr. Regan's narrow focus ignores these
10 considerations and instead focuses predominantly on his assessment of directory
11 assistance margins and his apparent view that implicit subsidies should be continued
12 indefinitely.
13
14 **Q. HAVE OTHER INTERVENORS OFFERED AN OPINION REGARDING QWEST'S**
15 **DIRECTORY ASSISTANCE PROPOSAL?**
16 A. Yes. Interestingly, RUCO, which represents the interests of Arizona consumers,
17 appears to understand the broader context of Qwest's directory assistance proposal.
18 At P. 199 of his testimony, Dr. Ben Johnson, on behalf of RUCO, states:
19 "It is not unreasonable to provide management with the discretion of
20 eliminating the free call allowance, provided the revenues generated by this
21 rate change are properly accounted for within the framework of the overall

revenue requirement and price constraints that are adopted in this proceeding."

Dr. Johnson's conclusion is that, to the extent the ACC determines that Qwest has a positive "revenue requirement" in this docket, rate adjustments are necessary to generate the incremental revenues required to recover the revenue requirement. He finds it reasonable that Qwest's directory assistance proposal be implemented as part of a larger set of adjustments in this context.

IV. DEPARTMENT OF DEFENSE

Q. DOES MR. LEE DISCUSS PRICING FLEXIBILITY FOR BASKET 1 SERVICES?

A. Yes. At P. 8, he suggests that "unfettered pricing flexibility within Basket 1 could result in sharp price increases for some services causing "rate shock" to individual customers." However, Qwest is not proposing additional pricing flexibility for Basket 1 services in this docket. Rather, Qwest is proposing that specific wire centers that are now subject to robust competition be classified as Competitive Zones, within which Qwest's retail services would be afforded Basket 3 pricing flexibility. In those areas, competition rather than regulation will govern the appropriate market price of the competitive services. With respect to services remaining in Basket 1, Mr. Lee's recommendation to limit price increases to 10% is not necessary.

Q. AT PAGE 5, MR. LEE AGREES WITH THE CONCEPT OF COMPETITIVE ZONES, BUT CONTENDS THAT CLASSIFICATION OF AREAS AS COMPETITIVE ZONES SHOULD ONLY BE GRANTED WHEN "ONE OR MORE FACILITIES-BASED COMPETITORS CAN BE SHOWN TO BE OFFERING SERVICE THROUGHOUT THE ZONE" AND IS PROVIDING SERVICE TO A "SIGNIFICANT NUMBER OF CUSTOMERS." WOULD YOU COMMENT?

A. Yes. Mr. Lee suggests that the Commission virtually ignore all local exchange competition except "facilities-based" competition, even though CLECs using Qwest's network to deliver service to end users may now enjoy a significant share of the market. To extend Mr. Lee's logic, he apparently believes that a CLEC using its own switch and UNE loops purchased from Qwest that has captured 15% of the market, and is considering deploying its own loop facilities once it has captured 20% of the market, should be disregarded in assessing the scope of local competition until the CLEC has, in fact, deployed its own loop facilities.

Similarly, a CLEC may determine that use of Qwest's loops and local switching, such as is available via the Qwest Platform Plus product, is in alignment with the CLEC's business model to build a customer base of sufficient size prior to making an investment in a local switch. In this example, the CLEC may enjoy a very significant market share in a particular geographic area within Qwest's Arizona service territory, yet that CLEC would be disregarded in Mr. Lee's market test.

Finally, it would appear that Mr. Lee would have the Commission ignore other forms of "facilities-based" competition, such as that represented by Wireless and VoIP services. In this instance, his view of the competitive telecommunications market is far too narrow and does not account for telecommunications alternatives Arizona customers are using today, and which are rapidly growing in terms of significance.

Q. MR. LEE, AT PAGE 9, ASKS THE COMMISSION TO ESTABLISH SEPARATE COMPETITIVE ZONES FOR RESIDENTIAL AND BUSINESS SERVICES. IS HIS PLAN WORKABLE?

A. No. Under Mr. Lee's proposal, he would have the Commission determine whether residential competition, business competition or both is present within each proposed competitive zone. This proposal would involve a service by service, application by application competitive assessment at a granular level (either zip code or wire center) and would be extremely cumbersome. In fact, Qwest's competitive zones proposal in this docket concerns the greater Phoenix and Tucson markets. In these markets, Cox has deployed telephone service very broadly and is serving both residential and business customers. Other CLECs discussed in my direct testimony are also actively serving both customer categories, and intermodal telecommunications service providers (such as wireless and VoIP) are now broadly available to residential and business customers in the Phoenix and Tucson areas.

As discussed in my direct testimony, once the Commission determines that local exchange competition is entrenched in a defined geographic area in Phoenix and Tucson and that pricing flexibility is appropriate for Qwest in that area, it is unnecessary and cumbersome to define areas as separate residential and/or business competitive zones.

V. COX COMMUNICATIONS

Q. AT P. 3, MR. LAFFERTY, STATES THAT "RECENT TRENDS SUGGEST THE SPREAD OF COMPETITION IS DECREASING." WOULD YOU COMMENT?

A. Yes. In my discussion earlier in this rebuttal testimony regarding the positions taken by Staff, I provided data showing that competition is, in fact, continuing to grow at a robust pace in Arizona. A significant amount of that competitive growth is being fueled by Cox in the Phoenix and Tucson markets. In actuality, Mr. Lafferty points to no trends (nor can he) that support his contention with respect to Arizona.

Q. AT P. 5, MR. LAFFERTY SUGGESTS THAT QWEST'S COMPETITIVE ZONES PROPOSAL BE MODIFIED TO DEFINE COMPETITIVE ZONES AT GEOGRAPHIC LEVELS NO SMALLER THAN A "TOWN OR EXCHANGE." HOW DOES THIS PROPOSAL COMPARE WITH STAFF'S PROPOSAL?

A. This proposal is strikingly different than Staff's proposal to define Competitive Zones at the zip code level. In fact, while Staff proposes that Competitive Zones should be defined by market areas potentially smaller than Qwest's wire center-based proposal, Cox's proposal suggests that Competitive Zones should be defined as an exchange or even an entire city -- a level much broader than Qwest's proposed definition. While Mr. Lafferty's proposal would likely be beneficial to Cox, from the perspective that Qwest would be constrained from competing effectively with a Cox service deployment that covered only a portion of a city or a Qwest exchange, it clearly is not granular enough to enable Qwest to fairly compete.

Q. MR. LAFFERTY, AT P. 6, OPINES THAT PRICES FOR QWEST'S SERVICES IN COMPETITIVE ZONES SHOULD BE CONSISTENT ACROSS ALL COMPETITIVE ZONES AND SHOULD ALSO BE CONSISTENT WITHIN EACH COMPETITIVE ZONE. WOULD YOU COMMENT?

A. Yes. Qwest intends to provide comparable prices to all similarly-situated customers within a competitive zone, recognizing that certain services are available under contract terms at varying prices. However, it is inappropriate to suggest that Qwest's prices should be held at the same level for services offered in multiple competitive zones. To the extent Qwest is experiencing competitive pressure from a competitor in only one wire center, for example, it would be inappropriate to force Qwest to make available a price or package it deploys in that wire center to respond

to a specific competitor to other wire centers where that competitor is not present. While this limitation on Qwest would clearly benefit Cox, since Qwest would be forced to respond to a Cox offer by deploying a competitive response in wire centers where Cox is present as well as wire centers where it is not present (and where the competitive response may not be warranted in view of the non-Cox competitors' offerings in those wire centers), it is a competitive limitation that is unfair to Qwest.

Q. AT P. 8, MR. LAFFERTY SUGGESTS THAT RECENT ACTIONS AT THE FEDERAL LEVEL SET THE STAGE FOR QWEST TO "REMONOPOLIZE THE ARIZONA MARKETPLACE." IS THIS CONTENTION CREDIBLE?

A. No. In fact, Mr. Lafferty's reference is to the past and pending actions of the FCC and D.C. District Court regarding the extent to which the BOCs must continue to provide certain unbundled network elements to CLECs. It must be noted that neither the FCC nor the Court have taken or will take actions designed to allow the BOCs to "remonopolize" any market. In fact, any final decisions to withdraw the requirement for BOCs to provide any given unbundled network elements can <u>only</u> be based on a finding that the element no longer meets the FCC's competitive impairment test. If the FCC ultimately determines that CLECs will be impaired if a particular unbundled element is no longer available, they will order the BOCs to continue to offer that element until impairment no longer exists. In addition, as discussed earlier in this testimony, Qwest has made available the QPP product for CLECs not yet interested

in deploying their own switching facilities to serve certain markets. Not only is Cox, Mr. Lafferty's client, unaffected by the transition of UNE-P to QPP since Cox utilizes its own switching and loop facilities, Mr. Lafferty's contentions are unsupported by the facts.

Q. AT PAGE 15, MR. LAFFERTY SUGGESTS THAT MUCH OF QWEST'S RETAIL ACCESS LINE LOSS IS ACTUALLY A RESULT OF QWEST'S CUSTOMERS REMOVING ADDITIONAL LINES WHEN INSTALLING QWEST DSL SERVICE. IS HE CORRECT?

A. No. Only a very small fraction of Qwest's retail access line reduction is due to the substitution of Qwest DSL for a Qwest access line. In my direct testimony at P. 5, I identified a reduction of approximately 577,000 Qwest retail access lines in Arizona from December 2000 to December 2003. In contrast, as of December 2003, Qwest had a total of ***confidential***Qwest DSL lines in service, and it has been Qwest's experience that many customers do not disconnect a retail voice grade line when installing Qwest DSL service. For example, through November 2004, fewer than half of all Arizona business customers installing Qwest DSL service had disconnected a Qwest voice grade business line. While some Qwest customers do, in fact, remove a voice grade line when installing Qwest DSL service, these access line disconnects represent only a very small proportion of Qwest's retail access line losses in the state.

Q. MR. LAFFERTY ADVANCES THE NOTION, AT PAGE 22, THAT QWEST ENJOYS A SUBSTANTIAL AMOUNT OF WHOLESALE REVENUE WHEN IT LOSES A RETAIL CUSTOMER TO A CLEC. WOULD YOU COMMENT?

A. While Qwest receives some wholesale revenue[37] when losing a retail customer to a UNE-based CLEC, it loses a very significant amount of revenue in this transition and also loses the relationship with the end user, curtailing future marketing opportunities. For example, when Qwest loses a customer to MCI's Neighborhood service, it loses feature revenue, long distance revenue as well as switched access revenue. The wholesale revenue it receives for UNE-P (or the replacement QPP product) is a small fraction of the total retail value of the end user.

Q. IN REGARD TO QWEST'S COMPETITIVE ZONES PROPOSAL, MR. LAFFERTY SUGGESTS AT PAGE 35 THAT QWEST WOULD POTENTIALLY HAVE THE ABILITY TO ENGAGE IN PREDATORY PRICING. IS HIS SUGGESTION VALID?

A. No. First, Qwest is constrained by state and federal laws against price predation. Second, even if Qwest were to engage in predatory pricing, that concept suggests that Qwest would hold prices down to an artificial level long enough to drive competitors from the market, then subsequently increase prices to recoup profits lost

[37] For example, using Staff witness Mr. Regan's analysis, Qwest loses about 67% of its revenue when a customer changes to a competitive provider utilizing Qwest's network on a wholesale basis. Qwest loses 100% of the revenue generated by a retail customer when the customer changes to the service of a full facilities-based competitor such as Cox.

during the supposed predation. This is a fallacy. Since competitors are now free to enter and exit telecommunications markets, any action by Qwest to raise prices to supranormal levels would encourage competitors to reenter the market, foreclosing Qwest's ability to recover its lost profits.

Q. AT P. 53, MR. LAFFERTY SUGGESTS THAT QWEST'S AUSF PROPOSAL MIGHT PROPERLY BE FUNDED BY ASSESSING AUSF CONTRIBUTIONS FOR EACH WIRELINE AND WIRELESS CARRIER IN ARIZONA BASED ON WORKING TELEPHONE NUMBERS SERVED BY EACH CARRIER. DOES HIS SUGGESTION HAVE MERIT?

A. This is an issue for the Commission to decide. Since the funding method is determined in Commission rules, this proposal might be appropriate for a rulemaking should Cox desire to propose one, but it is not appropriate in this proceeding.

VI. TIME WARNER

Q. AT P. 5, MR. GATES CONTENDS THAT ANY CURRENT IMPLICIT SUBSIDIES IN QWEST'S RATE STRUCTURE MUST BE ELIMINATED OR MADE EXPLICIT BEFORE QWEST SHOULD BE GRANTED ADDITIONAL REGULATORY FLEXIBILITY. WOULD YOU COMMENT?

A. Yes. Implicit in Mr. Gates' proposal is a recommendation to the Commission that Qwest's rates should be rebalanced such that each rate is set at cost-recovery levels, and if that is not possible in the near term, any remaining subsidies should be made explicit. With respect to Qwest's AUSF proposal, that mechanism is one means of making explicit the support required to provide, on a competitively neutral basis, telecommunications service to high cost wire centers. From this perspective, Mr. Gates' proposal is in alignment with Qwest's AUSF proposal. However, Mr. Gates appears to seek price reductions for certain specific services, such as Special Access, and seems willing to volunteer Qwest for such reductions without identification of a means to offset those revenue reductions. To this extent, Qwest strongly disagrees with Mr. Gates' suggestion, which is nothing more than an attempt to advance Time Warner's interests.

Q. AT P. 12, MR. GATES BOLDLY ASSERTS THAT "QWEST IS THE SOLE PROVIDER OF SPECIAL ACCESS" AND IS THE "MONOPOLY PROVIDER OF THIS CRITICAL SERVICE" IN ARIZONA. DOES HE PROVIDE ANY FACTUAL SUPPORT FOR HIS ASSERTION?

A. No. This is another example of Mr. Gates using strong rhetoric without factual support. In fact, in response to Qwest data request Set 4, No, 5 to Time Warner inquiring about Time Warner's factual support for the contention that Qwest is the sole provider of Special Access, Mr. Gates stated:

> "While there may be other niche providers of special access in Arizona, it does not change Mr. Gates' ***opinion*** that in the vast majority of Qwest's operating territory CLECs must rely upon Qwest for such service." (emphasis added).

Qwest does not dispute the fact that, due to the scope of its network in Arizona, it is a major provider of Special Access services to other carriers wishing to utilize Qwest's network to deliver telecommunications services to end users. However, Qwest is certainly not the "sole supplier of Special Access services" in Arizona, particularly in densely-populated areas such as Phoenix and Tucson where alternative providers have installed network facilities. Mr. Gates concedes as much in his response to Qwest's data request referenced above. Unless and until Mr. Gates provides facts to support his assertions, his "opinion" regarding Qwest's monopoly stranglehold on the Special Access market should be disregarded.

Q. HOW IS INTRASTATE SPECIAL ACCESS CLASSIFIED UNDER QWEST'S EXISTING PRICE PLAN AND TARIFF?

A. Special Access and Private Line services are considered as Basket 3 services and are therefore considered competitive. This classification has been in place for several years and to my knowledge has not been challenged by any party. This competitive classification appropriately determined that Special Access and Private Line services are competitive in Arizona. This is similar to the classification these services have in Qwest's interstate tariff.

Q. IS INTERSTATE SPECIAL ACCESS SERVICE THE PREDOMINANT FORM OF SPECIAL ACCESS UTILIZED BY CARRIERS IN ARIZONA?

A. Yes. Since carriers utilizing Special Access service typically provide a variety of services to end users over the Special Access facility, including local exchange services, data services and interstate long distance services, carriers are required to subscribe to interstate special access services if the interstate traffic on those services is 10% or more of the traffic provided to end users. In most instances, the amount of long distance usage exceeds 10% on Special Access circuits, and the vast majority of Special Access services provided to carriers by Qwest are governed by FCC interstate tariffs.

Q. IS THE FCC RESPONSIBLE FOR ENSURING THAT QWEST'S INTERSTATE SPECIAL ACCESS SERVICE RATES ARE JUST AND REASONABLE?

A. Yes. Qwest must seek and obtain FCC approval for any change in interstate Special Access rates, terms or conditions. Qwest does not have the latitude to increase Special Access rates without the FCC first examining such a request and determining the rate change to be just and reasonable. In fact, Mr. Gates acknowledges his understanding of the FCC's authority over Qwest's Special Access rates in his response to Qwest's data request Set 4, No. 6 to Time Warner when he says:

"TWTA admits that the FCC has jurisdiction over Qwest's interstate Special Access rates."

Q. AT P. 15, MR. GATES COMPLAINS THAT QWEST IS NOT SUBJECT TO FRANCHISE FEES, WHICH CONSTITUTES A COMPETITIVE ADVANTAGE FOR QWEST. DOES THIS REPRESENT A COMPETITIVE ADVANTAGE FOR QWEST?

A. No. In fact, Mr. Gates' argument is nothing more than a red herring. First, if this issue is a concern of CLECs in Arizona in general, it is not clear why Time Warner would be the lone CLEC raising this complaint. By Mr. Gates' estimation at P. 15, these franchise fees can "represent as much as 5% of a CLEC's gross revenues." Since CLECs are interested in optimizing their operating margins, it is highly unusual that CLECs other than Time Warner have not complained of this alleged disparity. However, further discussion of the franchise fee issue reveals why others have not complained.

Mr. Gates is correct that Qwest does not currently pay a franchise fee for operating in the state, and that this fee is assessed to CLECs. However, Mr. Gates failed to mention that most cities in Arizona have implemented a tax on telecommunications services as outlined in Section 470 of the Model City Tax Code ("MCTC"). Qwest and other telecommunications carriers must pay this tax. However, at least 33 cities, including cities in Qwest's territory such as Phoenix, Flagstaff, Glendale and

Peoria, have adopted tax rules that allow for franchise fee contributions to offset taxes due under Section 470, up to the entire amount of taxes due to the city. For example, if a particular CLEC has paid a franchise fee of $1,000 and also has city taxes of $1,000 due under Section 470, the CLEC is allowed to forego paying the tax of $1,000 since it has already paid the franchise fee. In Qwest's case, it must pay the tax of $1,000 without a franchise fee offset. In other words, the franchise fee offset available to the CLEC has the net effect of causing Qwest and CLEC to bear an equivalent tax and fee burden. This fact is likely the reason that other CLECs have not complained about the alleged "competitive disadvantage" represented by franchise fees.

Q. MR. GATES ALSO COMPLAINS, AT P. 16, THAT TIME WARNER IS COMPETITIVELY DISADVANTAGED IN CERTAIN INSTANCES WITH RESPECT TO ACCESS TO LARGE OFFICE TOWERS IN ARIZONA. WOULD YOU COMMENT?

A. Yes. At pages 16 and 17, Mr. Gates provides an unsworn, second-hand description of a situation involving two office towers in Phoenix where Time Warner encountered difficulty in negotiating with the building owner to obtain authority to bring Time Warner fiber facilities into the buildings.[38] The specific details involving these two

[38] Mr. Gates also supplied, in response to Qwest data request 4-3 to Time Warner, several other examples of properties in the Phoenix area where Time Warner was allegedly denied access to the building or asked to pay a substantial lease fee for space in the building to accommodate Time Warner's facilities. However, like Mr. Gates' testimony, no specifics or other details are provided regarding any of these alleged instances.

alleged negotiations are not supplied in Mr. Gates' testimony. Since no verifiable details were provided regarding these alleged instances, the Commission should give Mr. Gates' testimony on this point little weight. However, regardless of the authenticity and particular circumstances of the examples cited by Mr. Gates, this is an issue of commercial negotiation between Time Warner and the property owner, not one for the Commission to consider and act upon in this proceeding.

In any event, it is important to note it is not Qwest's policies or access to Qwest facilities that is at issue in this instance. Qwest is bound by the Section 271 checklist requirements to provide non-discriminatory access to qualifying carriers to its poles, ducts and rights of way.

Q. AT P. 21, MR. GATES TELLS THE COMMISSION THAT, SHOULD THE COMMISSION GRANT QWEST'S PRICING FLEXIBILITY REQUEST IN PHOENIX AND TUCSON, QWEST WOULD BE FREE TO: 1) INCREASE ITS WHOLESALE AND/OR RETAIL RATES AND EARN SUPRA-NORMAL PROFITS AT THE EXPENSE OF RATEPAYERS AND/OR WHOLESALE CUSTOMERS, AND/OR 2) LOWER ITS RETAIL RATES BELOW A RELEVANT PRICE FLOOR IN SELECT CIRCUMSTANCES TO DRIVE COMPETITORS FROM THE MARKET. WOULD YOU COMMENT?

A. Yes. Mr. Gates apparently believes that, should Qwest's competitive zones proposal be granted, it will have virtually unfettered latitude to adjust its wholesale and retail prices at will to drive its competitors from the market. Mr. Gates is mistaken. First, this proceeding has nothing to do with pricing flexibility for Qwest's wholesale services. This Commission will continue to have oversight over Qwest's intrastate wholesale prices while the FCC has continued oversight over Qwest's interstate wholesale rates. Any request to increase wholesale rates must withstand state or federal regulatory scrutiny to ensure the rate adjustments are reasonable and justified. It is highly unlikely, after fully investigating such a request, that this Commission or the FCC would allow a wholesale rate increase to go into effect if it created "supra-normal" profits, as Mr. Gates contends.

From an intrastate retail services perspective, a Competitive Zone can only be established if the Commission finds that sufficient competition exists in that geographic area such that continued full regulatory oversight is no longer necessary. In that instance, an attempt by Qwest to exercise pricing flexibility to increase retail rates to "supra-normal" levels can only invite additional competitive pressure. Where such competition exists, the free market will govern appropriate rate levels.

In regard to Mr. Gates' second suggestion that, in Competitive Zones, Qwest would be free to lower its retail rates below "relevant price floors in select circumstances to

drive competitors from the market," it is not clear what evidence Mr. Gates reviewed that led him to his conclusion. In effect, services in Competitive Zones are considered to be "Basket 3" competitive services in terms of pricing flexibility. The Commission's Rules governing the pricing of competitive services clearly mandate that the price of a competitive service be set at no less than the TSLRIC of the service.[39] If the Commission finds in the future that Qwest has violated price floor rules, the Commission retains the authority to revoke Competitive Zones flexibility in that circumstance.

Q. AT P. 22, MR. GATES SUGGESTS THAT QWEST "COULD ELIMINATE COMPETITION ENTIRELY USING ANTICOMPETITIVE PRICING TACTICS." IS HE CORRECT?

A. No. Mr. Gates merely draws on his unsupported speculation discussed above to build a myth that Qwest has the power to "squeeze" all of its competitors from the market. This is nonsense. In fact, should the Commission grant Qwest's Competitive Zones proposal, Qwest has every incentive to compete fairly in those areas. Competition continues to expand in Arizona and Qwest will soon be in front of the Commission with additional requests to classify more geographic areas as being subject to sufficient competition where Qwest should be granted pricing flexibility. If the myth Mr. Gates constructs were to become reality, it is

[39] R14-2-1109A.

extraordinarily unlikely the Commission would grant Qwest's request for additional Competitive Zones. More importantly, the Commission retains the authority to revoke existing Competitive Zones should it find impropriety in Qwest's retail pricing practices there.

Q. DOES MR. GATES ACKNOWLEDGE THAT A PRICE FLOOR PRESENTLY EXISTS FOR QWEST'S RETAIL SERVICES?

A. Yes. However, he suggests the existing imputation guideline identified in Commission Rule R14-2-1310C is insufficient to protect competition in Arizona. I would submit that the Commission has considered this issue extensively, and after full consideration, has set rules in place it feels provide sufficient safeguards to protect competition. Mr. Gates appears to now be asking the Commission to establish new rules, and if so, his suggestion should be rejected. A request of this nature should be entertained only in a rulemaking docket.

VII. RUCO

Q. AT P. 51, DR. JOHNSON INTRODUCES A PROPRIETARY "TABLE 1" WHICH ALLEGEDLY SHOWS THAT RESIDENTIAL CUSTOMERS IN ALL THREE COST ZONES GENERATE SUFFICIENT REVENUE TO PRODUCE POSITIVE MARGIN. IS HIS ANALYSIS CORRECT?

A. No. As discussed in Ms. Million's direct testimony, Qwest's revenues are deficient by approximately $64 million to cover the cost of providing local exchange service in high cost wire centers. This was the basis for Qwest's proposal to establish a competitively-neutral draw from the AUSF to support the provision of local exchange service to high cost areas. Interestingly, even Staff witness Mr. Regan identified a revenue shortfall of over $4.6 million in the Zone 3 wire centers,[40] and Mr. Regan's calculations are based on an extremely conservative set of assumptions regarding how TSLRIC costs should be calculated in his analysis.

Q. DR. JOHNSON STATES, AT P. 57 AND AGAIN AT P. 73, THAT QWEST CURRENTLY RECEIVES "VERY SUBSTANTIAL REVENUES AND PROFITS FROM YELLOW PAGES ADVERTISING" THAT CAN BE USED TO SUBSIDIZE BELOW-COST SERVICES. IS HE CORRECT?

[40] Schedule TMR-3, page 2 of 5.

1 A. No. I can only assume from his statements that Dr. Johnson is unaware that Qwest
2 no longer owns the Qwest Dex subsidiary, which in fact, was sold over one year ago
3 to the Carlyle Group.[41] Qwest no longer receives any revenue from Dex yellow
4 pages advertising. More directly however, pursuant to the settlement in the
5 Directory Asset Transfer docket, $72 million of "directory revenue" is imputed to
6 Qwest in the revenue requirement discussed by Mr. Grate in this docket, even
7 though Qwest no longer is in the directory business. As such, Dr. Johnson's wish for
8 this subsidy is included in Qwest's revenue requirement analysis.
9
10 **Q. AT P. 60, DR. JOHNSON INTRODUCES "TABLE 2," WHICH IS AN**
11 **ILLUSTRATIVE CHART BASED ON A SERIES OF ASSUMPTIONS**
12 **PURPORTEDLY SHOWING THAT QWEST RECEIVES SO MUCH REVENUE**
13 **FROM FEATURES AND TOLL SERVICES THAT IT'S RESIDENTIAL SERVICES,**
14 **IN THE NET, ARE PROFITABLE. WOULD YOU COMMENT?**
15 A. Yes. Dr. Johnson supports his Table 2 by saying: "Qwest doesn't rely exclusively on
16 its basic monthly rate to recover its costs, nor do any of its competitors." He is
17 correct. Qwest does receive revenues from other services that contribute to the
18 overall cost of serving a customer, just as Qwest's competitors do. However, the
19 revenue generated by customers in the highest cost wire centers is not sufficient to
20 cover Qwest's costs of providing service to those customers. This fact is the driver

[41] It is my understanding the Dr. Johnson testified in the Arizona proceeding regarding Qwest's sale of Qwest Dex to the

of Qwest's AUSF proposal. Essentially, Dr. Johnson is suggesting that the monopoly era system of implicit subsidies should be continued in perpetuity in Arizona. As I have previously discussed, this archaic view cannot be sustained in the modern era of telecommunications competition.

Q. AT P. 108, DR. JOHNSON INTRODUCES THE TERM "EFFECTIVE COMPETITION" AND SUGGESTS THAT EFFECTIVE COMPETITION MUST BE DEMONSTRABLY PRESENT IN ARIZONA BEFORE QWEST SHOULD BE GRANTED REGULATORY FLEXIBILITY. WOULD YOU COMMENT?

A. Yes. It appears that, by the term "effective competition," Dr. Johnson feels that no firm should possess a dominant share of the market. However, the term "effective competition" does not appear in any Arizona rule or statute that is relevant to this docket. In fact, in response to Qwest data request 2-2 served on RUCO, Dr. Johnson stated:

> "RUCO is not aware of any use of the term "effective competition" in any Arizona statute or Arizona Corporation rule related to telecommunications."

The term "effective competition" is not only missing from the Commission's rules, it is a term that may have multiple meanings. One such meaning is that effective competition is where there are no barriers of entry and the costs of entry are not excessive. That describes the current state of the telephony market in Arizona.

Carlyle Group. It is unclear why Dr. Johnson is now unaware of the sale.

Q. AT P. 176, DR. JOHNSON CONTENDS THAT THE "AVAILABLE EVIDENCE" MAY SUPPORT COMPETITIVELY CLASSIFYING CERTAIN SUB-MARKETS, SUCH AS PBX TRUNK SERVICE PROVIDED TO ENTERPRISE CUSTOMERS. IS HIS SUGGESTION A WORKABLE SOLUTION?

A. No. In fact, Dr. Johnson's suggestion would drive a required competitive analysis to an investigation of competition for individual customer sub-groups within a particular service and within defined geographic markets. His suggestion is perhaps interesting as an academic exercise but is impossible to effectuate.

Q. AT P. 178, DR. JOHNSON LISTS NINE SEPARATE FACTORS THAT DISTINGUISH WIRELESS SERVICE FROM WIRELINE SERVICE AND ARE, IN HIS OPINION, REASONS THAT WIRELESS CUSTOMERS DO NOT SUBSTITUTE WIRELESS SERVICE FOR TRADITIONAL WIRELINE SERVICE. WOULD YOU COMMENT?

A. Yes. In my direct testimony, at pages 56 through 62, I discussed the wireless services available in Arizona and explained that a segment of the wireless customer base has already entirely "cut the cord," meaning that the customer has entirely foregone traditional Qwest wireline telephone service in favor of wireless service. In Dr. Johnson's list of "nine factors," he merely states the obvious: there are differences between cellular service and traditional wireline service. However, the

same could be said for cargo transportation by rail and by truck: a train is certainly different than a truck but both can serve a similar need in delivering cargo from point A to point B. In discussing why cellular service is different from wireline service, Dr. Johnson understates the key point, which is that a substantial and rapidly increasing proportion of the wireless customer base has already considered Dr. Johnson's "list of nine," decided that cellular service is a very acceptable substitute for wireline service and has already abandoned wireline service.

Q. DOES DR. JOHNSON ACKNOWLEDGE THAT A SUBSTANTIAL NUMBER OF WIRELESS CUSTOMERS HAVE ALREADY "CUT THE CORD," AND THAT THIS NUMBER IS GROWING?

A. Yes. In fact, Dr. Johnson admits at P. 179 that "a growing number of consumers are replacing their land line with a wireless phone, but in the typical market just 6% of all consumers have made this switch" (referencing FCC data through March 2004). By this statement, Dr. Johnson acknowledges that the proportion of customers "cutting the cord" is trending upward, but offers only a static (and retrospective) cite to the FCC's conclusion regarding the number of wireless customers who have totally abandoned wireline service nearly one year ago. Even taking the percentage offered by Dr. Johnson at face value in the context of this proceeding, a significant number of wireless customers have foregone Qwest wireline service in favor of wireless service. However, the wireless market is very dynamic and this technology

offers many features additional customers may view as attractive enough to offset Dr. Johnson's "list of nine." For example, with the advent of wireless number portability in November 2003, wireline customers may now elect to transfer their existing wireline telephone number to their wireless telephone to ease the transition when "cutting the cord," large blocks of wireless usage are now available (and some carriers, such as Cricket, offer unlimited monthly usage at a flat price to Arizona customers) and expanded data functions such as internet access are continually being added to wireless offerings.

Q. BEYOND THE FCC STATISTICS REFERENCED BY DR. JOHNSON, DO YOU HAVE OTHER EVIDENCE SHOWING THE RATE OF SUBSTITUTION OF WIRELESS SERVICES FOR WIRELINE SERVICE IS INCREASING?

A. Yes. In October 2004, the Yankee Group released a study examining the trend of wireless/wireline convergence[42] and found that nearly 64% of U.S. households have both a wireless phone and a wireline phone and that 40% of these households expect their wireless phone to completely replace their landline phone. The Yankee Group's findings support the view that the trend in the number of customers "cutting the cord," is growing -- as Dr. Johnson states -- and is expected to continue to grow at a very significant rate.

[42] *The Success of Wireline/Wireless Strategies Hinges on Delivering Consumer Value,* The Yankee Group, October 2004.

Q. DOES DR. JOHNSON CHARACTERIZE CABLE TELEPHONY IN ARIZONA AS BEING "IN ITS INFANCY?"

A. Yes, at P. 179, Dr. Johnson asserts that "both VoIP and cable telephony are potentially much more direct substitutes for traditional telephony" and that "both of these technologies are in their infancy, and thus for many customers these offerings may still be seen as too risky to be considered viable alternatives to Qwest's traditional wireline services." By this statement, Dr. Johnson appears to be attempting to place VoIP and cable telephony services at the same early point in their life cycles. Dr. Johnson's testimony is extremely misleading, however, since Cox is already a very robust telecommunications competitor in the greater Phoenix and Tucson markets and is contributing to Arizona's status of one of Qwest's most competitive states, as discussed at length in my direct testimony. It would take an extreme stretch of the imagination to consider that the many thousands of current Cox telephone customers in Phoenix and Tucson would agree with Dr. Johnson that Cox's telephone service is "too risky to be considered a viable alternative to Qwest's traditional wireline service."

While VoIP service is certainly earlier in its life cycle than cable telephony, it nonetheless is already a viable telecommunications alternative to any customer with a broadband internet connection in Arizona. As discussed earlier in my rebuttal testimony, the VoIP market is evolving very rapidly and is creating a sea change in

telecommunications, with the Wall Street Journal reporting that approximately 800,000 customers are already VoIP subscribers[43] and that the number of VoIP subscribers is expected to reach 17 million within four years. Clearly, VoIP service must be considered a current and rapidly growing competitive factor in the Arizona telecommunications market as the Commission considers the range of competitive alternatives to Qwest's services in this proceeding.

VIII. CONCLUSION

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. In my rebuttal testimony, I addressed issues raised by Staff, RUCO, DOD, Time Warner and Cox Communications in their pre-filed testimonies in this proceeding. As discussed in my direct and rebuttal testimony, the Arizona telecommunications market is now subject to intramodal and intermodal competition and the Phoenix and Tucson markets are particularly competitive. In fact, these markets are among the most intensely competitive markets in Qwest's 14 state service territory. Qwest's retail service proposals in this docket, including the Competitive Zones proposal for the Phoenix and Tucson markets, the AUSF plan and Qwest's retail pricing proposals are all consistently driven by a primary objective of this proceeding:

[43] *Id*

repositioning of Qwest's services in the competitive market to facilitate fair competition within the context of the overall price plan.

Parties in this proceeding ask the Commission to find that only modest CLEC-based competition exists for Qwest's retail telecommunications services and further seek to have the Commission essentially ignore the competitive effects of intermodal services, such as wireless and VoIP products. In so doing, the parties would have the Commission turn a blind eye to the ongoing paradigm shift in the Arizona telecommunications market, perpetuate inappropriate (and competitively unfriendly) implicit subsidies within Qwest's pricing structures and limit Qwest's ability to fairly compete. The parties' efforts in this regard do a disservice to customers in high cost areas of the state who have yet to enjoy the choice of competitive alternatives promised by the Telecommunications Act of 1996 and ignore competitive marketplace realities in Qwest's most competitive markets in Arizona.

Each of Qwest's retail service proposals, including its Competitive Zones, AUSF, deregulation and retail price adjustment proposals are reasonable and are in appropriate alignment with the realities of the competitive telecommunications market in Arizona. I respectfully request the retail service proposals outlined in my direct testimony be approved as filed.

1

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

3 A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL EXHIBITS

OF

DAVID L. TEITZEL

QWEST CORPORATION

DECEMBER 20, 2004

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-20 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER – CHAIRMAN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNCATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL TESTIMONY OF

KERRY DENNIS WU

ON BEHALF OF

QWEST CORPORATION

DECEMBER 20, 2004

TABLE OF CONTENTS

	TOPIC	PAGE
I.	EXECUTIVE OVERVIEW	i
II.	IDENTIFICATION OF WITNESS	1
III.	PURPOSE OF TESTIMONY	1
IV.	QWEST'S DEPRECIATION RATES AND LIVES ARE CONSISTENT WITH FCC AND ARIZONA ADMINISTRATIVE CODE (AAC) UTILITY DEPRECIATION REQUIREMENTS	2
V.	BEGINNING-OF-YEAR VERSUS END-OF-YEAR DEPRECIATION RESERVE	15
VI.	ARIZONA CONCLUSIONS	16

I. EXECUTIVE OVERVIEW

In this Docket, Qwest did not request any change to the Commission prescribed depreciation lives or parameters. However, Qwest did propose a technical update and the adoption of Staff's recommended retirement of certain older plant vintages. These proposals reduce Arizona intrastate annual depreciation expense over $109 million. RUCO concurs in the use of Commission prescribed lives and parameters

Staff, on the other hand, requests that the prescribed depreciation lives be significantly lengthened and that depreciation rates be calculated based depreciation reserve balances at the end of the test year, instead of the beginning of the test year. Staff's combined proposals decrease test year depreciation expense $140 million more than Qwest's proposal. Staff is asking to reduce depreciation expense nearly $250 million in total.

Staff's depreciation life proposals are unwarranted and ignore the realities of competition, technology and the concept of test year expenses in Arizona. Mr. Dunkel asserts that currently prescribed Arizona depreciation lives and rate calculations "violate the ACC [sic] and USOA utility depreciation requirements."[1] Mr. Dunkel's argument relies on fundamentally flawed characterizations and interpretations of the Arizona Administrative Code (AAC) and the FCC's Uniform System of Accounts (USOA)

Qwest will be submitting revised exhibits that reflect calculation of depreciation rates based on end-of-test-year depreciation reserve balances.

[1] Direct Testimony and Schedules of William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, November 2004, p. 36.

This modification increases Qwest original depreciation reduction proposal by an additional $50 million to about $160 million.

II. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Kerry Dennis Wu. My title is Staff Director - Capital Recovery for Qwest Corporation. My business address is 1600 7th Avenue, Room 3006, Seattle, Washington 98191.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I filed direct testimony in this case and testified before this Commission in depreciation Docket T-01051B-97-0689.

III. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my rebuttal testimony is to address the modifications to Qwest's depreciation calculations Staff advocates in its direct testimony.

Q. WHAT SPECIFIC ISSUES WILL YOU ADDRESS?

A. Staff's Mr. Dunkel testifies: (1) utilizing depreciation lives less than implied by historical retirement rates "violates the ACC [sic] and USOA (Uniform System of Accounts) depreciation requirements"[2] and (2) that end-of-year 2003 rather than beginning-of-year 2003 reserve balances should be used to develop depreciation rates used for test year 2003. In the case of

[2] Direct Testimony and Schedules of William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, November 2004, pp. 5-6.

depreciation lives, Mr. Dunkel is incorrect. In the second, Qwest has updated its exhibits to reflect this modification.

IV. QWEST'S DEPRECIATION RATES AND LIVES ARE CONSISTENT WITH FCC AND ARIZONA ADMINISTRATIVE CODE (AAC) UTILITY DEPRECIATION REQUIREMENTS

Q. WHAT IS DEPRECIATION?

A. Mr. Dunkel misinterprets the requirements of FCC Part 32 and the Arizona Administrative Code §R-14-2-102. The following definitions are necessary to understand what depreciation is.

According to the Supreme Court of the United States,

> Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all factors causing the ultimate replacement of the property. These factors embrace wear and tear, decay, inadequacy and obsolescence. Annual depreciation is the loss which takes place in a year.[3]

FCC Part 32 states,

> Depreciation means the loss in value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of telecommunications plant in the course of service from causes where are known to be in current operation, against which the company is not protected by insurance and the effect of which can be forecast with a reasonable approach to accuracy. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence,

[3] *Lindheimer v. Illinois Bell Telephone Company*, 292 U.S. 151, 167 (1934).

> changes in technology, changes in demand and requirements of public authorities.[4]

The American Institute of Certified Public Accountants defines depreciation accounting as,

> Depreciation accounting is a system of accounting which aims to distribute cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation.[5]

The above definitions make clear that depreciation accounting is a process that assigns and allocates historical costs to accounting periods.

Q. DOES MR. DUNKEL ACCURATELY REPRESENT THE DEPRECIATION REQUIREMENTS SET FORTH IN THE FCC'S PART 32 ACCOUNTING RULES AND THE ARIZONA ADMINISTRATIVE CODE §R-14-2-102?

A. No. In alleging that Qwest's currently prescribed depreciation lives violate Part 32 and AAC §R-14-2-102, Mr. Dunkel mischaracterizes both.

Q. WHY DO YOU SAY MR. DUNKEL MISCHARACTERIZES PART 32?

A. Mr. Dunkel's allegation of a Part 32 violation relies on the following quote, found on page 37 of his direct testimony:

> Under "Depreciation Accounting", the USOA <u>requires</u> [(emphasis added)] that:
>
> > ...the loss in service value of the property ...be... distributed under the straight-line method during the

[4] FCC Part 32, §32.9000.
[5] Accounting Research and Terminology Bulletin #1, American Institute of Certified Public Accountants.

> service life of the property." (emphasis added [in original], §32.2000(g)(1))
>
> That service life ends when the investment is "retired from service". (USOA Part 32.2000(d))[6]

Based on this quote, Mr. Dunkel alleges that Part 32 requires "that depreciation be over the 'service life'" of assets and that service life must be estimated based solely on historical mortality data. From this he concludes that Qwest's current depreciation lives are inconsistent with Part 32.

Q. WHAT IS WRONG WITH MR. DUNKEL'S ALLEGATION?

A. Mr. Dunkel misquotes Part 32 and mischaracterizes what it means. Title 47 §32.2000 is entitled "Instructions for telecommunications plant accounts;" subsection (g) is entitled "Depreciation accounting" and paragraph (1) is entitled "Computation of depreciation rates." In its entirety it says:

> (i) Unless otherwise provided by the Commission, either through prior approval or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation, may be distributed (emphasis added) under the straight-line method during the service life of the property.
> (ii) In the event any composite percentage rate becomes no longer applicable, revised composite percentage rates shall be computed in accordance with paragraph (g)(1)(i) of this section.

[6] Direct Testimony and Schedules of William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, November 2004, p. 37.

> (iii) The company shall keep such records of property and property retirements as will allow the determination of the service life of property which has been retired, or facilitate the determination of service life indications by mortality, turnover, or other appropriate methods. Such records will also allow the determination of the percentage of salvage value and cost of removal for property retired from each class of depreciable plant.

Q. WHAT IS INACCURATE ABOUT MR. DUNKEL'S QUOTATION OF §32.2003?

A. Mr. Dunkel has selectively deleted language for the FCC Rule as indicated below:

> the loss in service value of the property , EXCEPT FOR LOSSES EXCLUDED UNDER THE DEFINITION OF DEPRECIATION, MAY be distributed under the straight line method during the service life of the project.
>
> [Mr. Dunkel's deletions in caps, emphasis added.]

By selectively quoting from 47 CFR §32.2000(g)(1) Mr. Dunkel argues that it prescribes only depreciation rates based exclusively on service lives that are based exclusively on mortality data. Clearly, this is not the case. 47 CFR §32.2000(g)(1)(i) is prefaced with exception language that permits the Commission to prescribe depreciation in other ways. 47 CFR §32.2000(g)(1)(iii) contemplates the determination of service life indications "by mortality, turnover, or other appropriate methods, " not just historical mortality.

By excluding the word "may," Mr. Dunkel changes the meaning of the language he quotes. By omitting "may," Mr Dunkel suggests that the language of the Rule is mandatory rather than optional. Only by misquoting the language of Part 32 can he support his highly restrictive reading of that Section.

Further, 47 CFR §32.2000(g) (2) is entitled "Depreciation charges." Subparagraph (iv) provides:

> In certain circumstances and upon prior approval of this Commission, monthly charges may be determined in total or in part through the use of other methods whereby selected plant balances or portions thereof are ratably distributed over periods prescribed by this Commission. Such circumstances could include but not be limited to factors such as the existence of reserve deficiencies or surpluses, types of plant that will be completely retired in the near future, and changes in the accounting for plant. Where alternative methods have been used in accordance with this subparagraph, such amounts shall be applied separately or in combination with rates determined in accordance with paragraph (g)(2)(ii) of this section.

This portion of Part 32 clearly allows for the determination of depreciation charges "through the use of other methods..." Thus, Mr. Dunkel's argument that Part 32 is violated if depreciation rates are based on anything other than service lives based exclusively on historical mortality data is incorrect and a misquotation of the FCC rule.

Q. DOES THE FCC ALWAYS BASE DEPRECIATION RATES ON ESTIMATED SERVICE LIVES BASED EXCLUSIVELY ON MORTALITY DATA?

A. No. In the FCC's September 2003 Unbundled Network Element Notice of Proposed Rulemaking (NPRM), the FCC stated,

> There are two components of depreciation – the useful life of the asset, and the rate at which the asset is depreciated over that useful life. In the *Local Competition Order*, the Commission stated that properly designed depreciation schedules should take into account expected declines in the value of goods. Similarly, the Commission's rules require the use of "economic depreciation" but

> provide no additional detail. In the *Triennial Review Order*, we declined to mandate any particular set of economic lives because there was no record to support such a finding. With respect to the rate of depreciation, however, we clarified that a carrier may accelerate recovery of the initial capital outlay for an asset over its life to reflect any anticipated decline in value. Recovering more of the initial outlay for the asset in the early years would enable a carrier to recover less in later years, thereby allowing it to compete with carriers that have purchased new, lower-priced equipment in those later years.[7] (emphasis added)

Clearly, the FCC does not view depreciation to be a process of cost allocation based on strictly on service lives determined from mortality data.

Q. IN ADVOCATING DEPRECIATION LIVES WITHIN THE FCC'S 1995 "SAFE HARBOR" LIFE RANGES, MR. DUNKEL SURELY RECOGNIZES THAT WHEN DEVELOPING ITS RECOMMENDATIONS, THE FCC DIDN'T MECHANISTICALLY APPLY RETIREMENT PATTERNS DOESN'T HE?

A. According to Mr. Dunkel, the historically observed life based on retirements of Arizona buried cable-metallic is 58.8 years, yet the 1995 FCC Arizona depreciation life for that account is 20 years. Clearly, Part 32 depreciation accounting is not blindly based on retirements only. In recommending a 23 year depreciation life instead of 58.8 year depreciation life, Mr. Dunkel asserts that Staff is being "generous[8]" in its depreciation allowance

---

[7] FCC 03-224, Notice of Proposed Rulemaking – *In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, pp. 33 – 34.

[8] Direct Testimony and Schedules of William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, November 2004, p. 34.

Q. IN RECOMMENDING THE MID-POINTS OF THE FCC'S "SAFE HARBOR" DEPRECIATION LIFE RANGES, IS STAFF BEING "GENEROUS"?

A. Hardly, the FCC's "Safe Harbor" depreciation life ranges were established nearly 10 years ago. They are no longer useful for establishing asset lives in today's intensely competitive environment. In two separate 2004 rulings, the public utility commissions in Illinois and Indiana commented on the applicability of the FCC's "Safe Harbor" depreciation life ranges considering all of the changes since the ranges were issued. In Illinois, the Commission said:

> .... The FCC's lives were adopted nine years ago and do not necessarily reflect the forward-looking impact to depreciation of the competitive market that TELRIC assumes.
>
> We find that financial book lives, as proposed by SBC, are appropriate for determining the economic life of SBC's assets. ... . Furthermore, since the FCC regulatory lives pre-date the 1996 Act and the TRO, they may no longer indicate risks associated with facilities-based competition. The shorter lives proposed by SBC are more in tune with current and forward-looking conditions. Thus, SBC's proposed depreciation lives are more in line with TELRIC principles.[10]

Similarly in early 2004, the public utility commission in Indiana stated the following regarding the FCC's "Safe Harbor" depreciation life ranges,

> As the FCC explained to the Supreme Court, the reference to regulatory depreciation lives in the First Report and Order "merely offer[ed] tentative guidance at a time when state commissions had to make large numbers of ratemaking determinations under the short time frames established in Section 252." Therefore, we reject

[10] Illinois Bell Telephone Company Filing to Increase Unbundled Loop and Nonrecurring Rates, Docket No. 02-0864, Section f) Commission's Analysis and Conclusion, June 9, 2004, p. 77.

> any claim that we are somehow bound to adopt regulatory lives or even that they must be used as a starting point. Whatever the merit of such an argument many have had in 1996, it carries no weight in 2003. .... We believe that our decision was correct in 1998 and is even more appropriate today. Technological advancement continues at a rapid pace, leading to faster obsolescence of all types of telecommunications equipment. ... .[11]

Q. IS MR. DUNKEL CORRECT WHEN HE CLAIMS THAT QWEST'S AUTHORIZED DEPRECIATION LIVES VIOLATE ARIZONA ADMINISTRATIVE CODE §R-14-2-102?

A. No. AAC §R-14-2-102(A)(3) states:

> Depreciation means an accounting process that <u>will permit</u> the recovery of the original cost of an asset less its net salvage over the service life. (emphasis added)

Mr. Dunkel asserts that that the definition of depreciation in Arizona <u>requires</u> that an asset be depreciated from the date an asset is placed into service until the date it's retired. Mr. Dunkel's interpretation of the AAC is incorrect.

Q. WHAT IS WRONG WITH MR. DUNKEL'S INTERPRETATION?

A. The AAC defines depreciation as an accounting process that "**<u>will permit</u>** recovery of the original cost of an asset less its net salvage over the service life." (emphasis added). This portion of the AAC defines depreciation and does not **<u>mandate</u>** how depreciation lives are to be established or **<u>mandate</u>** recovery over service life. Rather the Commission has historically established service lives as part of the process of setting depreciation notes for a utility in a rate case or in a

[11] Investigation and Generic Proceeding of Rates and Unbundled Network Elements and Collocation for Indiana Bell Telephone Company, Incorporated D/B/A SBC Indiana Pursuant to the Telecommunications Act of 1996 and Related Indiana Statutes, Cause No. 42393, Section B. Commission Findings and Conclusions, January 5, 2004.

depreciation proceeding. The Commission has not mechanically adopted the physical service life of all assets as their depreciation life.

Even if one were to believe (albeit incorrectly) that this language establishes how depreciation is to be calculated in Arizona, the language (like the FCC's language regarding depreciation) is permissive, not prescriptive. Clearly, the AAC does **not** say "**must recover**" or "**is required to recover**." Although physical plant retirement patterns are an ingredient in determining depreciation lives, they are not the sole determinant.

Q. WHEN DID THE COMMISSION DECIDE QWEST'S MOST RECENT ARIZONA DEPRECIATION CASE, AND WHAT IMPORTANT CONCLUSION OF LAW DID THE COMMISSION REACH?

A. The Commission decided Qwest's (then U S WEST's) last Arizona depreciation case, Docket No. T-01051B-97-0689, in May 2000. The third Conclusion of Law in Decision No. 62507 states,

> Advancements in technology, coupled with the desire to create robust competition in Arizona's telecommunications industry, warrants setting U S WEST's depreciation lives within the range of its competitors.

Q. DOES ARIZONA LAW REQUIRE THAT THE COMMISSION PRESCRIBE DEPRECIATION LIVES BASED ONLY ON HISTORICAL MORTALITY DATA?

A. No. After the currently-prescribed depreciation lives were ordered by the Commission, RUCO appealed that order to the Arizona Court of Appeals.

RUCO's arguments included the following that are similar to Mr. Dunkel's current advocacy:

1. RUCO argued that because U S WEST's calculation were based on lives reported for financial purposes rather than regulatory purposes, the Commission's reliance on that data was arbitrary and unreasonable.

2. RUCO contended that the approved projection lives were unreasonable because they did not resemble the actual lives of U S WEST's assets.

The Arizona Court of Appeals ruled against RUCO on all issues raised in its appeal and stated that the Commission has the authority to prescribe depreciation lives shorter than physical lives based on historical mortality data. The Court affirmed the Commission's Decision on what are now Qwest's currently prescribed depreciation lives stating,

> The Commission's regulations governing the establishment of depreciation rates authorize a public service corporation to "propose any reasonable method for estimating service lives." A.A.C. R14-2-102(C) (2). We do not find it unreasonable for the Commission to conclude that in a competitive environment, the lives of U.S. WEST's property should be set comparably to those of companies with which U.S. WEST would be competing. Given that premise, we are not persuaded that use of the SEC data was arbitrary or unreasonable.[13]
>
> Third, RUCO contends that the approved projection lives are unreasonable because they do not resemble the actual lives of U.S. WEST's assets. Evidence was presented, however, that

[13] Residential Utility Consumer Office v. The Arizona Corporation Commission and Qwest Corporation, Court of Appeals, July 24, 2001, Π20, pp. 11-12.

> advances in telecommunication technology driven by competition now require consideration of the likelihood that assets will become obsolete before they actually physically wear out. As already discussed, U.S. WEST presented evidence that metallic cable is likely to become obsolete in the near future as customers demand wider bandwidths and as increased use of the internet surpasses the limitation of DSL technology. Consequently, it was not arbitrary for the Commission to decide that the changing telecommunications environment warranted an approach to assessing U.S. WEST's depreciation lives that was different from simply relying on the actual physical life of the asset.[14]

Q. MR. DUNKEL CLAIMS THAT DEPRECIATION RATES AND LIVES OF QWEST'S COMPETITORS ARE NOT RELEVANT BECAUSE THEY DO NOT FOLLOW UTILITY REGULATORY DEPRECIATION RULES. WOULD YOU LIKE TO COMMENT?

A. Mr. Dunkel offers no explanation why Qwest's competitors as public service corporations in Arizona are not required to comply with AAC §R14-2-102. His explanation for the application of his interpretation of the Arizona Rule to Qwest applies equally to its competitors. However, Qwest's competitors do not follow so-called regulatory depreciation rules because they have no reason to. As interpreted by Mr. Dunkel, the Rules bear no relationship to the real world of competitive provisioning of telecommunications services.

Competitors use "financial reporting rates and lives" which represent economic cost recovery over the time period competitors' managements believe their assets are **economically** viable. Economic viability and the rate of technical obsolescence are determined not by factors relevant to regulation of static monopolies but by the competitive marketplace. If Qwest's prescribed depreciation rates are too low or its depreciation lives

[14] *Ibid*, Π28, p. 15.

are too long, it raises to unacceptably high levels the risk that Qwest will be unable to recover its investment. If it were unable to recover existing investment Qwest's ability to invest in new technology to provide new services in a marketplace characterized by rapidly changing technology would be financially jeopardized.

Qwest operates in a technologically competitive environment in Arizona. For example, Cox Cable, as an operator of a high capacity cable television system, is a direct and extremely robust competitor to Qwest's network in the greater Phoenix and Tucson markets.[15] Qwest's telephone network also faces fierce technological competition from wireless technology in Arizona. Today, more Arizona access lines are served by wireless technology than by technology based on wires.[16] In fact, a recently published study found "conclusive evidence that wireless and wireline services are substitutes"[17] and that "a one percent increase in wireline prices will result in a two percent increase in wireless demand."[18] Consequently, the financial depreciation rates and service lives that Qwest's technological competitors use are highly relevant to the service life estimation of Qwest's assets. Sadly, Mr. Dunkel intentionally chose to completely ignore this important factor.[19]

---

[15] Rebuttal Testimony of David Teitzel - Qwest, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, December 20, 2004, p. 58.
[16] Local Telephone Competition: Status as of December 31, 2003, Industry Analysis and Technology Division, Wireline Competition Bureau, June 2004.
[17] Wireless Substitution and Competition, Different Technology but Similar Service – Redefining the Role of Telecommunications Regulation, Issue Analysis, Competitive Enterprise Institute, 2004 No. 5, Stephen B. Pociask, December 15, 2004, p. 2.
[18] *Ibid.* p. 2.
[19] Staff's Response to Qwest Corporation's Ninth Set of Data Requests, Docket Nos. T-01051B-03-0454 and T-00000D-00-0672, Responses 9-1a, 9-1b, 9-1c, 9-1d and 9-2.

Q. MR. DUNKEL STATES, "THE FCC HAS PROPERLY CONCLUDED THAT THE 'FINANCIAL' REPORTING LIVES OR 'FINANCIAL' DEPRECIATION RATES ARE NOT APPROPRIATE IN CALCULATING DEPRECIATION EXPENSE WHICH WOULD BE USED TO SET RATES CHARGED TO RATEPAYERS." WOULD YOU COMMENT?

A. The FCC is not nearly so absolute as Mr. Dunkel would have this Commission believe. In fact in the FCC's Unbundled Network Element Notice of Proposed Rulemaking, the FCC stated,

> In its Section 271 decisions, the Commission has found both FCC regulatory lives and financial book lives to be consistent with TELRIC principles. Similarly, in the *Triennial Review Order*, the Commission declined to mandate one set of asset lives or the other.[20]

Similarly, the Arizona Court of Appeals' opinion on RUCO's appeal of the ACC's Decision in Qwest's last depreciation case stated that: (1) it was not unreasonable for the Arizona Commission to conclude U S WEST depreciation lives should be set comparably to its competitors and (2) that use of the SEC data [financial rates and lives] was not arbitrary or unreasonable.[21]

Q. HAS TELECOMMUNICATIONS COMPETITION INCREASED IN ARIZONA SINCE THE COMMISSION ISSUED ITS MAY 2000 DEPRECIATION ORDER?

---

[20] FCC 03-224, Notice of Proposed Rulemaking – *In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, para 96, p. 35.

[21] Residential Utility Consumer Office v. The Arizona Corporation Commission and Qwest Corporation, Court of Appeals, July 24, 2001, Π20, pp. 11-12.

A. Between December 2000 and December 2003, Qwest access lines decreased from 2,950,483 to 2,373,577.[22] This was a reduction of over 576,000 access lines.[23] According to the FCC's December 2003 Local Telephone Competition Status Report[24], Arizona-only competitive local exchange carriers' share of end-user switched access lines increased from 5% in December 2000 to 22% at the end of December 2003.[25] Competitors' subscriber lines increased from 165,597 to 707,477 during that three year period.[26] According to the same report, Arizona mobile wireless subscribers increased from 1,855,115 to 2,843,061 during the same period.[27] As of December 2003, the number of wireless subscribers exceeded Qwest's access lines by nearly half a million. Clearly, competition in Arizona's telecommunications marketplace is thriving.

V. BEGINNING-OF-YEAR VERSUS END-OF-YEAR DEPRECIATION RESERVE

Q. WHAT DEPRECIATION RESERVE BALANCE DATE DOES MR. DUNKEL RECOMMEND FOR CALCULATING A CHANGE IN DEPRECIATION RATES?

A. Mr. Dunkel proposes calculating depreciation rates by using end-of-year 2003 depreciation reserve levels instead of beginning-of-year balances.

---

[22] Rebuttal Testimony of David Teitzel - Qwest, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, December 20, 2004, p. 6.
[23] *Ibid.*, p. 6.
[24] Local Telephone Competition: Status as of December 31, 2003, Industry Analysis and Technology Division, Wireline Competition Bureau, June 2004.
[25] *Ibid*, Table 7.
[26] *Ibid*, Table 8.
[27] *Ibid*, Table 13.

Q. DO YOU AGREE WITH MR. DUNKEL?

A. Qwest's exhibits have been updated to reflect depreciation rate recalculations as of the end of the test year rather than the beginning. Those rates were then applied to the monthly average gross intrastate investment balances during the test year.

Q. WHAT IS THE RESULT OF THIS MODIFICATION?

A. Changing depreciation rate recalculations, from beginning to the end of the test year, increases Qwest's initially proposed depreciation reduction ($109 million) by an about $50 million.

VI. ARIZONA CONCLUSIONS

Q. DO QWEST'S COMMISSION AUTHORIZED ARIZONA DEPRECIATION LIVES "VIOLATE" FCC PART 32 AND A.A.C. AS ALLEGED BY MR. DUNKEL?

A. Absolutely not. In the preceding testimony, I cited and accurately quoted FCC Part 32, the Arizona Administrative Code and the Arizona Court of Appeals decision reaffirming Qwest's depreciation lives. Mr. Dunkel mischaracterizes what depreciation rules require and then claims Qwest "violates" those rules. The Commission should reject Mr. Dunkel's depreciation life claims.

In its proposal to reduce depreciation expense, Qwest did not request any change from currently prescribed depreciation parameters. The Commission was correct in its May 2000 Decision when it stated,

> "Advancements in technology, coupled with the desire to create robust competition in Arizona's telecommunications industry, warrants setting Qwest's depreciation lives within the range of competitors."[29]

Given the level of competition today compared to just four and a half years ago when that Conclusion of Law was reached, the currently authorized depreciation lives were prescient and are, if anything, more appropriate today.

Q. ARE THE FCC'S 1995 "SAFE HARBOR" LIFE RANGES APPROPRIATE IN TODAY'S COMPETITIVE TELECOMMUNICATIONS ENVIRONMENT?

A. Absolutely not. As previously discussed, the FCC's "Safe Harbor" life ranges were issue prior to the 1996 Telecom Act, the FCC's Triennial Review Order and all of the changes since. Depreciation life recommendations that might have been appropriate in 1995 have no applicability in 2005.

Q. SHOULD BEGINNING-OF-YEAR OR END-OF-YEAR DEPRECIATION RESERVE BALANCE BE USED TO DEVELOP TEST YEAR DEPRECIATION RATES?

A. Qwest is submitting revised exhibits that incorporate end-of-test-year depreciation rate recalculations.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.

---

[29] Arizona Docket No T-01051B-97-0689 Decision No. 62507, Conclusions of Law, May 4, 2000, Para 3, p. 14.

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-21 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

REJOINDER TESTIMONY

OF

PETER C. CUMMINGS

QWEST CORPORATION

JANUARY 27, 2005

TESTIMONY OF PETER C. CUMMINGS
INDEX OF TESTIMONY

I. TESTIMONY

EXECUTIVE SUMMARY i

IDENTIFICATION OF WITNESS 1

PURPOSE OF TESTIMONY 1

REJOINDER TO TESTIMONY OF JOEL M. REIKER

Market Value and Book Value 1

Adjusted betas 5

Reasonableness Check and M/M Theory 7

Conclusion Relative to Mr. Reiker's Testimony . . . 8

REJOINDER TO TESTIMONY OF WILLIAM A. RIGSBY

"Sanity Check" – Schedule WAR-10 10

Conclusion Relative to Mr. Rigsby's Testimony . . . 12

II. EXHIBITS

	Exhibit
Rework of Staff Schedule JR-S1	PCC-1RJ

EXECUTIVE SUMMARY

Rejoinder to the Testimony of Joel M. Reiker

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

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

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

Rejoinder to the Testimony of William A. Rigsby

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

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

IDENTIFICATION OF WITNESS

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

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

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

A. Yes, I am.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

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

REJOINDER TO THE TESTIMONY OF JOEL M. REIKER

Market Value and Book Value

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

A. The fundamental difference is whether market values or book values of debt and equity should be utilized in estimating the opportunity cost of capital.

Mr. Reiker's position is that, since the opportunity cost of equity capital is applied to a book value rate base[1], the opportunity cost of capital must be estimated utilizing book values for proxy companies. Further, Mr. Reiker argues that unlevering betas with a market value capital structure and relevering at the book value capital structure for Qwest Corp introduces known inconsistencies.

My position is that financial theory and practice require the use of market or economic values where they are available. Greater inconsistency is introduced into the estimate of the opportunity cost of capital by utilizing book values for the proxy group capital structure than by straightforward application of financial theory to the accounting book value environment of the regulated entity.

Q. IN SUPPORT OF BOTH MEASURING AND APPLYING THE COST OF CAPITAL USING BOOK VALUES, MR. REIKER QUOTES A CLASSIC WORK BY PROFESSOR STEWART C. MYERS.[2] HOW DO YOU RESPOND?

---

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

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

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

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

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

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

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

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

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

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

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

Adjusted Betas

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

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

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

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

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

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

Reasonableness Check and Modigliani/Miller Theory

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

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

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

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

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

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

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

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

Modigliani, Franco and Miller, Merton H., "The Cost of Capital, Corporation Finance and the Theory of Investment" American Economic Review Volume XLVIII, June 1958, p.268.

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

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

Conclusions Relative to Mr. Reiker's Surrebuttal Testimony

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

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

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

[5] See Cummings Direct Testimony Exhibit PCC-3.

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

REJOINDER TO THE TESTIMONY OF WILLIAM A. RIGSBY

"Sanity Check" – Schedule WAR-10

Q. MR. RIGSBY'S SCHEDULE WAR-10 IS OFFERED AS A "SANITY CHECK" TO DEMONSTRATE THAT YOUR 21.4% COST OF EQUITY ESTIMATE FOR QWEST CORP IS NOT REASONABLE. DO YOU AGREE THAT THIS SCHEDULE MAKES SUCH A DEMONSTRATION?

A. No. I disagree with Mr. Rigsby's interpretation of the data presented in Schedule WAR-10. Most of the data presented in Schedule WAR-10 has no bearing on estimating the cost of capital for the 33 companies selected and the data that is relevant is supportive of the 21.4% cost of equity estimate in my direct testimony.

Q. WHAT DATA HAS NO BEARING ON ESTIMATING THE COST OF CAPITAL?

A. The following have no bearing on the cost of capital for the 33 companies in Schedule WAR-10:

Column F	Regulated Company Yes/No
Column G	Pct of Debt 2003 (book value)
Column H	Pct of Common Equity 2003 (book value)
Columns I – N	Value Line Estimated ROEs

Cost of capital is determined by the actions of buyers and sellers in the capital markets. Whether a company is regulated or not only affects the risks to investors and companies of similar risk have similar costs of capital. The historical book value of a company's debt and equity does not impact the price of its securities or the returns expected by investors which determine the cost of capital. Likewise, the

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

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

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

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

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

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

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

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

Conclusions Relative to Mr. Rigsby's Surrebuttal Testimony

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

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

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

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	DOCKET NO. T-01051B-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	DOCKET NO. T-00000D-00-0672

REJOINDER EXHIBITS

OF

PETER C. CUMMINGS

QWEST CORPORATION

JANUARY 27, 2005

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

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

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

Adjusted WACC

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

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

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

Adjusted WACC

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

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

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

Adjusted WACC

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

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

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF WASHINGTON)
) **ss** **AFFIDAVIT OF PETER C. CUMMINGS**
COUNTY OF KING)

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

1. My name is Peter C. Cummings. I am Director – Finance for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Peter C. Cummings

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

LORI L. WHITE NOTARY PUBLIC COMMISSION EXPIRES 7-10-07 STATE OF WASHINGTON

Lori L. White
Notary Public

My Commission Expires: 7/10/07

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-22 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman

WILLIAM A. MUNDELL
Commissioner

MARC SPITZER
Commissioner

MIKE GLEASON
Commissioner

KRISTIN K. MAYES
Commissioner

IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN	))))	DOCKET NO. T-01051B-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	))))	DOCKET NO. T-00000D-00-0672

REJOINDER TESTIMONY OF

PHILIP E. GRATE

ON BEHALF OF

QWEST CORPORATION

JANUARY 27, 2005

TABLE OF CONTENTS

TABLE OF CONTENTS i
SUMMARY OF REJOINDER TESTIMONY i
IDENTIFICATION OF WITNESS 1
PURPOSE OF TESTIMONY 1
QWEST'S FINANCIAL PERFORMANCE 2
CHANGES IN REGULATORY ACCOUNTING METHODS 8
Regulatory Accounting in Arizona 8
History of Accounting Method Changes in Arizona 9
Accounting for Internal-Use-Software (Staff B-6, C-11; RUCO RB#2, OA#4) . 12
Accounting for OPEBs (Staff B-8, C-1) 15
RATEMAKING METHODS 22
Method of Annualization 22
Staff Adjustments C-2, C-3, C-4 and C-5 29
RUCO Operating Adjustment #2 34
STAFF Adjustment C-16 35
Pro Forma Adjustment to Accrued Expenses (Staff B-7; RUCO RBA#1) 41
DISALLOWANCE STANDARDS 45
The Commission's Disallowance Standards 45
Incentive Compensation Costs (Staff C-17; RUCO OA#9) 68
Marketing and Advertising Costs (Staff C-9) 72
OTHER REVENUE REQUIREMENT ISSUES 82
DSL (Staff B-3, C-6) 82
BSI – Construction Related Charges (Staff B-4, C-7) 98
FCC Deregulated Products (Staff C-19) 101
Telephone Plant Under Construction (Staff B-5, C-7; RUCO RBA#3, OA#7) 107
Property Taxes (RUCO OA#8) 113
Pension Asset (RUCO RBA#5) 116
Accumulated Depreciation – Station Apparatus (RUCO RBA#4) 118

FUTURE REPORTING REQUIREMENTS 119
REVENUE REQUIREMENT 121

SUMMARY OF REJOINDER TESTIMONY

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

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

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

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

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

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

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

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

IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

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

A. Yes.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REJOINDER TESTIMONY?

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

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

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

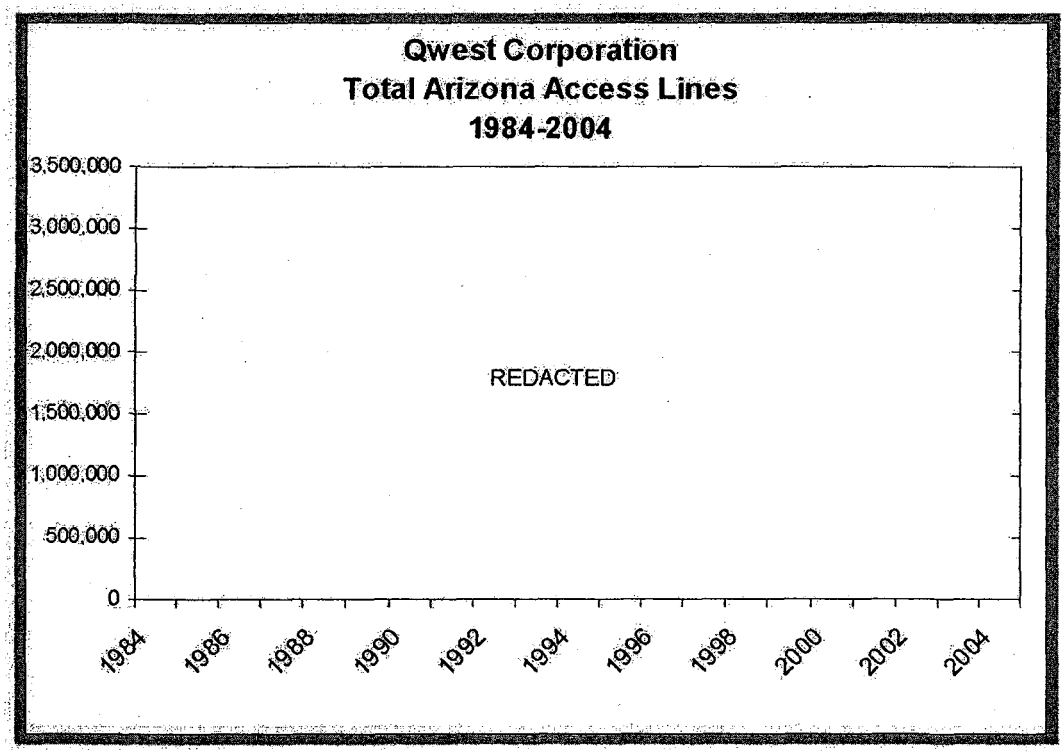
4 QWEST'S FINANCIAL PERFORMANCE

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

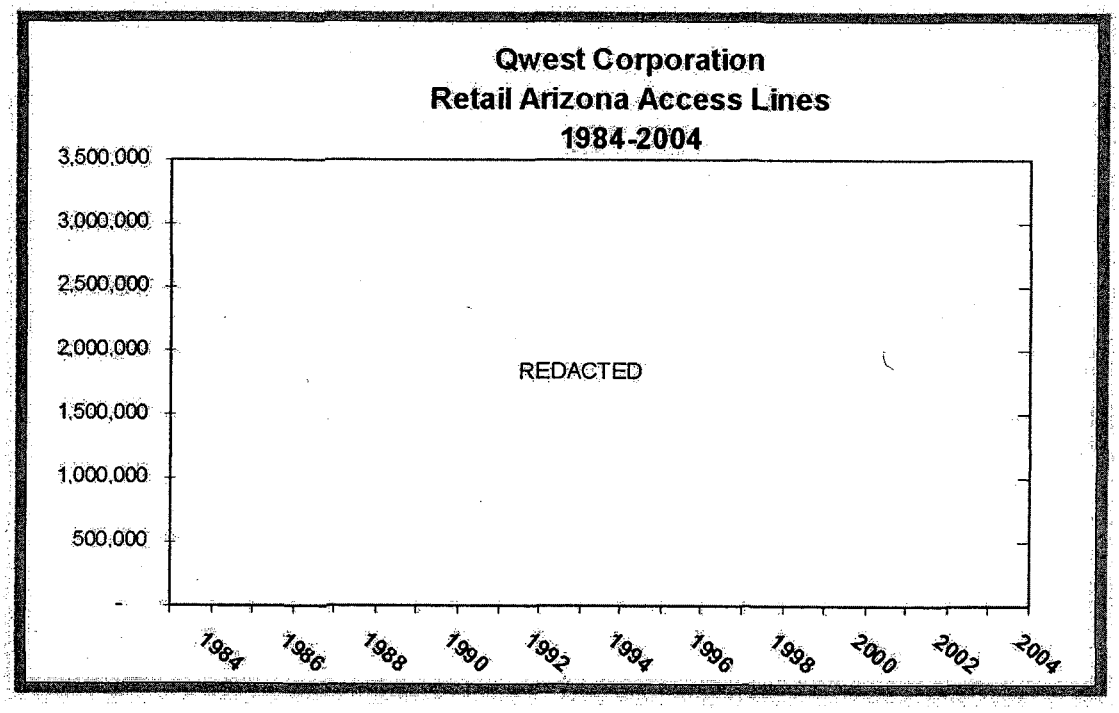
7 A. Mr. Brosch complains that the scale of the graph I presented on page 3 of my
8 rebuttal testimony visually amplifies the apparent trend in access line counts
9 and asserts that Qwest's REDACTED
10 REDACTED An understanding of the Company's access line history will help
11 the Commission put Qwest's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

12 It is my understanding that for over a century, interrupted only by the Great
13 Depression of the 1930's, the Company's access line count enjoyed REDACTED
14 REDACTED Since Qwest's retail access line count REDACTED
15 REDACTED the Company's access line count has REDACTED
16 REDACTED The following chart shows Qwest's
17 Arizona total (wholesale and retail) access line count over the past 20 years.

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



The chart shows that REDACTED REDACTED However, REDACTED REDACTED understates the effect of competition on Qwest's business because wholesale access lines are sold to Qwest's competitors. Hence, every wholesale access line represents direct retail competition for Qwest. The following graph of retail access lines more accurately reflects the effect of competition on Qwest's business because it excludes wholesale access lines sold to Qwest's competitors.



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

REDACTED

REDACTED

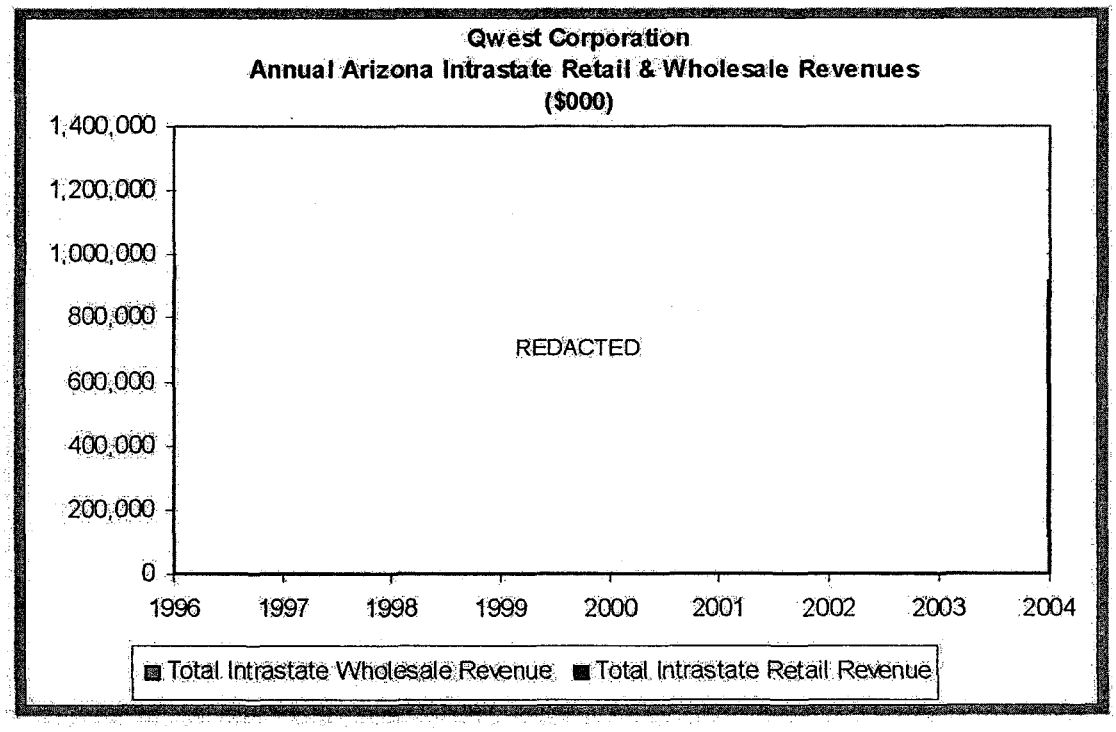
REDACTED

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

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

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

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



The graph shows REDACTED

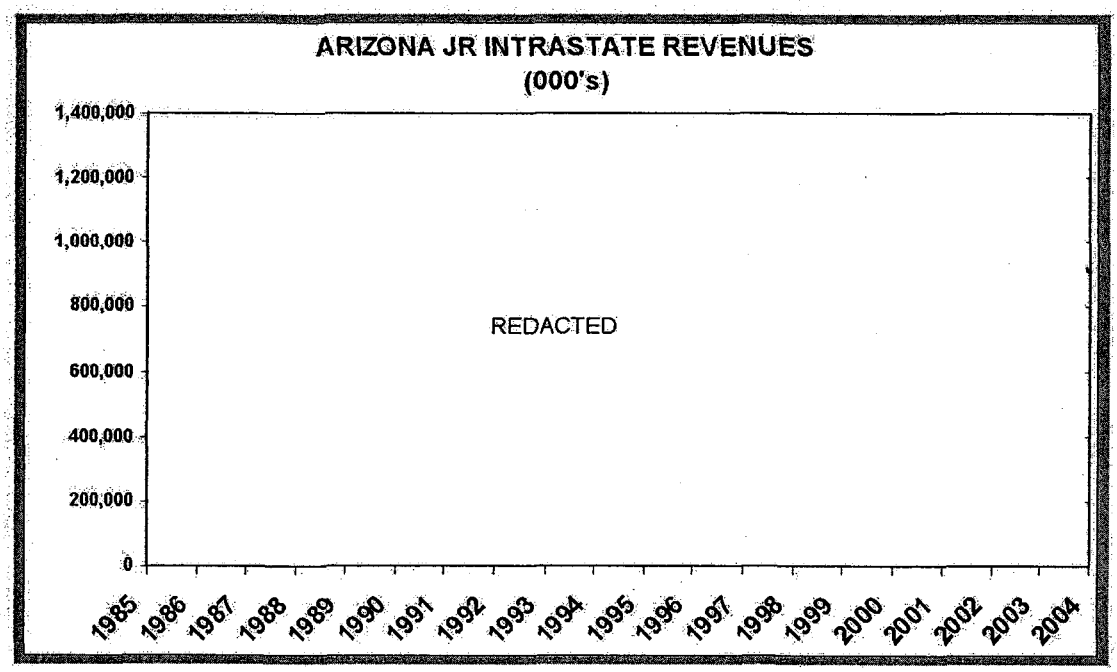
REDACTED

REDACTED

REDACTED

Q. REDACTED

A. Yes. The following graph shows Qwest's Arizona intrastate revenues over the past 20 years.

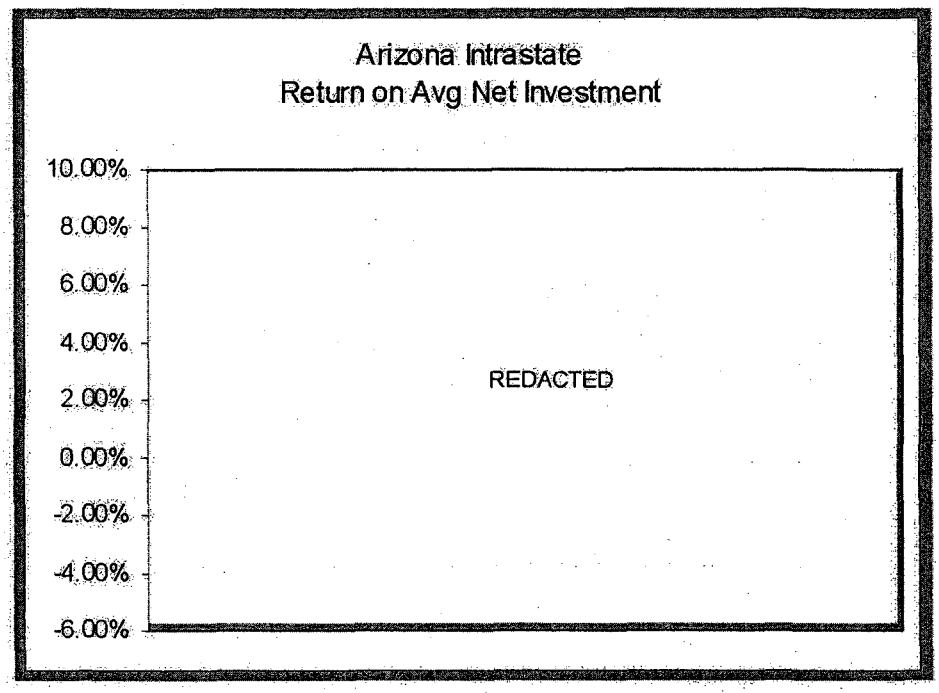


The graph shows that Qwest's total revenues (including retail and wholesale revenues) REDACTED

REDACTED

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

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



[3] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p.3. ll. 10-29.
[4] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p.3. ll. 11-12.

REDACT on the graph indicates REDACT

REDACTED

REDACTED

REDACTED

CHANGES IN REGULATORY ACCOUNTING METHODS

Regulatory Accounting in Arizona

Q. IN THIS CASE, WHAT IS THE REGULATORY ACCOUNTING ISSUE?

A. The issue is whether, absent an order from the Commission to the contrary, accounting method changes incorporated into the FCC's Uniform System of Accounts (USOA) are automatically incorporated into regulatory accounting and ratemaking in Arizona by operation of the Commission's own rule promulgated as AAC R14-2-510 G. In my rebuttal testimony I explained that the answer is "yes." In surrebuttal, Mr. Carver offers no facts or evidence showing that conclusion was incorrect. Consequently, there is nothing in his testimony to which I can offer substantive rejoinder.

Mr. Carver offers no substantive surrebuttal. Instead, he offers a variety of arguments that address subjects with no pertinence to the issue. Rather than congest the body of my rejoinder testimony with responses to "red herrings" I have prepared a separate discussion and analysis of nine arguments in Mr.

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

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

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

9 A. Yes. Staff had two complaints. The first was that my conclusion was
10 misleading because I did not discuss the testimony Mr. Carver filed in Docket
11 No. E-1051-88-146.[5]

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

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

[5] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 17, l. 28.
[6] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 12, l. 26.

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

2 A. Staff's second complaint is that my rebuttal testimony took out of context Mr.
3 Carver's testimony in Docket No. T-10510-99-105 that claimed Qwest had:
4 "previously sought regulatory approval and ratemaking treatment" for several
5 accounting method changes.[7] That Mr. Carver devotes six pages of
6 surrebuttal testimony to retrofit a meaning to those words[8] speaks for itself.
7 However, two observations about Mr. Carver's explanation are necessary.

8 The first observation is that Mr. Carver describes the accounting method
9 changes—adopted by USOA and automatically incorporated into Arizona
10 regulatory accounting by operation of Rule R14-2-105 G—as "ratemaking
11 adjustments the Company has included in its various R14-2-103 Filings over
12 the years."[9] (emphasis added) He considers these "ratemaking adjustments"
13 to be "requests for regulatory approval and ratemaking treatment"[10] despite
14 the absence of any mention of them in the Commission's decisions. He still
15 has not undertaken any "unnecessary research" that would substantiate his
16 claim.[11] Instead, he relies on his recollection, knowledge and belief that he
17 compiled a list of pro forma adjustments for accounting method changes that
18 he found in various R14-2-103 (Rule 103) Filings the Company made over the

[7] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 17, l. 28.
[8] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 13, l. 6 to p. 19, l. 5.
[9] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 17, l. 5.
[10] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 17, ll. 1-5.
[11] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 16, l. 23.

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

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

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

[12] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 16, l. 31 to p. 17, l. 1.
[13] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 17, ll. 14-19.

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

A. In response to the historical analysis of the adoption of ratemaking changes in Arizona and Exhibit PEG-R7[14] Mr. Carver's surrebuttal testimony argues that my rebuttal testimony is: 1) "misleading in its brevity" because it did not discuss the testimony Mr. Carver filed in Docket No. E-1051-88-146 (which complaint I addressed above); 2) takes Mr. Carver's testimony in Docket No. T-1051-99-105 out of context (also discussed above); and 3) is a red herring designed to distract attention from the revenue requirement effect of the adjustment (to be discussed below). However, none of Mr. Carver's testimony claims that my rebuttal testimony's analysis of the historical facts, or its conclusions concerning accounting method changes, are incorrect.

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

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

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

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

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

5 **Q. MR. CARVER'S TESTIMONY ASSERTS "MR. GRATE HAS TAKEN THE**
6 **POSITION THAT SOP 98-1 SHOULD HAVE BEEN ADOPTED FOR**
7 **ARIZONA REGULATORY ACCOUNTING PURPOSES" IN 1999.[15] IS HIS**
8 **UNDERSTANDING OF YOUR TESTIMONY CORRECT?**

9 A. No. My rebuttal testimony is not that SOP 98-1 should have been adopted in
10 1999 but rather that SOP 98-1 was adopted in 1999.[16] I also testified that
11 Qwest had notified the parties that Qwest's offbook accounting for internal-
12 use-software would be corrected to reflect 1999 adoption in Arizona and
13 several other states.[17]

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

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

[15] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 8, l. 21.
[16] Docket No. T-01051B-03-0454; Rebuttal Testimony of Philip E. Grate, p. 23, l.14 to p. 24, l. 2.
[17] Docket No. T-01051B-03-0454; Rebuttal Testimony of Philip E. Grate, p. 29, l. 15 to p. 30, l. 5.
[18] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 8, l. 22.

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

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

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

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

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

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

Q. STAFF'S CONSULTANTS CONTINUE TO MAINTAIN THAT THE ACCRUAL ACCOUNTING FOR OPEBS BEGAN FOR RATEMAKING PURPOSES IN 1999.[19] DO YOU HAVE ANY EVIDENCE TO SUGGEST THAT PRIOR TO YOUR FILING TESTIMONY IN THIS CASE STAFF'S CONSULTANTS BELIEVED ACCRUAL ACCOUNTING FOR OPEBS DID NOT YET APPLY TO QWEST?

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

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

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

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

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

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

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

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

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

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

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

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

1 **Q. DOES STAFF BELIEVE THE COMMISSION ISSUED AN ORDER**
2 **DIRECTING THE COMPANY TO CHANGE THE METHOD OF**
3 **ACCOUNTING FOR OPEBS IT ORDERED IN THE COMPANY'S 1994**
4 **RATE CASE?**
5 A. No. I apologize for misinterpreting Mr. Carver's testimony on this point. In
6 data request Qwest 10-17, Qwest asked Staff to identify the decision or order
7 where the Commission notified Qwest that it was authorized to use SFAS 106
8 to account for OPEBs. Staff's consultants responded: "Mr. Carver is not
9 aware of any decision or order of the ACC so notifying Qwest. Mr. Carver's
10 direct testimony in the current Docket does not claim that such a decision or
11 order has been issued." Unfortunately, I did not have an opportunity to read
12 Staff's reply to this question before preparing my rebuttal testimony or before
13 answering discovery Staff posed to Qwest on this question.

14 **Q. IF STAFF AGREES THERE IS NO ORDER DIRECTING THE COMPANY**
15 **TO ADOPT ACCRUAL ACCOUNTING WHY DOES STAFF BELIEVE**
16 **ACCRUAL ACCOUNTING FOR OPEBS WAS ADOPTED?**
17 A. Assuming I now correctly understand Mr. Carver's testimony, it is because
18 Qwest proposed that it be adopted in Qwest's last rate case and Staff did not
19 oppose such adoption. Mr. Carver believes that despite Mr. Carver's
20 vigorous opposition to accrual accounting for OPEBs in Qwest's 1994 rate
21 case, Staff's silence in the next rate case signaled Staff' agreement with

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

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

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

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

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

3 A. Yes. The consultants' current position appears to contradict the position they
4 took in Qwest's 1994 rate case. Under cross examination in Docket No.
5 E-1051-93-183, Mr. Brosch was asked about his understanding of a passage
6 of Mr. Carver's direct testimony[23] concerning a rate case stipulation:

7 Q. * * * Do you agree with Mr. Carver's position?
8 A. Yes, I agree with his position.
9 Q. And what are you agreeing to?
10 A. It's my impression that in the context of a stipulated case, **if either**
11 **party desires a finding or a conclusion that can be relied upon in**
12 **subsequent proceedings, that finding or conclusion needs to be set**
13 **out as part of the stipulation**. And in particular, whether it's language
14 that expressly states that parties are not reaching any specific finding or
15 conclusion of precedential value, no one should rely upon it for that
16 purpose.[24] (emphasis added)

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

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

[23] The testimony of Mr. Carver about which Mr. Brosch was being questioned can be found on page 8 of the Direct Testimony of Steven C. Carver, in ACC Docket No. E-1051-93-183.
[24] Transcript from ACC Docket No. E-1051-93-183, dated 6/3/94, page 3201, line 22 to page 3202, line 6.

1 **"UNFORTUNATE OVERSIGHT."[25] DO YOU AGREE THAT IT WAS AN**
2 **OVERSIGHT?**
3 A. No. If the 1997 Southwest Gas Corporation settlement (to which Staff was a
4 party) included language explicitly adopting accrual accounting for OPEBs,
5 then clearly the settlement agreement between Staff and Qwest in the
6 Company's last rate case could have too. Given that in 1994 Mr. Brosch
7 gave testimony that he and Mr. Carver believed that "if either party desires a
8 finding or a conclusion that can be relied upon in subsequent proceedings,
9 that finding or conclusion needs to be set out as part of the stipulation," I
10 cannot accept Mr. Carver's claim that the omission was an oversight,
11 particularly where Mr. Carver and Mr. Brosch were Staff's consultants in the
12 docket in which the Settlement Agreement was reached.

13 **Q. SHOULD THE COMMISSION ADOPT STAFF'S PROPOSED**
14 **ADJUSTMENTS FOR OPEBS?**
15 A. No. Staff is the only party that takes the position accrual accounting for
16 OPEBs was adopted for ratemaking purposes in 1999. Staff, RUCO and
17 Qwest agree that the Settlement Agreement did not provide for adoption of
18 accrual accounting for OPEBs and that the Commission did not order Qwest
19 to adopt accrual accounting for OPEBs in 1999. Adjustments B-8 and C-18
20 rely on language that could have been easily included in the settlement but

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

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

RATEMAKING METHODS

Method of Annualization

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

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

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

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

A. Six.[26]

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

A. One, which is Arizona.

Q. WHAT IS THE PURPOSE OF THE ANNUALIZATION ADJUSTMENT?

A. Given that Arizona ratemaking rules require the use of an end-of-test-year rate base, the purpose of the annualization adjustment is to synchronize test year revenues and expenses with an end-of-test-year rate base so that the revenue requirement calculation reflects the <u>same</u> test period for revenues, expenses and rate base.[27] In other words, because Arizona requires that rate

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

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

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

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

---

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

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

Q. WHAT IS THE GOAL OF THE ANNUALIZATION ADJUSTMENT?

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

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

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

> UTI will analyze decreasing as well as increasing cost of service components to determine whether test year **operating results** are **reasonable overall** and indicative of future events.[28] (emphasis added)
>
> * * *
>
> Annualized Sales and Revenue Levels – **Monthly revenue activity is analyzed** by FCC account during and subsequent to the test period, along with new product/service deployment plans, customer statistical data and other information **to determine a normalized, ongoing level of sales, and revenues** consistent with the cutoffs employed throughout the balance of the case (for example, year-end rate base). It is not uncommon for a utility to adjust revenues to eliminate prior period adjustments, cost

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

> study true-ups, sales of exchanges, and employee concession service. Notably, telephone companies often fail to adjust revenues to reflect end-of-period sales and revenue levels. **Our analyses will focus on assessing the reasonableness of the adjustments proposed by USWC and investigating available options to synchronize ongoing revenue levels with end-of-period rate base.**
>
> Price cap revenue changes and **the revenue impact of pricing flexibility must be analyzed and annualized** into the revenue requirement calculations. Qwest will undoubtedly propose ratemaking adjustments for price reductions that require verification and testing. UTI will also investigate offsetting volume impacts and instances where service bundling may distort the recorded amounts of regulated revenues.[29] (emphasis added)

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

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

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

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

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

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

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

[30] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 19, ll. 20-24.
[31] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 19, ll. 10-24.

1 **Q. MR. CARVER CLAIMS THAT YOU ADVOCATE ACHIEVING TEST YEAR**
2 **CONSISTENCY BY DEVELOPING AND BLINDLY APPLYING A SINGLE**
3 **MATHEMATICAL OR FORMULISTIC TECHNIQUE TO EACH AND EVERY**
4 **SIGNIFICANT ELEMENT OF THE INCOME STATEMENT.[32] IS THIS TRUE?**
5 A. No. Mr. Carver's claim is incorrect. I advocate the consistent application of a
6 sound annualization methodology as opposed to the piecemeal
7 methodological approach that Staff's consultants appear to prefer.

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

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

[32] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 24, l. 6.
[33] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 26, l. 17 to p. 27, l. 33.

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

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

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

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

10 Staff's approach in this case, as in all prior Arizona rate cases, is to
11 analyze available data to seek a **reasonable** annualization approach that
12 produces **reasonable results,** without constraining the analysis to a
13 particular methodology or algorithm. The differences in proposed
14 annualized revenues between Staff and Qwest regarding Access Charge
15 Revenues (Grate Rebuttal pages 48-50), Toll Service Revenues (Grate
16 Rebuttal page 50) and Directory Assistance Revenues (Grate Rebuttal
17 page 51) all have to do with Qwest's notion that one must rigidly apply the
18 same calculation algorithm to every single account, or a reasonable
19 annualization cannot be quantified.[34] (emphasis added)
20 * * *
21 Staff evaluated Mr. Grate's new regression approach and results and
22 accepted them in certain instances where the results were reasonable,
23 while making further adjustments if the results of Mr. Grate's new
24 approach were not reasonable.[35] (emphasis added)

[34] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 16, l. 29 to p. 17, l. 1.
[35] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 18, ll. 23-26.

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

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

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

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

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

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

Q. WHAT DID THE TEST REVEAL?

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

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

1

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

2
3 Note (1): Miscellaneous Revenue excludes FCC Deregulated Revenue and Rent Compensation
4 Revenue.

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

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

4 The annualization approach Staff's consultants used in this case (and which
5 Mr. Brosch asserts they have used in all prior Arizona rate cases[36]) was to
6 "analyze available data... without constraining the analysis to a particular
7 methodology or algorithm."[37] The test shows that this approach was less
8 reliable than the annualization approach Qwest used. Consequently—and
9 not surprisingly—the test proves that Qwest's consistent application of its
10 statistical regression analysis produced annualization results that were more
11 reasonable overall than the piecemeal annualization approach that Staff
12 employed.

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

[36] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 16, ll. 23-27.
[37] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 16, l. 29 to p. 17, l. 1.
[38] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 16, l. 29 to p. 17, l. 1.

RUCO Operating Adjustment #2

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

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

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

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

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

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

8 **STAFF Adjustment C-16**

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

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

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

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

4 **Q. MR. CARVER ASSERTS, "THE QUANTITIES AND PRICES THAT DRIVE**
5 **EXPENSES ARE DIFFERENT FROM REVENUES."[41] PLEASE RESPOND.**
6 A. It seems Mr. Carver still fails to grasp difference between exogenous
7 (external) variables and endogenous (internal) variables. Access lines and
8 customers are external (exogenous) variables that influence revenues and
9 costs. Exogenous variables are outside the direct control of the Company but
10 they do drive revenues and, ultimately, costs. Through advertising, service
11 quality and other means, the Company tries to influence the number of
12 customers that buy its products.

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

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

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

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

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

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

1 **Q. MR. CARVER ASSERTS, "MR. GRATE WOULD HAVE THIS**
2 **COMMISSION BLINDLY ENDORSE AND ADOPT A COMMON**
3 **APPROACH FOR THE SAKE OF CONSISTENCY AND IGNORE KNOWN**
4 **AND MEASURABLE CHANGES."[43] PLEASE COMMENT**
5 A. This assertion is incorrect. I am not suggesting the Commission blindly
6 endorse anything. As I have already explained, because of the unique test-
7 year construction in Arizona that relies on an end-of-test-period rate base, I
8 believe the Commission should establish and communicate a policy that
9 requires those who propose annualization adjustments to show that they are
10 1) applying a technically defensible methodology and 2) they are applying it
11 consistently to all elements of operating results, not just a few as Staff's
12 adjustment C-16 does.

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

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

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

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

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

13 **Q. MR. CARVER ARGUES IT IS "INAPPROPRIATE TO RECOGNIZE AN**
14 **ANNUALIZATION ADJUSTMENT FOR WAGE RATE LEVELS (PRICES)**
15 **THAT INCREASE DURING THE TEST YEAR AND IGNORE QWEST'S**
16 **DOWNWARD TREND IN EMPLOYEE STAFFING LEVELS (QUANTITIES)**
17 **THAT OCCURRED DURING THE TEST YEAR."44 PLEASE RESPOND.**
18 A. Mr. Carver's assumption—that Qwest's regression analysis of expenses
19 ignored the downward trend in employee staffing levels—is incorrect. The

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

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

3 **Q. MR. CARVER CLAIMS THAT REGULATORS TYPICALLY DO NOT**
4 **PREDETERMINE SPECIFIC RATEMAKING METHODOLOGIES,**
5 **PRACTICES OR APPROACHES.[45] PLEASE RESPOND.**
6 A. I am not suggesting that the Commission to prescribe a particular
7 annualization methodology. However, I do believe the Commission should
8 expect the parties to apply a sound methodology consistently instead of using
9 a piecemeal, scattershot approach.

10 **Q. MR. CARVER ARGUES UTILITECH HAS SOUGHT TO CONSISTENTLY**
11 **ANNUALIZE KNOWN AND MEASURABLE CHANGES IN ARIZONA RATE**
12 **CASE PROCEEDINGS. DO YOU AND HE DISAGREE ON THE MEANING**
13 **AND APPLICATION OF THE CONSISTENCY CONCEPT?[46]**
14 A. Indeed we do. I believe annualization is more reliable when one applies a
15 sound methodology consistently to all significant revenue and expense
16 accounts. Mr. Carver consistently applies the same piecemeal approach in
17 all rate cases. Consistently using an inferior approach does not make the
18 approach correct.

---

[45] Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 22, ll. 22-24.
[46] Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 27, l. 35 to p. 28, l. 2.

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

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

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

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

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

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

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

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

* * *

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

* * *

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

* * *

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

[47] Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 36, l. 21-25 quoting Direct Testimony of same witness page 26, ll. 21-24.
[48] Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 36, ll. 29-38.
[49] Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 37, ll. 18-21.
[50] Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 37, ll. 28-30.

approach, regardless of the rate base impact (i.e., increasing or decreasing rate base).[51]

Q. WHAT IS YOUR ANALYSIS OF THIS REASONING?

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

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

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

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

A. Ms. Diaz Cortez argues:

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

Q. IS THIS ARGUMENT CORRECT?

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

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

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

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

DISALLOWANCE STANDARDS

The Commission's Disallowance Standards

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

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

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

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

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

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

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

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

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

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

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

A. Yes. Except during the Great Depression, the Company and its predecessors in Arizona enjoyed continuous access line growth for the first 120 years that the Company did business in Arizona. REDACTED

REDACTED

even as Arizona's population grew. Given Qwest's long history of continuous access line growth, nothing except robust retail competition adequately explains how Qwest could REDACTED

REDACTED particularly in a state with a rapidly growing population.

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

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

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

13 **Q. WHY DOES STAFF BELIEVE THAT, DESPITE A PROFOUND GROWTH IN**
14 **COMPETITION, MONOPOLY-ERA POLICIES DISALLOWING IMAGE**
15 **ADVERTISING AND INCENTIVE COMPENSATION SHOULD CONTINUE**
16 **TO BE APPLIED TO QWEST IN THIS CASE?**
17 A. In response to discovery on this question, Mr. Brosch explained: "Qwest is
18 distinct from its non-regulated competitors in being subject to cost of service

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

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

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

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

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

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

[56] Staff's response to data request No. Qwest 15-2(e) (2).
[57] Staff's response to data request No. Qwest 15-3.

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

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

REDACTED

REDACTED

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

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

[58] Webster's Ninth New Collegiate Dictionary, © 1984, Merriam-Webster, Inc.
[59] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-8 and 22-9.

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

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

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

1 **Q. STAFF'S CONSULTANTS MAINTAIN THAT THE COMMISSION'S**
2 **DECISION IN A PARTICULAR RATE CASE MUST BE BASED ON THE**
3 **UNIQUE FACTS, CIRCUMSTANCES AND EVIDENCE OF THAT CASE.[60]**
4 **DO YOU AGREE?**
5 A. Yes. The revenue requirement should be determined based on the particular
6 facts and circumstances attendant to the case. In the current case, whether
7 any of Qwest's test year costs should be disallowed must be determined by
8 the facts and circumstances that exist now, not the facts and circumstances
9 of the past.

10 **Q. STAFF'S CONSULTANTS ALSO CONTEND THAT THE COMMISSION**
11 **NEED NOT ESTABLISH SPECIFIC "DISALLOWANCE STANDARDS" TO**
12 **GOVERN THE DISALLOWANCE OF UTILITY COSTS.[61] HOW DO YOU**
13 **RESPOND?**
14 A. As either a ratepayer or as an investor I would find this viewpoint troubling.
15 Mr. Brosch claims that the Commission "need not predetermine any specific
16 disallowance standards so as to better protect investor interests."[62] Instead,
17 he asserts that "the Commission is only required to consider and weigh all
18 relevant evidence before determining whether any specific utility-incurred

[60] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 23, ll. 7-8.
[61] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 4, ll. 23-25.
[62] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 4, ll. 23-25

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

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

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

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

1 **Q. DOES STAFF RELY ON ANY ADMINISTRATIVE RULE OR JUDICIAL**
2 **OPINION TO SUPPORT ITS PROPOSED DISALLOWANCE OF IMAGE**
3 **ADVERTISING AND INCENTIVE COMPENSATION?**
4 A. No. According to Mr. Brosch, "Staff is not relying upon any administrative rule
5 or judicial opinion in support of its proposed treatment of corporate image
6 advertising or incentive compensation..."[64] He points out that there is no
7 Commission rule that would "presume costs are reasonable" or that would
8 impose a "clear and convincing evidence" standard upon Staff in support of
9 proposed disallowances.

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

[64] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 8, ll. 20-23.
[65] Arizona Administrative Code R 14-2-103 (I).

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

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

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

[66] Docket No. E-1051-84-100, Decision No. 54843 page 20, line 4.
[67] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-1.
[68] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-3(a).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[71] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 8, ll. 26-30.
[72] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 43, ll. 22-24.

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

Q. WHY DO YOU SAY STAFF'S CHALLENGES ARE ARBITRARY AND BASED ON NO PARTICULAR DISALLOWANCE STANDARD?

A. In discovery Qwest asked Staff if any of the "other criteria" described in the direct testimony filed on behalf of Staff relied on a standard of disallowance that compares Qwest's costs to commercially reasonable costs (i.e. costs that would be considered reasonable and prudent by competent managers of unregulated large commercial enterprises). Staff's answer was in the negative.[73]

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

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

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

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

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

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

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

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

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

---

[75] These include:

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

[76] These include:

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

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

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

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

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

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

[77] Docket No. T-01051B-03-0454; Direct Testimony of Michael L. Brosch, p. 9, ll. 17-19.
[78] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 23, ll. 7-8.
[79] Docket No. E-1051-84-100, Decision No. 54843 page 20, line 4.

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

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

---

[80] Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 43, ll. 11-13 quoting Direct Testimony of Steven C. Carver, p. 40.
[81] Docket No. T-01051B-99-105, Direct Testimony of Steven C. Carver, p. 106 ll. 15-18. Docket No. E-01345A-03-0437, Direct Testimony of James R. Dittmer, p. 37, l. 35 to p. 38, l. 1. Docket No. E-01345A-03-0437, Direct Testimony of Steven C. Carver, p. 63 ll. 18-20. Docket No. E-1051-93-183, Direct Testimony of Michael L. Brosch, p. 127, l. 11 which reads: "In my opinion, legislative affairs cost do not provide tangible benefits to telephone ratepayers, sufficient to justify the recovery..."

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

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

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

[82] Docket No. T-01051B-03-0454; Direct Testimony of Philip E. Grate, pp. 21-22.
[83] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 7, l. 17 to p. 8, l. 9.

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

14 **Q. DO YOU AGREE?**

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

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

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

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

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

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

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

15 Q....Is "direct tangible benefit to ratepayers" the <u>sole</u> criteria used by
16 Utilitech to determine which operating expenses should be allowed or
17 disallowed?
18 A. No.[85]

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

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

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

10 **Q. DOES STAFF HAVE ANY EVIDENCE THAT IN ESTABLISHING REVENUE**
11 **REQUIREMENT UNDER COST OF SERVICE RATEMAKING, THE**
12 **FEDERAL COMMUNICATIONS COMMISSION DISALLOWS TEST YEAR**
13 **COSTS FOR THE REASON THAT THE DISALLOWED COSTS PROVIDE**
14 **RATEPAYERS NO DIRECT TANGIBLE BENEFIT?**
15 A. No.[87]

16 **Q. DO YOU HAVE ANY OTHER COMMENTS ABOUT UTILITECH'S**
17 **ANALYSIS CRITERIA?**
18 A. Mr. Brosch explains that Utilitech analyzes utility expenses for disallowance in
19 "many different ways."[88] Qwest is concerned whether these many ways serve

[86] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 43, l. 11
[87] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-9.

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

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

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

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

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

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

---

[88] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 7, ll. 4-5.
[89] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-4.
[90] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 25-5.

1 **Q. DOES STAFF HAVE EVIDENCE TO SHOW THAT QWEST'S**
2 **UNADJUSTED REVENUE REQUIREMENT BASED ON THE 2003 TEST**
3 **YEAR WOULD HAVE BEEN GREATER HAD THE AMOUNTS PAID OUT**
4 **UNDER THE 2003 BONUS PLAN BEEN PAID INSTEAD AS BASE**
5 **SALARY?**
6 A. According to Staff's response to discovery, the answer is no.[91]

7 **Q. DOES STAFF HAVE EVIDENCE TO SHOW THAT THE LEVEL OF**
8 **QWEST'S MANAGEMENT COMPENSATION, INCLUDING BASE SALARY,**
9 **INCENTIVE COMPENSATION AND NON-CASH BENEFITS IN THE TEST**
10 **YEAR, WAS UNREASONABLE WHEN COMPARED WITH THE LEVELS**
11 **OF COMPENSATION PAID IN THE PREVAILING LABOR MARKET IN THE**
12 **UNITED STATES?**
13 A. According to Staff's response to discovery, the answer is no.[92]

14 **Q. DOES STAFF AND ITS CONSULTANTS HAVE EVIDENCE TO SHOW**
15 **THAT QWEST EMPLOYEES' PURSUIT OF 2003 BONUS PLAN**
16 **PERFORMANCE TARGETS CAUSED RATEPAYERS DIRECT TANGIBLE**
17 **HARM?**
18 A. According to Staff's response to discovery, the answer is no.[93]

---

[91] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-6.
[92] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-7.
[93] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-9.

1 **Q. DOES MR. CARVER'S DIRECT OR SURREBUTTAL TESTIMONY SHOW**
2 **THAT THE INCENTIVE COMPENSATION EXPENSE IN QWEST'S TEST**
3 **YEAR IS COMMERCIALLY UNREASONABLE?**
4 A. No.

5 **Q. DOES MR. CARVER'S DIRECT OR SURREBUTTAL TESTIMONY SHOW**
6 **THAT THE INCENTIVE COMPENSATION EXPENSE IN QWEST'S TEST**
7 **YEAR IS INJURIOUS TO RATEPAYER INTERESTS?**
8 A. No. None of the reasons Mr. Carver argues for disallowing Qwest's incentive
9 compensation costs explain how they represent a utility's financial exploitation
10 of its position in the marketplace from which ratepayers require protection.

11 **Q. WAS QWEST OBLIGATED UNDER AN AGREEMENT WITH ITS UNIONS**
12 **TO PAY THE INCENTIVE COMPENSATION COSTS TO ITS UNION**
13 **EMPLOYEES?**
14 A. Yes. The letter of agreement between the Communications Workers of
15 America and the Company provided—in its entirety—as follows:

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

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

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

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

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

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

[94] Qwest Corporation—Exhibit PEG-R12.
[95] Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz Cortez, p. 14, ll. 10-12.

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

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

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

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

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

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

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

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

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

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

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

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

Arizona Advertising Costs by Category ($000)

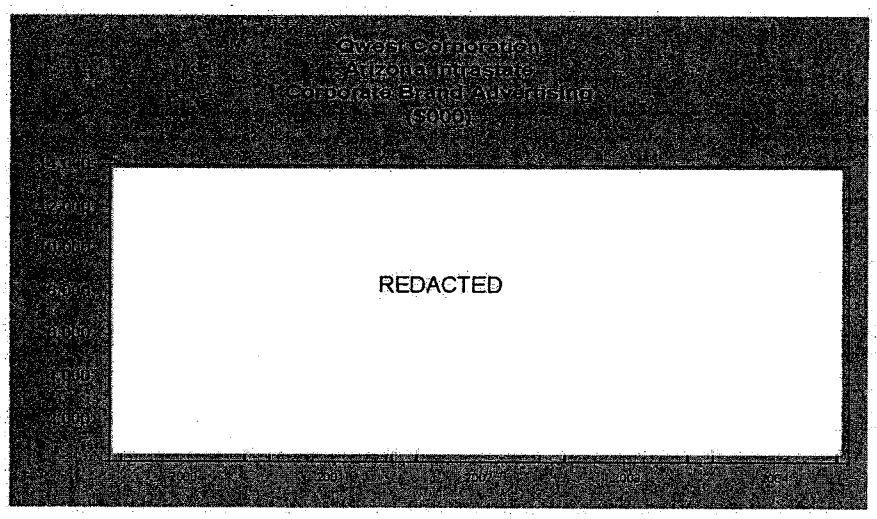
2000	2001	2002	2003*	Oct 2004 Annualized
REDACTED				
REDACTED				
REDACTED				

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

10 Corporate Brand Advertising is much larger in the 2003 test year than in
11 2002, as Qwest's financial difficulties, accounting investigations and senior
12 management turnover started to be widely publicized. Brand Advertising
13 expenses are also slightly higher in 2003 than the average expense levels
14 for 2000 through 2002.[98]

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

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



The graph reveals that corporate brand (image) advertising in 2003 was greater than 2002, just as Mr. Brosch claims. However, it also reveals that image advertising costs in 2002 were REDACTED REDACTED REDACTED

Q. WHY WERE QWEST'S IMAGE ADVERTISING COSTS SO MUCH LESS IN 2002?

A. I am not certain of the reasons for the unusually low level of image advertising costs in 2002 but I would note that in June, 2002 Richard C. Notebaert replaced Joseph P. Nacchio as Qwest's chairman and chief executive officer. Under Mr. Notebaert, the Corporation changed its brand image from a technology focus with its "ride the light" slogan to a commitment to "The Spirit

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

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

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

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

1 **Q. DOES MR. BROSCH BELIEVE THAT ARIZONA REGULATORY**
2 **JURISPRUDENCE IMPOSES ON THE UTILITY THE BURDEN OF PROOF**
3 **TO SHOW WHY IMAGE ADVERTISING SHOULD NOT BE DISALLOWED**
4 **AND PERMITS DISALLOWANCE OF IMAGE ADVERTISING IN**
5 **RATEMAKING UNLESS A UTILITY MEETS A BURDEN OF PROVIDING**
6 **ECONOMIC JUSTIFICATION FOR IT?**
7 A. Qwest asked these questions in discovery. Mr. Brosch declined to provide
8 any opinion in response.[100]

9 **Q. DO STAFF'S CONSULTANTS BELIEVE THAT ARIZONA REGULATORY**
10 **JURISPRUDENCE IMPOSES ON THE UTILITY THE BURDEN OF**
11 **PROVING THAT ITS IMAGE ADVERTISING IS EFFECTIVE, THE BURDEN**
12 **OF PROVING THAT ITS IMAGE ADVERTISING IS REASONABLE AND**
13 **THE BURDEN OF PROVING THAT ITS IMAGE ADVERTISING IS COST**
14 **EFFECTIVE.**
15 A. Qwest asked these questions in discovery. Mr. Brosch declined to provide
16 any opinion in response.[101]

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

---

[100] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-5 and 22-6(a).
[101] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(b), (c) and (d).

EXPENDITURES WERE COMMERCIALLY UNREASONABLE OR WASTEFUL OR IMPRUDENT?

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

Q. HAS STAFF OFFERED SUBSTANTIAL COMPARATIVE DATA SHOWING THAT QWEST'S TEST YEAR IMAGE ADVERTISING EXPENDITURES WERE COMMERCIALLY UNREASONABLE OR WASTEFUL OR IMPRUDENT OR INEFFECTIVE?

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

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

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

---

[102] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(e).
[103] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(f).
[104] *See* Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(g).

1 **Q. DOES STAFF KNOW PRECISELY THE STANDARD OF REVIEW THAT**
2 **APPLIES TO THE INCLUSION OF AN ARIZONA UTILITY'S IMAGE**
3 **ADVERTISING IN CALCULATING THE COST OF SERVICE FOR**
4 **PURPOSES OF ESTABLISHING REVENUE REQUIREMENT?**
5 A. Qwest asked Staff this question in discovery. Staff indicated that it did not
6 know what the precise standard of review was.[105]

7 **Q. DOES STAFF KNOW WHAT BURDEN OF PROOF ARIZONA UTILITIES**
8 **MUST BEAR IN ORDER TO INCLUDE IMAGE ADVERTISING COSTS IN**
9 **THE CALCULATION OF COST OF SERVICE FOR PURPOSES OF**
10 **ESTABLISHING REVENUE REQUIREMENT?**
11 A. Qwest asked Staff this question in discovery. Staff did not answer the
12 question asked but instead reiterated its position that Qwest must "convince
13 the Commission that changed circumstances now warrant revision of past
14 regulatory policy in Arizona that excluded corporate image advertising costs.
15 Staff offered no authority in support of its position.[106]

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

---

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

1 **IMPROVES OVERALL PRODUCT AWARENESS WITHIN AN**
2 **ENTERPRISE'S CUSTOMER BASE.[107] PLEASE RESPOND.**
3 A. Utilitech and I agree, the Commission's decision in a particular rate case must
4 be based on the unique facts, circumstances and evidence of that case.[108] In
5 1993, when Qwest voluntarily removed image advertising from its Rule 103
6 filing, the facts and circumstances pertinent to advertising were markedly
7 different. Specifically, the Commission had not determined that the local
8 markets for telephone service are open to competition in Arizona. The
9 Company was not competing head-to-head with a variety of competitors (who
10 are well documented in Mr. Teitzel's testimony). The Company was not
11 providing REDACTED wholesale access lines to its competitors and REDACTED
12 REDACTED

13 In Mr. Brosch's direct testimony the conclusion—that the Commission's
14 decision in a particular rate case must be based on the unique facts,
15 circumstances and evidence of that case—did not appear to extend to image
16 advertising. Instead, he concluded, "It is not reasonable to burden ratepayers
17 of regulated services with corporate image advertising costs simply because
18 markets have become more competitive" because "there has always been a
19 degree of competition facing many of Qwest's regulated products and
20 services." Instead of urging the Commission to consider the unique facts,

[107] Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 11, ll. 10-22.
[108] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 23, ll. 7-8.

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

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

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

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

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

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

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

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

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

OTHER REVENUE REQUIREMENT ISSUES

DSL (Staff B-3, C-6)

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

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

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

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

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

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

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

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

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

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

Simply put, the FCC limited changes in "directly assigned" costs to changes in the level (increase or decrease) of directly assigned costs that were already being studied and/or directly assigned prior to the initiation of the freeze. Paragraph 23 clearly limits the direct assignment of costs to those costs that were "directly assigned in the past"—that is, being directly assigned prior to the freeze date. Taken in full context, Paragraph 23 of the Freeze Order confirms this conclusion:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

[120] See, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, FCC 01 – 162, CC, Docket No. 80-286 Adopted: May 11, 2001, Released: May 22, 2001at ¶12, which states: "Since the *NPRM* was released in 1997, there have been rapid changes in the telecommunications infrastructure, such as the growth in Internet usage and the increased usage of packet switching. We believe that these types of changes may produce cost shifts in separations results because these and other new technologies, such as digital subscriber line (DSL) services, as well as a competitive local exchange marketplace, are not sufficiently contemplated by the current Part 36 rules. We believe, therefore, that the most effective action at this time will be to freeze the separations process on an interim basis, until the Commission and the Joint Board have had the opportunity to more comprehensively reform Part 36."
[121] Separations Joint Board "Glide Path," a paper entitled *Options for Separations, A Paper Prepared by the State Members of the Separations Joint Board*, Approved December 17, 2001, page 2
[122] *Ibid*, pp. 4-6.

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

Q. MR. DUNKEL CLAIMS "WE HAVE THE DSL INVESTMENT FIGURES WE NEED FOR THE ADJUSTMENT STAFF PROPOSES."[123] IS HE CORRECT?

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

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

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

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

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

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

A. Yes. The FCC also clearly stated its intentions to assess solutions to this and other technology issues in future Separations Reform proceedings. Specifically, in its Separations Freeze order the FCC stated[124]:

> .... The interim freeze will be in effect for five years or until the Commission has completed comprehensive separations reform, whichever comes first. We further conclude that several issues, including the separations treatment of Internet traffic, should be addressed in the context of comprehensive separations reform. (Emphasis added)
>
> Since the NPRM was released in 1997, there have been rapid changes in the telecommunications infrastructure ... We believe that these types of changes may produce cost shifts in separations results because these and other new technologies, such as digital subscriber line (DSL) services, as well as a competitive local exchange marketplace, are not sufficiently contemplated by the current Part 36 rules. *(Emphasis added)*

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

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

FREEZE PERIOD.[125] ARE THE NECA INSTRUCTIONS MR. DUNKEL CITES PERTINENT TO QWEST OR THIS PROCEEDING?

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

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

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

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

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

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

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

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

---

[126] See, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, FCC 01 – 162, CC, Docket No. 80-286 Adopted: May 11, 2001, Released: May 22, 2001, at ¶ 23, which states: Similarly, we find that in order to relieve all carriers of performing traffic or relative - use studies for separations purposes, all allocation factors used to assign Part 36 categories, subcategories, or further subdivisions to the state or interstate jurisdictions shall be frozen utilizing the factors calculated for the calendar year 2000.
[127] Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p. 29, l.19 to p. 30, l. 15.
[128] Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p. 30, ll. 6-7.

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

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

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

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

[129] Even the Courts refer matters to the FCC, under the doctrine of primary jurisdiction, when issues arise with respect to the meaning of a FCC rule or order in a given case.
[130] Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p. 30, l. 5.

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

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

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

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

15
16
17
18
19 REDACTED
20
21
22
23

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

REDACTED

Q. WHY DO YOU AGREE WITH THOSE CONCLUSIONS?

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

Q. WHAT WAS THE TASK FORCE'S CONCLUSION?

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

REDACTED

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

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

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

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

Q. WHAT IS THE CORRECT TEST YEAR ADJUSTMENT?

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

REDACTED

REDACTED

REDACTED

REDACTED

REDACTED

REDACTED

REDACTED

REDACTED

REDACTED

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

REDACTED

A. REDACTED

REDACTED

FCC Deregulated Products (Staff C-19)

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

A. Yes. Mr. Carver argues:

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

Q. DO YOU AGREE?

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

[133] Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel, p. 20, ll. 1-3.
[134] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 47, ll. 21-27.

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

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

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

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

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

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

- Errors discovered in Qwest adjustment PFN-O1, Out of Period Revenues and Expenses
- Omission of adjustment PFN-09, Call Centers (an adjustment FCC deregulated revenue)
- Failure to remove the portion of adjustments PFN-01 and PFN-03 related to FCC deregulated products in Arizona price cap Baskets and Voice Messaging.

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

Q. PLEASE EXPLAIN THE ERRORS DISCOVERED IN QWEST ADJUSTMENT PFN-O1, OUT OF PERIOD REVENUES AND EXPENSES.

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

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

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

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

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

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

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

Q. WHAT IS THE RESULT OF THESE CORRECTIONS?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

REALIZED AFTER THE CONSTRUCTION PROJECTS ARE COMPLETED AND PLACED IN SERVICE.[137] HOW DO YOU RESPOND?

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

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

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

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

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

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

---

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

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

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

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

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

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

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

Q. MR. CARVER ARGUES "THE COMMISSION SHOULD FOCUS ATTENTION ON THE REAL IMPACT OF THE COMPANY'S RECOMMENDATION ON OVERALL REVENUE REQUIREMENT..."[140] DO YOU AGREE.

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

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

---

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

1 **Q. IN SURREBUTTAL MS. DIAZ CORTEZ ARGUES THAT UNLESS THERE**
2 **IS A RATE CASE EACH YEAR, THE RATE BASE VALUE WILL REMAIN**
3 **UNCHANGED AND THE COMPANY WILL CONTINUE TO EARN ON THE**
4 **UNDEPRECIATED VALUE OF THE TPUC.[141] HOW DO YOU RESPOND?**
5 A. This argument is another illustration of Ms. Diaz Cortez's confusion about the
6 relationship between the rate base in a test year and the recovery of rate
7 base through depreciation. I addressed this misunderstanding in rejoinder to
8 Ms. Diaz Cortez's surrebuttal regarding RUCO's Rate Base Adjustment #1,
9 Accumulated Depreciation. For economy's sake, I will not repeat that
10 explanation here. Ms. Diaz Cortez's argument is incorrect and adjustment
11 RUCO's proposed Rate Base Adjustment #3 – Construction Work in Progress
12 and Operating Adjustment #7 – AFUDC Offset Adjustment should be
13 rejected.

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

15 **Q. IN REBUTTAL YOU EXPLAINED THAT MS. DIAZ CORTEZ'S PROPERTY**
16 **TAX CALCULATION WAS INCORRECT. DOES SHE AGREE?**
17 A. No. She continues to claim that her calculation properly utilizes the formula the
18 Arizona Department of Revenue (ADOR) uses to calculate property taxes.[142]

[141] Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz-Cortez; p. 4.
[142] Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz Cortez; p. 12.

1 **Q. MS. DIAZ CORTEZ CLAIMS THAT BY UTILIZING THE TEST YEAR**
2 **ADJUSTED NET PLANT IN HER CALCULATION SHE CAPTURED ONLY**
3 **THE PROPERTY TAX RELATED TO REGULATED ARIZONA**
4 **JURISDICTIONAL PLANT. IS SHE CORRECT?**
5 A. No. Qwest Corporation's property tax assessment (full cash value) is
6 determined by the ADOR based on a detailed reporting of Qwest assets by
7 class, vintage year and un-depreciated historical book cost of all the Arizona
8 property (including construction work in progress and materials & supplies);
9 and then depreciated at statutorily prescribed rates (not Commission
10 prescribed rates) to a minimum residual value of 20%. For Arizona property
11 tax purposes, the 20% residual value is carried for as long as the property
12 value remains on the books.

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

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

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

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

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

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

FUTURE REPORTING REQUIREMENTS

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

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

Q. ARE ALL OF THE ADJUSTMENTS THAT STAFF PROPOSES TO QWEST'S UNADJUSTED RESULTS OF OPRATIONS CORRECT?

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

- Accrual basis accounting for OPEBs per Carver testimony;
- SOP 98-01 accounting for software per Carver testimony; and
- FCC Nonreguated Services revenue imputation.

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

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

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

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

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

REVENUE REQUIREMENT

Q. HAS QWEST UPDATED ITS CALCULATION OF REVENUE REQUIREMENT SINCE YOUR REBUTTAL TESTIMONY WAS FILED?

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

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman

WILLIAM A. MUNDELL
Commissioner

MARC SPITZER
Commissioner

MIKE GLEASON
Commissioner

KRISTIN K. MAYES
Commissioner

IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN	DOCKET NO. T-01051B-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	DOCKET NO. T-00000D-00-0672

REJOINDER EXHIBITS OF

PHILIP E. GRATE

ON BEHALF OF

QWEST CORPORATION

JANUARY 27, 2005

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

INDEX OF EXHIBITS

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

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

Red Herring #1: Offbook accounting system

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

> Mr. Grate does accurately quote Rule R14-2-510(G), at rebuttal page 9:
>
> > 2. Each utility shall maintain its books and records in conformity with the Uniform Systems of Accounts for Class A, B, C and D Telephone Utilities as adopted and amended by the Federal Communications Commission ...
>
> Other than requiring Qwest to maintain its books and records in conformity with the FCC USOA, this Rule does not address nor is it dispositive of the ratemaking treatment to be afforded any specific accounting change for Arizona regulatory purposes. In fact, Qwest has maintained an offbook accounting system for many years to recognize differences in jurisdictional accounting that exist between the FCC and the state jurisdictions in which the Company provides regulated telecommunications service.

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

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

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

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

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

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

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

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

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

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

This testimony is a red herring because the issue is not about what Mr. Caver didn't claim. Rule R-2-510(G) prescribes the use of the USOA as adopted and amended by the Federal Communications Commission for purposes of regulatory accounting in Arizona. The issue is whether, as Mr. Carver's direct testimony[1] asserts, Qwest must first propose and seek Commission approval of the change in accounting method already incorporated into the USOA and adopted in Arizona by operation of Rule R-2-510(G).

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

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

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

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

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

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

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

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

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

> Subsequent to the filing of his direct testimony in this proceeding, Mr. Grate has altered Qwest's interpretation of R14-2-510(G) as requiring the adoption of SOP 98-1 (internal use software) in 1999, a matter that will be subsequently addressed in more detail.

This testimony is a red herring because Mr. Grate's direct testimony makes no mention of Rule R14-2-510(G) much less offers an interpretation of it. As Mr. Grate explained in rebuttal testimony, when he filed his direct testimony he was unaware of the existence of Rule R14-2-510(G). Consequently, it would be impossible for him to have interpreted it in his direct testimony and impossible for his interpretation to have changed between his direct testimony and his rebuttal testimony.

Red Herring #6: Qwest inconsistently applied Rule R14-2-510(G)

At page 6, line 18, Mr. Carver's surrebuttal testimony reads:

> In any event, Qwest has inconsistently applied and considered this rule [Rule R14-2-510(G)] over the years.

Mr. Carver provides his own testimony in a prior case as an offer of proof for an allegation related to a Company witness' position, instead of offering the Company witness' testimony from that case. From reading Mr. Carver's testimony one cannot tell precisely what position the Company's witness took in the case. However, there is nothing in Mr. Carver's testimony that suggests the Company's interpretation of Rule R14-2-510(G) then was in any way inconsistent with the interpretation Mr. Grate provided in rebuttal testimony.

In any event, Mr. Carver's testimony on this point is a red herring because Qwest's interpretation of Rule R14-2-510(G) in a prior case on a different and unrelated issue has no bearing on the issue at hand now. The issue now is whether accounting method changes incorporated into the USOA and adopted into Arizona regulatory accounting by operation of Rule R-2-510(G) are

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

automatically incorporated into Arizona ratemaking absent a Commission order to the contrary.

Red Herring #7: Qwest says SOP 98-1 "should have been" adopted in 1999

At page 8, line 21, Mr. Carver's surrebuttal testimony reads:

> Now, Mr. Grate has taken the position that SOP 98-1 should have been adopted for Arizona regulatory accounting purposes -- in 1999.

This testimony is both *misleading* and a *red herring* because Mr. Grate's testimony did not say that that SOP 98-1 should have been adopted for Arizona regulatory accounting purposes in 1999. It says it was adopted in 1999. Beginning on page 23, line 14, Mr. Grate's rebuttal testimony reads:

Q. WHEN WAS SOP 98-1 ADOPTED FOR PURPOSES OF THE FCC'S USOA?
A. January 1, 1999.
Q. WHEN WAS SOP 98-1 ADOPTED FOR PURPOSES OF AND REGULATORY ACCOUNTING UNDER A.A.C. R-14-2-510 G?
A. January 1, 1999.
Q. WHEN DO RUCO AND QWEST BELIEVE SOP 98-1 WAS ADOPTED?
A. January 1, 1999.

Beginning on page 29, line 18, Mr. Grate's rebuttal testimony also reads:

> I concluded that Qwest's adjustment PFA-03 regarding the adoption of SOP 98-1 was incorrect, because it assumed adoption in 2003 instead of 1999. I notified the parties of this conclusion in Qwest's supplemental response to Staff's data request UTI 4-1(a) as follows: "Qwest will revise its test year to reflect the adoption of SOP 98-1 effective January 1, 1999, the same date Qwest adopted SOP 98-1 for FCC reporting purposes." In response to part (c) of that data request I provided an attachment with a revised calculation of Adjustment PFA-03 to reflect the fact that SOP 98-1 had been adopted January 1, 1999.

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

Red Herring #8: Qwest's position is bad for ratepayers

At page 8, line 22, Mr. Carver's surrebuttal testimony reads:

> Qwest's shifting proposals present the worst possible scenario for ratepayers:
>
> - Oppose any regulatory recognition of SOP 98-1 in Docket No. T-1051B-99-105, denying ratepayers the opportunity to enjoy the transition benefits of such adoption;
> - Establish and maintain offbook accounting records for Arizona intrastate accounting purposes as if SOP 98-1 had never been implemented; and
> - Now that Mr. Grate has concluded that SOP 98-1 should be recognized for Arizona intrastate regulatory purposes, adopt the accounting change retroactively to 1999.
>
> This latest development in the SOP 98-1 saga is disingenuous at best. Unlike the scenario painted by Mr. Redding in the last rate case, Mr. Grate's creative accounting will deny, not delight, ratepayers with the early year benefits of SOP 98-1 adoption and jump right to the higher "permanent rate level" opined by Mr. Redding. It is interesting, though I suppose not surprising, that the Company consistently seeks to deny ratepayers any participation in the positive benefits of transitioning between accounting method changes but pulls out all the stops to make sure that any transition costs (e.g., prospective amortization of the FAS106 transition benefit obligation) are fully reflected in overall revenue requirement. So much for the "goose and gander" barb Mr. Grate casts at Mr. Brosch and myself in footnote 29 at page 41 of his rebuttal testimony.

Mr. Carver asserts that Mr. Grate's rebuttal testimony is "disingenuous at best" but offers no evidence or argument that would show why this is true. Instead, wearing his bias on his sleeve, Mr. Carver critiques Qwest's position to determine whether it is favorable to ratepayers, not whether the rebuttal testimony correctly presents and analyzes the facts.

Red Herring #9: ACC need not follow FCC accounting for ratemaking

At page 8, line 18, Mr. Carver's surrebuttal testimony reads:

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

Q. Do you have any additional comments regarding Mr. Grate's statement at rebuttal page 14 that "It is clear that absent a Commission order to the contrary, an accounting method change incorporated into the USOA is (and consistently has been) automatically incorporated into Arizona regulatory accounting by operation of Rule R14-2-510 G."

A. Yes. I have been advised by Counsel that the Arizona courts have held that the Arizona Constitution and the Arizona Statutes convey broad discretion to the Commission over ratemaking. However, Mr. Grate's citation to Rule R14-2-510(G) seems to attempt to construct a regulatory theory that, while not explicitly stated, Qwest is required to follow FCC accounting rules, which the Arizona Corporation Commission is obliged to adopt for ratemaking purposes. In my experience, this is simply not appropriate.

* * *

It defies logic to imply that both Qwest and the ACC must blindly follow for ratemaking purposes the accounting policies established by the FCC when the Arizona Court of Appeals clearly recognizes and defers to this Commission's constitutional authority to make such determinations.

This testimony is a red herring because nothing in Mr. Grate's direct or rebuttal testimony argues directly or indirectly that the ACC is obliged to adopt—blindly or otherwise—FCC accounting rules for ratemaking purposes. Beginning at page 27, line 17, Mr. Grate's rebuttal testimony says:

> I concluded that Mr. Carver's testimony in the Company's last rate case was incorrect. With the exception of its order in the Company's 1994 rate case that explicitly rejected FAS 106 and adopted the capitalization method of accounting for STPUC (both at the behest of Mr. Carver), the Commission had adhered to Arizona's regulatory accounting rule for purposes of establishing the Company's revenue requirements.

Beginning at page 30, line 6, Mr. Grate's rebuttal testimony also says:

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

Q. MR. CARVER COMPLAINS: "THIS REVISED POSITION...IS SPONSORED BY MR. GRATE EVEN THOUGH THE COMPANY HAS NEVER PREVIOUSLY PROPOSED NOR SOUGHT COMMISSION APPROVAL TO RECOGNIZE THIS ACCOUNTING CHANGE FOR INTRASTATE REGULATORY PURPOSES."[2] WHAT IS YOUR RESPONSE?

A. I discovered in my research that Arizona has no requirement for the Company to seek or the Commission to grant approval of this accounting change. Under Arizona's regulatory accounting rule, as promulgated by this Commission, the adoption of this change was automatic in 1999. Mr. Carver complains of non-compliance with a nonexistent requirement.

As Mr. Grate's testimony makes clear, the issue in this case is not whether the ACC must follow FCC accounting rules for ratemaking purposes but whether accounting method changes incorporated into the USOA and adopted into Arizona regulatory accounting by operation of Rule R14-2-510(G) are automatically incorporated into Arizona ratemaking absent a Commission order to the contrary.

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

1) Actual -- Normalized Intrastate Revenue - July 2003 - June 2004:

	Normalized Intrastate July 2003 - June 2004 (Excludes FCC Dereg): 1A	Remove Rent Comp from the Analysis (Acct 5240.8 & .7) 1B	Normalized Excluding Rent Comp 1C
Local	786,989,221		786,989,221
Intra Access	76,318,682		76,318,682
Toll	9,569,587		9,569,587
Intra Misc	101,813,595	12,725,607	114,539,203
TOTAL	974,691,086	12,725,607	987,416,693

2) Qwest -- Normalized Intrastate Revenue - Test Year 2003

	2003 Unadjusted Intrastate 2A	PFN-01 Out of Period Revenue and Expense 2B	PFN-02 In-Test-Year Rate Changes 2C	PFN-03 Operating Income Annualization 2D	Remove FCC Dereg portion of Operating Income Annualization 2E	PFN-13 Contingency Accruals 2Ea	PFN-17 Separations Changes 2G	PFN-01 Reverse Incorrect Sign on Portion of Revenue in PFN-01 OOP 2Fa	Reclass 5060.3 Dir Assistance Rev From Misc to Local 2F	Remove Rent Comp from the Analysis (Acct 5240.8 & .7) 2H	Qwest Normalized 2003 TY Rev 2i = Sum(2A:2H)	2003 TY Less Jul03-Jun04 TY 2J=2i - 1C
Local	842,673,206	(1,324,160)	(7,056,656)	(36,669,635)		0	0	20,547	(7,062,189)		790,581,113	3,591,891
Intra Access	72,786,041	(2,035,173)	0	3,149,049		0	0	1,904,883			75,804,800	(513,882)
Toll	11,163,067	0	0	(2,343,182)		0	0	0			8,819,885	(749,702)
Intra Misc	86,953,480	(656,903)	0	(9,924,850)	13,057,531	5,700,000	1,270,218	(657,109)	7,062,189	14,803,278	117,607,834	3,068,631
TOTAL	1,013,575,794	(4,016,236)	(7,056,656)	(45,788,618)	13,057,531	5,700,000	1,270,218	1,268,321	0	14,803,278	992,813,632	5,396,939
	Source: az1203 Interface sheet JR Intrastate. Does not include FCC Dereg addback.	Source: file az1203_Revised 12-07-04.xls; tab Normalizing	Source: file az1203_Revised 12-07-04.xls; tab Normalizing	Source: file az1203_Revised 12-07-04.xls; tab Normalizing	Source: File Op_Inc_Normal_Price Adjusted_20041105.xls tab Summary	Source: file az1203_Revised 12-07-04.xls; tab Normalizing	Source: file az1203_Revised 12-07-04.xls; tab Normalizing	Source: file is Out_of_Period_2003_Revised_11-05-04.xls; tab OOP_REV	Source: File Op_Inc_Normal_PriceAdjusted_20041105.xls tab Summary	Calculate Intrastate based on monthly Booked results.		Plus = Rate Case Est is higher
	Unadjusted Intrastate. Does not include FCC deregulated revenue.	Remove all out-of-periods as identified in PFN-01.	Price adjust 1st qtr to 4/1/04 rates so TY is at constant price.	Adjustment to TY revenue to reflect EOP volumes.	Focus of analysis is "Reg" revenue annualization. FCC dereg is treated differently by the parties.	This adjustment was made in normalizing the data for annualization and was removed from TY (PFN-13) as well as a non-recurring event.	Separations changes. Out of period intrastate revenue that relates to 2003 (Wireless B&C Acct 5270).	A portion of PFN-01 Rev OOP has incorrect sign and should be reversed.	Reclass to correctly show as Local. UTI correctly shows as Local.	Focus of the anlaysis is EOP annualizations; Rent Comp is not annualized.		

3) Staff -- Normalized Intrastate Revenue - Test Year 2003

	Qwest Normalized 2003 TY Rev 3A=2i	Staff C-2 3B	Staff C-3 3C	Staff C-4 3D	Staff C-5 3E	Staff Normalized 2003 TY Rev 3F = Sum(3A:3E)	2003 TY Less Jul03-Jun04 TY 3G=3F - 1C
Local	790,581,113	0			3,705,000	794,286,113	7,296,891
Intra Access	75,804,800		(132,000)			75,672,800	(645,882)
Toll	8,819,885			1,076,000		9,895,885	326,298
Intra Misc	117,607,834					117,607,834	3,068,631
TOTAL	992,813,632	0	(132,000)	1,076,000	3,705,000	997,462,632	10,045,939

Staff adj C-2 of +$792k to Local was agreed to by QC and is included in the PFN-03 adj above. PFN-03 above is from a view after the Oct view used by Staff.

		Source File Type	Rev Type	5 2003-01	6 2003-02	7 2003-03	8 2003-04	9 2003-05	10 2003-06	11 2003-07	12 2003-08	13 2003-09	14 2003-10	15 2003-11	16 2003-12
A	**1990s Intrastate Data:**														
	LCLSER_REVFRA_			73,221,060	73,941,572	75,940,934	72,719,732	71,176,434	69,597,436	69,637,798	68,488,670	70,480,603	66,962,339	67,129,544	63,377,084
	ACCESS_REVFRA_			7,181,017	6,703,205	6,336,534	6,545,967	2,973,187	6,763,716	5,986,902	6,269,725	6,213,621	6,636,964	6,184,462	4,990,741
	LONGDT_REVFRA_			1,143,413	959,675	880,281	951,763	932,915	773,864	1,063,462	963,477	900,798	992,807	821,070	779,542
	MISC___REVFRA_			7,946,097	10,185,928	4,775,445	6,701,215	6,260,292	7,368,127	6,658,087	7,870,498	7,592,705	7,382,421	8,524,988	6,957,895
	TOTAL__REVFRA_			89,491,587	91,790,380	87,933,194	86,918,677	81,342,828	84,503,143	83,346,249	83,592,370	85,187,727	81,974,531	82,660,064	76,105,262
				0	0	0	0	0	0	0	0	0	0	0	0
B	**OOP Adjs Booked in 2003 (In Yr & Prior Yr):**														
	NA - None relating to Jul03-Jun04	TY Anlztn	Acc x												
	NA - None relating to Jul03-Jun04	TY PFN-01	Acc x												
InY:	Restate Dec 2003 Accrual for November (5001.21)	TY Anlztn	Lcl x											353,530	(353,530)
InY:	5060.141 - Resale Central Office Features Recurring Business	TY Anlztn	Lcl x							40,570	40,570	40,570	(446,275)	40,570	40,570
	5060.43 Wide Area Calling Backbilling for PY's	TY PFN-01 & Anlztn	Lcl x									(1,303,613)			
InY:	Nov 2003 Reversal (5001.12)	TY Anlztn	Lcl x											(876,483)	876,483
InY:	Dec 2003 Part 64 TrueUp (5060.122)	TY Anlztn	Lcl x							(198,768)	(198,768)	(198,768)	(198,768)	(198,768)	2,186,445
InY:	Normalize Nov 2003 Entries (5060.39 Dir Asst)	TY Anlztn	Lcl x							(1,818)	(1,818)	(1,818)	(1,818)	18,182	
Int:	Normalize July03 Accrual to June03 (5240.91)	TY PFN-01	Misc x							(768,928)					
Int:	18) WDA 17-2 and 10C-18S1 BSI Colloc Adj	TY PFN-01	Misc x							(17,105)	(17,105)	(17,105)	(17,246)	(17,246)	(17,246)
Int:	7) UTI 04-032 QLDC Payable OOP (Aug 2003)	TY PFN-01	Misc x								(129,145)				
Int:	8) UTI 4-032 QCC Payable OOP (Aug 2003)	TY PFN-01	Misc x								(127,739)				
Int:	Normalize BARTONL Mar04 (5262)	TY Anlztn	Misc x							(69,408)	(69,408)	(69,408)	(69,408)	(69,408)	(69,408)
Int:	Normalize Feb 2003 (5263)	TY Anlztn	Misc x							171,398	171,398	171,398	171,398	171,398	171,398
Int:	Normalize May 2003 (5264.7)	TY Anlztn	Misc x							21,195	21,195	21,195	21,195	21,195	21,195
Int:	Normalize Oct 2003 (5264.7)	TY Anlztn	Misc x							(10,402)	(10,402)	(10,402)	114,424	(10,402)	(10,402)
100:	Reverse Dec 2003 Accrrual for Franchise Tax (5264.9)	TY Anlztn	Misc x												5,700,000
Int:	QCC Out of Period, UTI 4-032 (Aug03 5270) - Already picked up in: 8) UTI 4-032 QCC Payable OOP (Aug 2003) of PFN-01 file.	TY Anlztn	Misc x												
Int:	QLDC Out of Period, UTI 4-032 (Aug03 5270) Duplicate of above - Already picked up in: 7) UTI 04-032 QLDC Payable OOP (Aug 2003) of PFN-01 file.	TY Anlztn	Misc x												
InY:	June 2003 Reclass (5100.21)	TY Anlztn	Toll x										(158,000)		
InY:	July 2003 Part64 Overbooked (5100.21)	TY Anlztn	Toll x							(37,815)					
	NA - None	TY PFN-01	Toll x												
100:	Nov 2003 Normalization (5230.19 Directory)	TY Anlztn	WhtPg x							26,909	26,909	26,909	26,909	(269,091)	
	Subtotal - Local									(160,015)	(160,015)	(1,463,628)	(646,861)	(662,968)	2,749,968
	Subtotal - Intra Access									0	0	0	0	0	0
	Subtotal - Toll									(37,815)	0	0	(158,000)	0	0
	Subtotal - Intra Misc									(646,342)	(134,298)	122,586	247,271	(173,555)	5,795,536
C	**OOP Adjs Booked in 2004:**														
	Jan 2004 Out of Period (AT&T Roam & Oth - Acct 5084.21xx)	TY Anlztn	Acc x							(48,506)	(48,506)	(48,506)	(48,506)	(48,506)	(48,506)
	Jan 2004 Out of Period (AT&T Roam & Oth - Acct 5084.22xx)	TY Anlztn	Acc x												(234,207)
	NA - already treated in the above 2 lines for TY Anlztn Adj	TY PFN-01	Acc x												
	NA	TY Anlztn	Lcl x												
	NA - None	TY PFN-01	Lcl x												
	NA	TY Anlztn	Toll x												
	NA - None	TY PFN-01	Toll x												
	May 2004 Out of Period 2001 & 2002(Acct 5001.11)	New	Lcl x												
	May 2004 Out of Period for 2001 & 2002 (Acct 5084)	New	Acc x												

		Source File Type	Rev Type		2003-01	2003-02	2003-03	2003-04	2003-05	2003-06	2003-07	2003-08	2003-09	2003-10	2003-11	2003-12
Int	May 2004 Out of Period 2001 & 2002 (Acct 5240.5xxx & 5263.2)	New	Misc	x												
Int	Misc Jan & Mar 2004 OOP in PFN-01 (Various Accts: 5240, 5250, 5263, 5264)	TY PFN-01	Misc	x												(240,159)
	Subtotal - Local										0	0	0	0	0	0
	Subtotal - Intra Access										(48,506)	(48,506)	(48,506)	(48,506)	(48,506)	(282,713)
	Subtotal - Toll										0	0	0	0	0	0
	Subtotal - Intra Misc										0	0	0	0	0	(240,159)
C	**Manual Overlays in Dec03 1990s:**															
	Wireless B&C (Overlay in Dec03 for Jan-Dec))	PFN-17	Misc								143,648	154,048	145,975	144,616	146,260	(1,681,232)
	Subtotal - Local															
	Subtotal - Intra Access															
	Subtotal - Toll															
	Subtotal - Intra Misc										143,648	154,048	145,975	144,616	146,260	(1,681,232)
D	**Manual Overlays in Booked Jan04 already reflected in Dec03 1990s:**															
	AT&T Roaming (Reverse full amount Incl in Dec03 1990s since have Normlzd to months in 2004 OOP above)	19990s	Acc	x												1,011,563
	Subtotal - Local															
	Subtotal - Intra Access										0	0	0	0	0	1,011,563
	Subtotal - Toll															
	Subtotal - Intra Misc															
E	**Remove 2004 Price Decrease from Apr-Jun 2004:**															
	Reverse Local Price Decrease as Shown in PFN-04	PFN-04	Lcl													
	Reverse Local Price Decrease Shown as Access in PFN-04	PFN-04	Acc													
	Note: Price Decrease for Access was temporarily in effect Ap 1 - Jul 1.		Acc													
	Subtotal - Local		Lcl								0	0	0	0	0	0
	Subtotal - Intra Access		Acc								0	0	0	0	0	0
	Subtotal - Toll															
	Subtotal - Intra Misc															
F	**Sum Normalizing Intrastate Adj's July 2003 - June 2004:**															
	Local										(160,015)	(160,015)	(1,463,628)	(646,861)	(662,968)	2,749,968
	Intra Access										(48,506)	(48,506)	(48,506)	(48,506)	(48,506)	728,850
	Toll										(37,815)	0	0	(158,000)	0	0
	Intra Misc										(502,694)	19,750	268,561	391,887	(27,295)	3,874,145
	TOTAL										(749,030)	(188,772)	(1,243,574)	(461,480)	(738,770)	7,352,962
G	**Normalized Intrastate July 2003 - June 2004:**															
	Local										69,477,783	68,328,655	69,016,975	66,315,478	66,466,576	66,127,052
	Intra Access										5,938,396	6,221,219	6,165,115	6,588,458	6,135,956	5,719,591
	Toll										1,025,647	963,477	900,798	834,807	821,070	779,542
	Intra Misc										6,155,393	7,890,248	7,861,266	7,774,308	8,497,693	10,832,039
	TOTAL										82,597,219	83,403,598	83,944,153	81,513,051	81,921,294	83,458,224

		Source File Type	Rev Type	17 2004-01	18 2004-02	19 2004-03	20 2004-04	21 2004-05	22 2004-06	2003 YTD	Jul03-Jun04
A	1990s Intrastate Data:										
	LCLSER_REVFRA_			65,693,934	64,301,680	63,636,579	62,554,005	58,470,870	60,789,861	842,673,206	781,522,967
	ACCESS_REVFRA_			5,402,365	6,495,203	6,320,966	6,441,406	(140,022)	6,873,091	72,786,041	67,675,424
	LONGDT_REVFRA_			751,372	757,649	712,325	752,676	665,443	604,781	11,163,067	9,765,402
	MISC___REVFRA_			8,485,183	7,966,649	8,718,425	9,048,373	6,643,210	9,391,902	88,223,698	95,240,334
	TOTAL__REVFRA_			80,332,854	79,521,181	79,388,295	78,796,460	65,639,501	77,659,635	1,014,846,012	954,204,127
				0	0	0	0	0	0	0	0
										1,270,218	
B	OOP Adjs Booked in 2003 (In Yr & Prior Yr):										
	NA - None relating to Jul03-Jun04	TY Anlztn	Acc								0
	NA - None relating to Jul03-Jun04	TY PFN-01	Acc								0
InYr	Restate Dec 2003 Accrual for November (5001.21)	TY Anlztn	Lcl								0
InYr	5060.141 - Resale Central Office Features Recurring Business	TY Anlztn	Lcl								(243,423)
	5060.43 Wide Area Calling Backbilling for PY's	TY PFN-01 & Anlztn	Lcl								(1,303,613)
InYr	Nov 2003 Reversal (5001.12)	TY Anlztn	Lcl								0
InYr	Dec 2003 Part 64 TrueUp (5060.122)	TY Anlztn	Lcl								1,192,606
InYr	Normalize Nov 2003 Entries (5060.39 Dir Asst)	TY Anlztn	Lcl								10,909
Intr	Normalize July03 Accrual to June03 (5240.91)	TY PFN-01	Misc								(768,928)
Intr	18) WDA 17-2 and 10C-18S1 BSI Colloc Adj	TY PFN-01	Misc								(103,054)
Intr	7) UTI 04-032 QLDC Payable OOP (Aug 2003)	TY PFN-01	Misc								(129,145)
Intr	8) UTI 4-032 QCC Payable OOP (Aug 2003)	TY PFN-01	Misc								(127,739)
Intr	Normalize BARTONL Mar04 (5262)	TY Anlztn	Misc								(416,451)
Intr	Normalize Feb 2003 (5263)	TY Anlztn	Misc								1,028,388
Intr	Normalize May 2003 (5264.7)	TY Anlztn	Misc								127,169
Intr	Normalize Oct 2003 (5264.7)	TY Anlztn	Misc								62,413
100%	Reverse Dec 2003 Accrual for Franchise Tax (5264.9)	TY Anlztn	Misc								5,700,000
Intr	QCC Out of Period, UTI 4-032 (Aug03 5270) - Already picked up in: 8) UTI 4-032 QCC Payable OOP (Aug 2003) of PFN-01 file.	TY Anlztn	Misc								0
Intr	QLDC Out of Period, UTI 4-032 (Aug03 5270) Duplicate of above - Already picked up in: 7) UTI 04-032 QLDC Payable OOP (Aug 2003) of PFN-01 file.	TY Anlztn	Misc								0
InYr	June 2003 Reclass (5100.21)	TY Anlztn	Toll								(158,000)
InYr	July 2003 Part64 Overbooked (5100.21)	TY Anlztn	Toll								(37,815)
	NA - None	TY PFN-01	Toll								0
100%	Nov 2003 Normalization (5230.19 Directory)	TY Anlztn	WhtPg								(161,455)
	Subtotal - Local			0	0	0	0	0	0		(343,521)
	Subtotal - Intra Access			0	0	0	0	0	0		0
	Subtotal - Toll			0	0	0	0	0	0		(195,815)
	Subtotal - Intra Misc			0	0	0	0	0	0		5,211,198
C	OOP Adjs Booked in 2004:										
	Jan 2004 Out of Period (AT&T Roam & Oth - Acct 5084.21xx)	TY Anlztn	Acc	582,076							291,038
	Jan 2004 Out of Period (AT&T Roam & Oth - Acct 5084.22xx)	TY Anlztn	Acc	234,207							0
	NA - already treated in the above 2 lines for TY Anlztn Adj	TY PFN-01	Acc								0
	NA	TY Anlztn	Lcl								0
	NA - None	TY PFN-01	Lcl								0
	NA	TY Anlztn	Toll								0
	NA - None	TY PFN-01	Toll								0
	May 2004 Out of Period 2001 & 2002(Acct 5001.11)	New	Lcl					2,484,775			2,484,775
	May 2004 Out of Period for 2001 & 2002 (Acct 5084)	New	Acc					6,090,657			6,090,657

		Source File Type	Rev Type	2004-01	2004-02	2004-03	2004-04	2004-05	2004-06	2003 YTD	Jul03-Jun04
Int	May 2004 Out of Period 2001 & 2002 (Acct 5240.5xxx & 5263.2)	New	Misc					2,308,748			2,308,748
Int	Misc Jan & Mar 2004 OOP in PFN-01 (Various Accts: 5240, 5250, 5263, 5264)	TY PFN-01	Misc	219,580		20,579					0
	Subtotal - Local			0	0	0	0	2,484,775	0		2,484,775
	Subtotal - Intra Access			816,283	0	0	0	6,090,657	0		6,381,695
	Subtotal - Toll			0	0	0	0	0	0		0
	Subtotal - Intra Misc			219,580	0	20,579	0	2,308,748	0		2,308,748
C	**Manual Overlays in Dec03 1990s:**										
	Wireless B&C (Overlay in Dec03 for Jan-Dec))	PFN-17	Misc								(946,685)
	Subtotal - Local										0
	Subtotal - Intra Access										0
	Subtotal - Toll										0
	Subtotal - Intra Misc			0	0	0	0	0	0		(946,685)
D	**Manual Overlays in Booked Jan04 already reflected in Dec03 1990s:**										
	AT&T Roaming (Reverse full amount Incl in Dec03 1990s since have Normlzd to months in 2004 OOP above)	19990s	Acc								1,011,563
	Subtotal - Local										0
	Subtotal - Intra Access			0	0	0	0	0	0		1,011,563
	Subtotal - Toll										0
	Subtotal - Intra Misc										0
E	**Remove 2004 Price Decrease from Apr-Jun 2004:**										
	Reverse Local Price Decrease as Shown in PFN-04	PFN-04	Lcl				1,108,333	1,108,333	1,108,333		
	Reverse Local Price Decrease Shown as Access in PFN-04	PFN-04	Acc				416,667	416,667	416,667		
	Note: Price Decrease for Access was temporarily in effect Ap 1 - Jul 1.		Acc				0	0	0		
	Subtotal - Local		Lcl	0	0	0	1,108,333	1,108,333	1,108,333		3,325,000
	Subtotal - Intra Access		Acc	0	0	0	416,667	416,667	416,667		1,250,000
	Subtotal - Toll										0
	Subtotal - Intra Misc										0
F	**Sum Normalizing Intrastate Adj's July 2003 - June 2004:**										
	Local			0	0	0	1,108,333	3,593,108	1,108,333		5,466,254
	Intra Access			816,283	0	0	416,667	6,507,324	416,667		8,643,258
	Toll			0	0	0	0	0	0		(195,815)
	Intra Misc			219,580	0	20,579	0	2,308,748	0		6,573,261
	TOTAL			1,035,863	0	20,579	1,525,000	12,409,180	1,525,000		20,486,959
G	**Normalized Intrastate July 2003 - June 2004:**										
	Local			65,693,934	64,301,680	63,636,579	63,662,338	62,063,978	61,898,194		**786,989,221**
	Intra Access			6,218,648	6,495,203	6,320,966	6,858,073	6,367,302	7,289,758		**76,318,682**
	Toll			751,372	757,649	712,325	752,676	665,443	604,781		**9,569,587**
	Intra Misc			8,704,763	7,966,649	8,739,004	9,048,373	8,951,958	9,391,902		**101,813,595**
	TOTAL			81,368,717	79,521,181	79,408,874	80,321,460	78,048,681	79,184,635		**974,691,086**

YEAR	2004
JEC	AZ

Sum of AMT					MONTH			DR/<CR>	Adjust May04
REFID	EGID	EVT_GRP_DESC	EVT_GRP_DES2	ACCOUNT	05	Rev Type	Intra%	Intra $	Intra $
2216	2004050000000503	ENTRY TO MOVE MONEY TO	S CAN BE REFERRED TO SU	41209000	(11,700,000)				
				50011100	2,484,775	Local	100.00%	2,484,775	2,484,775
				50842231	5,733,914	Access	100.00%	5,733,914	5,733,914
				50843110	356,743	Access	100.00%	356,743	356,743
				52405121	1,053,759	Misc	75.64%	797,062	797,062
				52405531	627,717	Misc	75.64%	474,804	474,804
				52405532	269,022	Misc	75.64%	203,488	203,488
				52632000	1,174,070	Misc	70.98%	833,394	833,394
2216 Total					0				
Grand Total					0				

5240 Rent Compensation
DR/<CR> Ledger Amounts

JEC	AZ

Sum of AMT		MAINSUB		
YEAR	MONTH	52407000	52408000	Grand Total
2003	01	83,366	1,950,483	2,033,849
	02	83,366	1,950,483	2,033,849
	03	83,366	1,950,483	2,033,849
	04	83,366	1,950,483	2,033,849
	05	83,366	1,950,483	2,033,849
	06	83,366	1,950,483	2,033,849
	07	83,366	1,415,409	1,498,775
	08	83,366	1,415,409	1,498,775
	09	83,366	1,415,409	1,498,775
	10	83,366	1,415,409	1,498,775
	11	83,366	1,415,409	1,498,775
	12	83,366	1,415,409	1,498,775
2003 Total		1,000,392	20,195,352	21,195,744
2004	01	83,366	1,369,901	1,453,267
	02	83,366	1,369,901	1,453,267
	03	83,366	1,369,901	1,453,267
	04	83,366	1,369,901	1,453,267
	05	83,366	1,793,756	1,877,122
	06	83,366	1,454,672	1,538,038

Yr 2003	Intra Factor	Intra	
21,195,744	69.841%	14,803,278	**DR/<CR> Ledger Amounts**

Jul2003-Jun2004			
18,220,878	69.841%	12,725,607	**DR/<CR> Ledger Amounts**

Az Factors Without FCC Dereg

	2003 YTD
1990s Intrastate Factor:	
5230_____FRA_	1.0000
5240_____FRA_	0.7564
5250_____FRA_	0.7588
5260_____FRA_	0.7098

Qwest Corrections to
Staff Schedule C-19

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
FCC DEREGULATED SERVICES – REVENUE IMPUTATION
TEST YEAR ENDING 12/31/2003

(000's)
CONFIDENTIAL

Line No.	Description (A)	Qwest ATL FCC Dereg (excl. B&C) (B)	Qwest ATL Remove Payphone (C)	Remove Planning/ Payphone "Correction" (D)	Remove FCC Dereg In AZ Price Cap Baskets (E)	Remove "Corrected" Voice Messaging (State Dereg Rec.) (F)	*Corrected* Qwest Pro Forma Adjustments (G) Source Qwest: PFN-01 & PFN-03	*Corrected* Qwest Pro Forma Adjustment Omitted by Staff in Error (G1) Source Qwest: PFN-09	*Corrected* Remove Qwest Pro forma Relating to "FCC Dereg In AZ Price Cap Baskest" & VMS (G2)	*Corrected* Total "Corrected" FCC Dereg Remaining ATL (H) = Sum B:G2	*Corrected* FCC Dereg Staff Revenue 50% Imputation (I)	*Corrected* Adjusted FCC Dereg Remaining ATL (J)
	Revenues											
1	Miscellaneous											
2	Total Operating Revenues											
	Expenses											
3	Maintenance											
4	Engineering Expense											
5	Network Operations											
6	Network Administration											
7	Other											
8	Total Cost of Services & Products											
9	Customer Operations											
10	Corporate Operations											
11	Property & Other Taxes											
12	Uncollectibles											
13	Total Selling, General and Administrative											
14	Other Operating Income & Expense											
15	Depreciation Expense											
16	Total Operating Expense											
17	**Income From Operations**											
18	Federal Income Tax 32.561%											
19	State & Local Income Tax 6.968%											
20	**Net Operating Income**											
21	**Rate Base**											
22	Telephone Plant In Service											
23	Materials and Supplies											
24	*Accumulated Depr & Amort Reserve*											
25	Accumulated Deferred Income Tax											
26	Customer Deposits											
27	**End-Of-Period Rate Base**											
28	***Return On Investment***											
	Revenue Requirement											

REDACTED

FOOTNOTES:

(a) Source: Qwest spreadsheet "az1203_Revised 10-27-04.xls" & sheet "Interface-1990Financials".
(b) Source: Qwest spreadsheet "az1203_Revised 10-27-04.xls" & Adjustment PFN-12, Planning for Enhanced Services.
(c) Source: Staff Adjustment C-1 & Qwest Adjustments PFN-03, Revised Operating Income Annualization (trending), & PFN-01, Revised Out of Period Revenues.
(d) **Revenue Imputation Adjustment**

End-Of-Period Rate Base	$ 6,884
Staff Proposed Rate of Return	9.50%
Operating Income Required	654
Net Operating Income Available	5,864
Operating Income Deficiency	(5,210)
Revenue Conversion Factor	1.69098
Revenue Deficiency (Excess)	(8,811)
ACC Allowance D 58927	50%
Staff Proposed Imputation	$ (4,405)

	Change in ACC Staff Revenue Requirement
C-19 Original (Per Schedule E pg 1 Line 36 Col D)	(6,576)
With Qwest Corrections to C-19 (using Staff ROR & RevMult))	4,406
Change in ACC Staff Revenue Requirement	10,982

(e) Source: Staff Workpaper C-19 & Qwest confidential response to Staff Data Request UTI 9-9, Attachment B -- corrected for Planning for Enhanced Services.

Qwest Corrections to
Staff Schedule C-24

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
VOICE MESSAGING -- STATE DEREGULATED SERVICE
TEST YEAR ENDING 12/31/2003
(000's)

CONFIDENTIAL

Line No.	Description	"Corrected" Voice Messaging (State Dereg)	Staff Adjustment Removing Voice Messaging	*Corrected* Qwest Proformas Relating to VMS (From Corrected C-19)	*Corrected* Remove Qwest Proformas Relating to VMS	*Corrected* Staff Adjustment Removing Voice Messaging
	(A)	(B)	(C)	D	E = -D	F = C + E
	Revenues					
1	Miscellaneous					
2	Total Operating Revenues					
	Expenses					
3	Maintenance					
4	Engineering Expense					
5	Network Operations					
6	Network Administration					
7	Other					
8	Total Cost of Services & Products					
9	Customer Operations					
10	Corporate Operations					
11	Property & Other Taxes					
12	Uncollectibles					
13	Total Selling, General and Administrative					
14	Other Operating Income & Expense					
15	Depreciation Expense					
16	Total Operating Expense					
17	**Income From Operations**					
18	Federal Income Tax					
19	State & Local Income Tax					
20	**Net Operating Income**					
21	ACC Staff Adjustment to Remove Test Year Revenues and Expenses Consistent with Staff Recommendation to Deregulated Voice Messaging Services					
	Revenue Requirement					

REDACTED

FOOTNOTES:

(a) Source: Staff Workpaper C-19 & Qwest confidential Attachment B -- corrected for Planning for Enhancec

Tax Rates Used in Cols D & E:

Federal Income Tax	32
State & Local Income Tax	6

ACC Staff RevMult Used in Revenue Requirement:

Revenue Conversion Factor	

Data Worksheet for Qwest Corrections to ACC Staff Schedules C-19 and C-24:

1) PFN-03 Miscellaneous Dereg Revenue (Acct 5280) Adjustments:
Source file -- Op_Inc_Normal_PriceAdjusted_20041019.xls; tab: Summary; Col: G.

Line	Type	Account	(G) PFN-03 Intrastate Increase (Decrease) [$ 000's]	*Input Correction to ACC Staff Adj C-19 Revised Col (G2)* Remove Qwest Profoma Relating to "FCC Dereg In AZ Price Cap Baskest" & VMS	Remainder	*Input Correction to ACC Staff Adj C-24 Revised Col D* Proforma Amounts In Test Year Related to VMS
28	Miscellaneous	5280.13 - Miscellaneous - Account Recording	25		25	
29	Miscellaneous	5280.1421 - Miscellaneous - Business Voice Msg Recur	359	(359)	0	359
30	Miscellaneous	5280.1423 - Miscellaneous - Residence Voice Msg Recur	(5,357)	5,357	0	(5,357)
31	Miscellaneous	5280.2210 - Miscellaneous - Wire Mtce Business Recur	323	(323)	0	
32	Miscellaneous	5280.2221 - Miscellaneous - Wire Mtce Residence Recur	(8,936)	8,936	0	
33	Miscellaneous	5280.2222 - Miscellaneous - Wire Mtce Residence NonRecur	1,469	(1,469)	0	
34	Miscellaneous	5280.2239 - Miscellaneous - Wire Mtce Bus NonRecurring	(533)	533	0	
35	Miscellaneous	5280.53 - Miscellaneous - Enhanced Directory Assistance	(407)	407	0	
	Subtotal		(13,058)	13,083	25	(4,999)
			Subtotal matches ACC Staff Schedule C-19 Col G Line 12			

2) PFN-01 Miscellaneous Dereg Revenue (Acct 5280) Adjustments:
Source file -- Out_of_Period_2003_Revised_01-25-05 Rejoinder.xls; TABS: "5) UTI 10-8 Att A NONREG" and "14) UTI 3-36S1 Con Att B"
NOTE: Data from tab "5) UTI 10-8 Att A NONREG" was revised 1-25-04 to correct sign reversal and show impacts as 100% intrastate

Category	YEAR	Account Descr	MAINSUB	Total ($Whole) {DR/<CR>}	PFN-01 Intrastate Increase (Decrease) [$ 000's]	Remove Qwest Profoma Relating to "FCC Dereg In AZ Price Cap Baskest" & VMS	Remainder	Proforma Amounts In Test Year Related to VMS
Miscellaneous	2004	Voice Messaging - Tariffed Expense	52803130	160,011	(160)	160	0	(160)
Miscellaneous	2004	Voice Messaging - Tariffed Expense	52803130	(5,830)	6	(6)	0	6
Miscellaneous	2004	Voice Messaging - Tariffed Expense	52803130	24,194	(24)	24	0	(24)
Miscellaneous	2004	National Dir Asst Listings	52803420	(18,940)	19	(19)	0	
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	27,150	27	(27)	0	27
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	14,504	15	(15)	0	15
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	(7,371)	(7)	7	0	(7)
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	7,926	8	(8)	0	8
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	7,762	8	(8)	0	8
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	56,009	56	(56)	0	56
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	(28,143)	(28)	28	0	(28)
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	27,773	28	(28)	0	28
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	27,651	28	(28)	0	28
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	27,418	27	(27)	0	27
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	236,454	236	(236)	0	236
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	288,267	288	(288)	0	288
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	233,709	234	(234)	0	234
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	176,980	177	(177)	0	177
Miscellaneous	2003	Other - Sales/Joint Marketing Service - Affiliate Norecurring	52809712		(301)		(301)	
	Subtotal				(636)	(937)	(301)	918
	TOTAL Sections 1 & 2				(12,422)	12,146	(276)	(4,081)
					Input to ACC Staff Schedules C-19 Pg 1 Column G Line 12			

NOTE: **FCC Deregulated Account Map to Product:**
5280.13 – 21110 CDAR (Account Reporting)
5280.14 – 23400 Voice Messaging
5280.22 – 13100 Premise Service
5280.313 – 23400 Voice Messaging
5280.342 – 35010 National Directory Assistance
5280.53 – 35010 National Directory Assistance
5280.9712 - 45020 Joint Marketing

Data Worksheet for Qwest Corrections to ACC Staff Schedules C-19 and C-24:

3) PFN-09 Call Centers Miscellaneous Dereg Revenue (Acct 5280) Adjustments:
Source file -- CallCntrExp.xls;tab:AffilRev-Adj;tab:Summary;Col:G.

YEAR 2003 - Estimated Re-allocation of Affiliate Revenues Booked in 2003

Line	Description	Source	Amount ($ Whole)	*Input Correction to ACC Staff Adj C-19 Revised* PFN-09 Intrastate Adjustment (000's)	Qwest Profoma Relating to FCC Dereg In AZ Price Cap Baskest"& VMS	Remainder
1	Total Service Orders Processed for QLDC in Year 2003	Records	2,795,288			
2	Per Service Order Rate Charged to QLDC	Records	$ 31.51			
3	Amount Paid by QLDC to QC - ACT 5280.9712	L1xL2	$ 88,079,524.88			
4	Arizona Percent	Records (HQ Prorate)	16.587%			
5	AZ Revenues HQ Allocated	L3xL4	$ 14,609,750.79			
6	Actual AZ Affiliate Revenue Booked in Year 2003 for the Service Order Function	Records	$ 5,142,967.67			
7	Difference	L5-L6	$ 9,466,783.12			
8	Intrastate Percent	Test Year	80.952%			
9	Difference = Additional Affiliate Revenues	L7xL8	$ 7,663,512.41	7,664	0	7,664

Note:
1)Account 5280.9712 is part of the Joint Marketing product group for FCC Deregulated services.

QWEST CORPORATION
ARIZONA INTRASTATE OPERATIONS
Test Year Ending December 31, 2003
(IN THOUSANDS OF DOLLARS)

Date: 1/26/2005
Time: 4:56 PM
PFN 18

		BSI Remote Colocation Revenue
Revenues		
1	Local Service Revenues	
2	Network Access Service Revenues	
3	Long Distance Network Service Rev.	
4	Miscellaneous	1,169
5	Total Oper. Rev. (L1 thru L4)	1,169
Expenses		
6	Maintenance	
7	Engineering Expense	
8	Network Operations	
9	Network Administration	
10	Access Expense	
11	Other	
12	Total Cost of Services & Products(L6 thru L11)	0
13	Customer Operations	
14	Corporate Operations	
15	Property & Other Taxes	
16	Uncollectibles	
17	Tot Selling, General & Admin.(L13 thru L16)	0
18	Other Operating Income & Expense	
19	Depreciation Expense	
20	Universal Service Fund	
21	Link Up America	
22	Total Operating Expense(L12+L17 thru L21)	
23	Income From Operations (L5-L22)	1,169
Taxes		
24	Federal Income Tax (L23-L30) x Eff FIT Rate	383
25	State & Local Income Tax (L23-L30) x Eff SIT Rate	76
26	**Net Operating Income (L23-L24-L25)**	710
Other		
27	Nonoperating Income & Expense	
28	Nonoperating Income Tax	
29	Net Operating Earnings (L26-L27-L28)	710
30	Interest Expense	
31	Juris Diff & Nonreg Net Income	
32	Extraordinary Items	
33	**Net Income (L29-L30-L31-L32)**	710
Rate Base		
34	Telephone Plant In Service	
35	Short-Term Plant Under Contruction	
36	Materials and Supplies	
37	Allowance for Cash Working Capital	
38	Accumulated Depreciation & Amortization Reserve	
39	Accumulated Deferred Income Tax	
40	Customer Deposits	
41	Land Development Agreement Deposits	
42	Other Assets & Liabilities	
43	**End-of-Period Rate Base** (L34+L35+L36+L37-L38-L39-L40-L41+L42)	0

Arizona Corporation Commission
Docket No.
Title: BSI Remote Colocation Revenue
Time: 458 PM
Date: 1/26/2005
Adj. # PFN-18

Qwest Corporation

Arizona Intrastate Operations

Add 2003 BSI Non-recurring Revenue

Test Year Ending December 31, 2003

$000)

Operating Revenues	1,169
Operating Expenses	
Total Operating Income Taxes	459
Net Operating Income	710
Rate Base	0
Revenue Reqirement	(1,199)

This adjustment adds Non-recurring revenue for shelves added at Physical Remote Collocation sites by BSI in 2003.

BSI PHYSICAL REMOTE COLLOCATION

CONFIDENTIAL

SAI ADDRESS	Total Shelves	12/13/04 Billable Shelves	Initial Cabinet Turn Up Date	Non-Recurring Space per mounting unit @$868.13	Non-Recurring FDI Terminations per binder group @$558.99	Total Non-Recurring Charges	Intrastate Revenues @.8095
X 5133 N 78 ST							
X 252 N LAKEVIEW BLVD							
X 2270 E PECOS RD							
X 7200 N 43 AV							
X 7639 N 42 LN							
X 8755 N 43 AV							
X 18955 N 67 AV							
X 4801 E ROADRUNNER RD							
X 5841 W DEL LAGO CIR							
X 6749 N 43 AV							
X 1201 E GLENN DR							
X 4104 N 78 ST							
X 6747 W ARROWHEAD LOOP RD							
X 707 E MYRTLE AV							
X 18301 N 9 ST							
I 8401 W MONROE ST							
X 17824 N 20 ST							
X 35603 N 33 LN							
X 5020 E VILLAGE PKWY							
X 1906 W WAYNE LN							
X 2754 N HIGH NOON WY							
X 43296 N NAVIGATION WY							
X 10352 E WINDGATE PASS DR							
X 2066 W WOLF RUN DR							
X 2594 W HASTINGS WY							
X 5304 E VILLAGE PKWY							
X 1369 S GARDEN CIR E							
X 1372 S GARDEN CIR E							
X 3655 W ANTHEM WY							
X 9619 E DESERT CAMP DR							
X 10902 E WINDGATE PASS DR							
X 3480 S CALISTOGA DR							
X 3430 E MENLO PARK DR							
X 42022 N GAVILAN PEAK PKWY							
X 2294 W HASTINGS WY							
X 2438 W PECOS RD							
X 10875 N 78 ST							
X 1351 E BUFFALO ST							

	SMU	FDI
1 shelf =	4	4

REDACTED

CONFIDENTIAL

BSI PHYSICAL REMOTE COLLOCATION

SAI ADDRESS	Total Shelves	12/13/04 Billable Shelves	Initial Cabinet Turn Up Date	Non-Recurring Space per mounting unit @$868.13	Non-Recurring FDI Terminations per binder group @$558.99	Total Non-Recurring Charges	Intrastate Revenues @.8095
X 3395 E PALMER ST							
X 42184 N MANTLE WY							
I 4041 N CENTRAL AV							
X I 1121 N 44 ST							
X 1850 W WOLF RUN DR							
X 5261 W IRONWOOD DR							
X 112 E CHANDLER BLVD							
X 15433 S 13 DR							
X 590 W CHANDLER BLVD							
X 1502 E LIBERTY LN							
X 2374 W GERMANN RD							
X 2647 W COYOTE CREEK CT							
X 4262 W ORANGEWOOD AV							
X 5350 E DOUBLETREE RANCH RD							
X 593 E CANYON CREEK RD							
X 130 N COLORADO ST							
X 18200 N 9 ST							
X 4231 W EVA ST							
X 5205 N 78 ST							
X 5801 N 78 ST							
X 875 N MCQUEEN RD							
X 5550 N 78 ST							
X 700 E BELMONT AV							
X 7708 N 12 ST							
X 17030 N 15 ST							
X 1860 E MICHIGAN AV							
X 27527 N NORTERRA PKWY							
X 7829 E VISTA DR							
X 986 E SPECTRUM WY							
X 3130 E RYAN RD							
X 2604 S HARTFORD ST							
X 1498 E FRYE RD							
X 3493 W PARKSIDE LN							
X 34203 N 24 AV							
X 607 E DERRINGER WAY							
X 3230 W DYNAMITE BLVD							
X 7613 S 20 ST							
I 6683 S CLUBHOUSE DR							
X 42337 N 45 DR							

REDACTED

BSI PHYSICAL REMOTE COLLOCATION

SAI ADDRESS	Total Shelves	12/13/04 Billable Shelves	Initial Cabinet Turn Up Date	Non-Recurring Space per mounting unit @$868.13	Non-Recurring FDI Terminations per binder group @$558.99	Total Non-Recurring Charges	Intrastate Revenues @.8095
X 10265 E ROB'S CAMP RD							
X 25600 N STETSON HILLS LP							
X 7602 S 21 DR							
I 9400-7 W MARYLAND AVE							
X 5025 N 36 ST							
X 6258 S BRADSHAW WAY							
X 4088 S POSSE TR							
X 4104 S HIGLEY RD							
I 4369 E VILLAGE PKWY							
X 6201 S TURQUOISE DR							
X 12603 E HEMLOCK WAY							
X 13731 E SHANNON ST							
X 24201 N 61 AV							
X 3129 W PINNACLE VISTA DR							
X 3595 S TATUM LN							
I 875 W PECOS RD							
X 2082 E WILLIS RD							
X 2897 W SHAUGHNESSEY RD							
X 3619 S CUPERTINO DR							
X 28203 N 31 AV							
X 8559 W BRILES RD							
X 1625 S SANDERS DR							
X 1708 S SANDERS DR							
X 27240 N PLEASANT VALLEY DR							
X 330 W GERMANN RD							
X 3600 E YALE ST							
X 15725 E OCOTILLO RD							
X 1856 S BLUEJAY DR							
X 19638 N 31 AV							
X 2135 E TAURUS PL							
X 2841 E AGRITOPIA LP							
X 2951 S HIGLEY RD							
X 3145 E WATERVIEW DR							
X 3720 E RAY RD							
X 3777 S NAPA LN							
X 5300 S RIGGS MEADOWS DR							
X 5791 S GILBERT RD							
X 1717 E OCOTILLO RD							
X 1730 E BROOKS FARM RD							

REDACTED

BSI PHYSICAL REMOTE COLLOCATION

SAI ADDRESS	Total Shelves	12/13/04 Billable Shelves	Initial Cabinet Turn Up Date	Non-Recurring Space per mounting unit @$868.13	Non-Recurring FDI Terminations per binder group @$558.99	Total Non-Recurring Charges	Intrastate Revenues @.8095
X 2099 E BLUE RIDGE WAY							
X 2100 W SAINT CHARLES AV							
X 1320 N LAKE PARK DR							
X 6506 S MCQUEEN RD							
X 2802 S LINDSAY RD							
X 6753 S MAREN DR							
X 950 W GERMANN RD							
X 3782 E MANZANITA RD							
X 3321 W VINEYARD RD							
X 3574 S HIGLEY RD							
X 7210 S 31 AV							
X 3869 S LANTANA RANCH BLVD							
X 6029 S SUN GROVES BLVD							
X 2070 S ASHLAND RANCH RD							
X 1310 S ASHLAND RANCH RD							
X 29788 N SCOTTSDALE RD							
X 3680 S GILBERT RD							
X 8621 W VARNEY RD							
X 1352 N PLEASANT DR							
X 6586 W DEER VALLEY RD							
X 2289 E OCOTILLO RD							

REDACTED

QWEST CORPORATION
Arizona Intrastate Operations
Test Year Ending December 31, 2003
ROLLDOWN OF REVENUE REQUIREMENT

		A	B	C	D = A+C
		Revenue Requirement - Rebuttal Exhibit PEG-R1	Revised Qwest or Uncontested ACC Staff Adjustments (Notes 1 & 2)	Change in Revenue Requirement	Revenue Requirement - Rejoinder Exhibit PEG-RJ05
A.	Earned Return Per Books	0		0	0
B.	Revenue Requirement Authorized	417,448		0	417,448
	Accounting Adjustments				
	PFA-01 Depreciation	(145,538)		0	(145,538)
	PFA-02 Post Employment Benefits Other Than Pensions	40,002		0	40,002
	PFA-03 REVISED SOP98 Adoption	19,005		0	19,005
	PFA-04 Plant Under Construction	4,087		0	4,087
C.	**Total Accounting Adjustments**	(82,444)	0	0	(82,444)
	Normalizing Adjustments				
	PFN-01 Out of Period Revenue and Expense	(19,781)	(11,250) #	8,532	(11,250)
	PFN-02 In-Test-Year Rate Changes	7,272		0	7,272
	PFN-03 Operating Income Annualization	44,706		0	44,706
	PFN-04 Post-Test-Year Rate Changes	18,858		0	18,858
	PFN-05 Wage and Salary Rates	211		0	211
	PFN-06 Headquarters Factors Update	(4,447)		0	(4,447)
	PFN-07 Rent Compensation Update	(2,924)		0	(2,924)
	PFN-08 Incentive Compensation True-Up	(1,181)		0	(1,181)
	PFN-09 Call Centers	(4,669)		0	(4,669)
	PFN-10 Property Tax Update	(798)		0	(798)
	PFN-11 Depreciation Synchronization	4,616		0	4,616
	PFN-12 Planning for Enhanced Services TrueUp	(8,320)		0	(8,320)
	PFN-13 Contingency Accruals	(6,011)		0	(6,011)
	PFN-14 Separations Factors	(345)		0	(345)
	PFN-15 Effective Income Tax Rates	330		0	330
	PFN-16 Sponsorships	(493)		0	(493)
	PFN-17 Separations Changes	(3,181)		0	(3,181)
	PFN-18 BSI Remote Colocation Revenue		(1,199) #	(1,199)	(1,199)
	PFN-S1 Remove Voice Messaging		(480) ##	(480)	(480)
	PFN-S2 Qwest Wireless Prices (ACC Staff C-10)		(530) ##	(530)	(530)
	PFN-S3 Re-Audit, D&O, Sec Litigation Costs (ACC Staff C-12)		(2,034) ##	(2,034)	(2,034)
	PFN-S4 PUBLIC AFFAIRS COSTS (Staff ACC C-14)		(389) ##	(389)	(389)
	PFN-S5 QSC COST EXCLUSIONS (Staff ACC C-15)		(116) ##	(116)	(116)
D.	**Total Normalizing Adjustments**	23,843	(15,997)	3,784	27,627
	Ratemaking Adjustments				
	PFR-01 Directory Revenue Imputation	(74,196)		0	(74,196)
	PFR-02 Fines and Penalties	(1,405)		0	(1,405)
	PFR-03 Interest Synchronization	(19,526)		0	(19,526)
	PFR-04 Cash Working Capital	(9,892)		0	(9,892)
	PFR-05 Pension Asset	18,462		0	18,462
	PFR-06 Remove 1991 Merger Cost	(4)		0	(4)
	PFR-07 Charitable Contributions	(1,159)		0	(1,159)
	PFR-08 Customer Deposits	130		0	130
E.	**Total Ratemaking Adjustments**	(87,589)	0	0	(87,589)
F.	**Total Adjustments**	(146,190)	(15,997)	3,784	(142,406)
G.	**Adjusted Revenue Requirement**	271,258	(15,997)	3,784	275,042

Notes:
1) Data source:
- Source is a Qwest calculated adjustment.
##- Source is an ACC Staff calculated adjustment (Schedule E).
2) Impact of changes in adjustments are assumed here to have a diminimus effect on other, dependent adjustments (i.e. Interest Sync & CWC).
Interest Sync and Cash Working Capital adjustments, while uncontested, are generally standard calculations based on a parties total adjusted Intrastate.
These adjustments will only be determined when the Commission renders a decision or the parties reach a settlement.

REDACTED

REDACTED

ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TENTH SET OF DATA REQUESTS

Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

Furthermore, it should also be noted that Qwest's offbook accounting records have not complied with PAYGO accounting, as addressed in Decision No. 58927. At pages 69-70, Mr. Carver describes how Qwest has continued to maintain its Arizona intrastate accounting records on an accrual basis, except for the TBO amortization, not on PAYGO basis.

Respondent: Steven Carver

REQUEST: Qwest 10-18

Identify the date and method by which the Arizona Corporation Commission notified Qwest that it was authorized to begin using Statement of Financial Accounting Standards No. 106 (SFAS 106) to account for the cost of other post employment benefits (OPEBs) for ratemaking purposes in Arizona. Please provide copies of any and all documents that support your answer.

RESPONSE:

See the response to Qwest DR 10-17.

10-19 Please identify by citation (including the page and line numbers) the Arizona Corporation Commission decision or order that prescribes for Qwest how it is to amortize the Transition Benefit Obligation for ratemaking purposes.

RESPONSE:

See the responses to Qwest DRs 10-17 and 10-18. In Docket No. T-1051B-99-105, Staff and RUCO concurred with Qwest's proposed TBO amortization for ratemaking purposes. The Company was fully aware of its proposed TBO amortization and the fact that Staff and RUCO were supportive of such accounting for OPEB costs.

Respondent: Steven Carver

REQUEST: Qwest 10-20

Staffs Supplemental Response to Qwest Data Request No. 2-42 includes a document entitled "Proposal to the Arizona Corporation Commission Utilities Division, Qwest Corporation Filing of a Renewed Price Cap Plan" prepared by Utilitech, Inc., 740 NW Blue Parkway, Ste. 204, Lee's Summit, MO and showing a due date of March 26, 2004, 3:OO p.m. On the page numbered 16 of that document the third full paragraph reads:

ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TENTH SET OF DATA REQUESTS
Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

"Accumulated Deferred Income Taxes - Like accumulated depreciation, review of detailed transactions in the accumulated deferred income tax reserve balance generally yields low "payback" results in terms of rate case adjustments. However, any material transactions which impact the level of booked deferred taxes will be reviewed. In addition, component parts of the reserve will be compared to the regulatory treatment of associated balance sheet accounts for consistency between transactions and their related tax effects. For example, given the ACC's historical treatment of FAS 106 costs, deferred taxes associated with this accounting change may be treated as non-jurisdictional." Emphasis added.

a. Please admit that the assumptions underlying the treatment of deferred taxes associated with this accounting change as non-jurisdictional are as follows:

1. The deferred tax balance arose as a result of timing differences between FAS 106 cash basis cost recognition under federal income tax law and accrual basis cost recognition under FCC rules; and

2. The deferred taxes are non-jurisdictional in Arizona because unlike the FCC, Arizona employs cash basis cost recognition for Qwest's FAS 106 costs.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit, including but not limited to, a detailed explanation of what assumption about the Arizona Corporation Commission's historical treatment of FAS 106 costs UTI made with regard to treating as non-jurisdictional the deferred taxes associated with this accounting change.

RESPONSE:

a.1. With regard to OPEB costs, accumulated deferred income taxes and the related ADIT reserve balance are associated with the timing difference between the recording of accrual basis costs and allowable IRC deductions for PAYGO, or cash basis, expenditures to or on behalf of eligible retirees.

a.2. In general terms, the recognition of accumulated deferred income tax (ADIT) reserves in rate base follows ratemaking recognition of the underlying transactions giving rise to those tax/ book timing differences. In ACC Docket No. E-1051-93-183, then U S West proposed adoption of accrual accounting and rate base

ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TENTH SET OF DATA REQUESTS

Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

recognition of both an OPEB liability and related debit deferred income tax reserve balance. In that proceeding, Staff proposed and the Commission adopted the continuation of PAYGO accounting in lieu of FAS106 accrual basis recognition. Staff Adjustment B-8 removed the OPEB liability and the debit ADIT reserve balances from rate base, increasing intrastate rate base by about $5 million. In Docket No. T-1051B-99-105, the pro forma OPEB recommendations sponsored by Company witness Redding, including any embedded rate base and ADIT impacts, were not contested by Staff. In the current proceeding, Mr. Carver sponsors Staff Adjustment B-8, which recognizes a rate base reduction for the excess of cumulative OPEB accruals over PAYGO during the period 1999 through 2003 – net of related debit ADIT reserve impacts – consistent with Staff's adoption of Mr. Redding's OPEB recommendations in Docket No. T-1051B-99-105. The net effect of Staff Adjustment B-8 in the current proceeding increases rate base by about $78.7 million, as compared to Qwest's proposed treatment.

Respondent: Steven Carver

REQUEST: Qwest 10-21

Staffs Supplemental Response to Qwest Data Request No. 2-42 includes a document entitled "Proposal to the Arizona Corporation Commission Utilities Division, Qwest Corporation Filing of a Renewed Price Cap Plan" prepared by Utilitech, Inc., 740 NW Blue Parkway, Ste. 204, Lee's Summit, MO and showing a due date of March 26, 2004, 3:OO p.m. On the page numbered 19 of that document the second full paragraph reads:

> "FAS 106 - The cost of post-retirement benefit (OPEB) programs will be assessed on the basis of past Arizona precedent as well as Company efforts to mitigate cost exposures. The utilization of tax-advantaged funding vehicles and the existence of reasonable actuarial determinations of such costs will also be considered. UTI will work with ACC Staff personnel to formulate the position taken on this issue. The materiality of any amounts Qwest proposes to include in cost of service will be considered in determining the amount of project resources assigned to this area."

a. Identify with specificity the past Arizona precedent to which the first sentence in the paragraph refers. Please provide a copy of any and all documents that establish the "past Arizona precedent'' concerning OPEBs to which the first sentence refers.

b. Please provide copies of any and all notes, correspondence, and other

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

ARIZONA CORPORATION COMMISSION

BRIAN C. MCNEIL
Executive Secretary

January 25, 2005

Sent via email and First Class Mail

Timothy Berg
FENNEMORE CRAIG
3003 N. Central Avenue Ste. 2600
Phoenix, Arizona 85012

Norman G. Curtright
QWEST CORPORATION
4041 N. Central Avenue, Ste. 1100
Phoenix, Arizona 85012

Re: Qwest Corporation's Amended Renewed Price Regulation Plan
Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

Dear Messrs. Berg and Curtright:

Enclosed please find Staff's responses to Qwest's Twenty-first, Twenty-second and Twenty-third sets of Data Requests.

Should you have any questions, you may contact me at (602) 542-6022.

Very truly yours,

Maureen A. Scott
Attorney, Legal Division

MAS:daa
Enclosure

REQUEST NO.: Qwest 21-1

In answering this request, please refer to the Dunkel Surrebuttal Testimony. Identify and provide an electronic copy of any and all of Mr. Dunkel's workpapers that support his RCND analysis and his development of the conditions percents shown on Schedule WDA-S5.

RESPONSE: 21-1

The workpapers for all of the accounts, including the three addressed in Mr. Dunkel's Surrebuttal testimony may be found on the enclosed disk.

Respondent: William Dunkel

REQUEST NO.: Qwest 22-1

In answering this request, please refer to Page 6, Line 8 of the Brosch Surrebuttal Testimony. Is it your position that Arizona regulatory jurisprudence does not presume operating expense items, such as advertising, lobbying, corporate contributions and incentive compensation, to be reasonable? If your response is yes, please identify any and all relevant citations to any Arizona authority that supports your answer.

RESPONSE: 22-1

Mr. Brosch is not an attorney and offers no legal opinion regarding what is permitted under Arizona jurisprudence. Mr. Brosch is advised by Staff Counsel that legal issues associated with Staff's revenue requirement positions will be addressed in Staff's Briefs in this Docket.

Mr. Brosch's Surrebuttal Testimony is responsive to Mr. Grate's inaccurate citation of cost recovery review standards in Arizona, said to be applicable to operating expense items such as advertising, lobbying, corporate contributions and incentive compensation. Upon review of the Commission's rules, Mr. Brosch found no prescribed standards for regulatory review of operating expenses and no presumption that such costs are reasonable, as asserted by Mr. Grate.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-2

In answering this request, please refer to Page 7, Line 17 through Page 8, Line 9 of the Brosch Surrebuttal Testimony. For each of the following, identify and explain how <u>each</u> provides benefits to ratepayers that are both <u>tangible</u> and <u>direct</u>:

a) Employees' paid vacations and sick leave;
b) Employees' healthcare benefits;
c) Employees' retirement savings plan benefits;
d) Employees' post employment benefits;
e) Employee training expenses;
f) Cost of compliance with immigration laws;
g) Cost of compliance with environmental laws;
h) Cost of compliance with safety laws;
i) Cost of compliance with and workers' compensation laws;
j) Costs of operating Qwest's accounts receivable department;
k) Costs of operating Qwest's accounts payable department;
l) Costs of operating Qwest's customer billing department;
m) Costs of operating Qwest's customer credit department;
n) Costs of operating Qwest's legal department;

o) Costs of operating Qwest's tax department;
p) Costs of operating Qwest's human resources department;
q) Costs of operating Qwest's risk management department; and
r) Costs of operating Qwest's real estate department.

RESPONSE: 22-2

Rate recovery of the listed types of costs are not at issue in this Docket and are not the subject of Mr. Brosch's Surrebuttal Testimony. Staff's review of operating expenses in this Docket did not find rate recovery of any of the listed costs (listed items a through r) to be objectionable or to be inconsistent with past Arizona Corporation Commission ratemaking policies. In contrast other expenses, such as corporate image advertising, have been excluded in past Qwest rate cases and remain subject to disallowance. In his Surrebuttal response to Mr. Grate's assertion that virtually all costs are as "discretionary"as corporate image advertising, Mr. Brosch states, "The employee benefits and various department costs listed by Mr. Grate are representative of costs that do provide tangible, direct benefits to the Company and its ratepayers and are not discretionary to the same extent as the corporate image advertising, legislative affairs and incentive compensation costs that are being challenged by Staff."

With respect to employee benefit costs (listed items a through e), it is obvious that Qwest Corporation employees are essential to the provision of services in Arizona and that these elements of their compensation, if reasonable in amount, represent costs associated with human resources that are of direct tangible benefit to Qwest customers. Staff has not asserted that Qwest Corporation employees are not providing direct tangible benefits to customers by responding to their service demands and maintaining the network and support systems required to provide safe and adequate regulated services.

With respect to compliance with laws (listed items f through i), Staff recognizes that public utility operations are subject to tax, labor, environmental and other laws and that compliance activities and reasonable costs incurred with respect to legal compliance are essential and non-discretionary costs of doing business. Costs associated with compliance with such laws provides a direct and tangible benefit to customers by ensuring that Qwest pays only the taxes and fees that it owes while avoiding fines and penalties associated with non-compliance.

Similarly, the "departmental" costs (listed items j through r) represent essential business functions that provide tangible direct benefits to Qwest Corporation and its customers, by allowing the business to comply with laws and regulations, cost-effectively manage its human resources, administer insurance programs and acquire/manage real estate, for which the costs incurred, if reasonable in amount, are generally viewed by regulators as recoverable.
All of the listed costs are distinguishable from Qwest's corporate image advertising and

incentive compensation costs which are largely discretionary and are subject to heightened regulatory scrutiny before the ACC and other state commissions as a matter of regulatory policy.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-3

In answering this request, please refer to Page 8, Lines 20-30 of the Brosch Surrebuttal Testimony.

Admit that none of the "other criteria" described in the direct testimony filed on behalf of Staff Testimony relies on a standard of disallowance that compares Qwest's costs to commercially reasonable costs (i.e. costs that would be considered reasonable and prudent by competent managers of unregulated large commercial enterprises).

_____Admit _____Deny

If your answer to this request is anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit, and provide all facts and data that form the basis for this assertion.

RESPONSE: 22-3

a) Staff admits that none of the listed "other criteria" in Mr. Brosch's Surrebuttal are premised upon adoption of Mr. Grate's preferred and erroneous regulatory review standard that would generally presume all incurred expenses of regulated utilities to be reasonable as long as such costs "would be considered reasonable and prudent by competent managers of unregulated large commercial enterprises".

b) Please identify any Commission precedent upon which you rely for your proposed adjustment C- 1 7 regarding incentive compensation expenses.

Response:
Mr. Carver sponsors Staff's Adjustment C-17. A review of his direct testimony reveals no citation to or explicit reliance upon any ACC precedent. However, in response to Qwest Data Request 16-1 and surrebuttal testimony (pages 43-46), Mr. Carver quotes from various ACC decisions supporting the exclusion of incentive compensation costs.

c) Please identify any Commission precedent upon which you rely for your proposed adjustment C-9 regarding marketing and advertising costs.

Response:
Please refer to Mr. Brosch's Direct Testimony at page 8, line 15 through page 10, line 6.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-4

In answering this request, please refer to Page 9, Lines 16-19 of the Brosch Surrebuttal Testimony.

a) Identify any facts, documents, Commission precedent or other evidence upon which you rely for the proposition that your adjustment C-17 regarding incentive compensation expenses is an established Commission regulatory policy.

RESPONSE: 22-4

The reference to Brosch Surrebuttal Testimony Page 9, lines 16-19 is unclear. Please refer to Mr. Carver's Direct Testimony at pages 36 through 45 where he explains the facts, documents and other evidence he (rather than Mr. Brosch) relied upon. See also the response to Qwest Data Request 22-3, above.

b) Identify any facts, documents, Commission precedent or other evidence upon which you rely for the proposition that your proposed adjustment C-9 regarding marketing and advertising costs is an established Commission regulatory policy.

Response:
Please refer to Mr. Brosch's Direct Testimony at page 8, line 15 through page 10, line 6.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-5

In answering this request, please refer to Page 12, Line 17 of the Brosch Surrebuttal Testimony.

Admit that it is your position that Arizona regulatory jurisprudence permits disallowance of image advertising in ratemaking unless a utility meets a burden of providing economic justification for it.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit, and

identify and provide all facts and data that form the basis for this assertion. In particular, identify and provide any relevant citation to the source of Arizona regulatory authority (including but not limited to Arizona statutes, administrative rules, or Commission decisions) that forms or supports your opinion.

RESPONSE: 22-5

Mr. Brosch is not an attorney and offers no legal opinion regarding what is permitted under Arizona jurisprudence. Mr. Brosch is advised by Staff Counsel that legal issues associated with Staff's revenue requirement positions will be addressed in Staff's Briefs in this Docket.

Mr. Brosch's testimony recommends disallowance of corporate image advertising based upon past ACC treatment of such costs in past rate proceedings as well as other criteria described at pages 12 through 17 of his Direct Testimony, recognizing that Qwest has the opportunity to explain and justify the cost-effectiveness and need for such image advertising as it seeks to modify past ACC treatment by including such costs within the revenue requirement.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-6

In answering this request, please refer to Page 12, Line 23 of the Brosch Surrebuttal Testimony.

a) Admit that it is your position that Arizona regulatory jurisprudence imposes on the utility the burden of proof to show why image advertising should not be disallowed.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion. In particular, identify and provide any relevant citation to the source of Arizona regulatory authority (including but not limited to Arizona statutes, administrative rules or Commission decisions) that forms or supports your opinion.

RESPONSE: 22-6

Please see Staff's response to Qwest Data Request 22-5 above.

b) Admit that it is your position that Arizona regulatory jurisprudence imposes on the utility the burden of proving that its image advertising is cost effective.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion. In particular, identify and provide any relevant citation to the source of Arizona regulatory authority (including but not limited to Arizona statutes, administrative rules or Commission decisions) that forms or supports your opinion.

Response:
Please see Staff's response to Qwest Data Request 22-5, above.

c) Admit that it is your position that Arizona regulatory jurisprudence imposes on the utility a burden of proving that its image advertising is reasonable.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion. In particular, identify and provide any relevant citation to the source of Arizona regulatory authority (including but not limited to Arizona statutes, administrative rules or Commission decisions) that forms or supports your opinion.

Response:
Please see Staff's response to Qwest Data Request 22-5, above.

d) Admit that as a matter of ratemaking policy, you believe that Arizona regulatory jurisprudence imposes on the utility a burden of proving that its image advertising is cost effective.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion. In particular, identify and provide any relevant citation to the source of Arizona regulatory authority (including but not limited to Arizona statutes, administrative rules or Commission decisions) that forms or supports your opinion.

Response:
Please see Staff's response to Qwest Data Request 22-5, above.

e) Admit that you have not offered expert opinion to show that Qwest's test year image advertising expenditures were commercially unreasonable or wasteful or imprudent.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion. In particular, identify the expert witness upon whom Staff relies, and identify that witness' qualifications to offer expert testimony that Qwest's image advertising expenditures were commercially unreasonable, wasteful or imprudent.

Response:
Please see Staff's responses to Qwest Data Requests 22-3(a) and 22-5, above.

f) Admit that Staff has not offered substantial comparative data showing that Qwest's test year image advertising expenditures were commercially unreasonable or wasteful or imprudent or ineffective.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion.

Response:
Please see Staff's responses to Qwest Data Requests 22-3(a) and 22-5, above.

g) Admit that you have not offered expert opinion showing that compared to commercial standards of conduct, Qwest's test year image advertising expenditures were commercially unreasonable or wasteful or imprudent or in effective.

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion.

Response:
Please see Staff's responses to Qwest Data Requests 22-3(a) and 22-5, above.

h) Identify and explain precisely the standard of review that applies to the inclusion of Arizona utility's image advertising in calculating the cost of service for purposes of establishing revenue requirement. Identify by specific citation, including page number, the source of Arizona statute, rule, decision or other precedent that informs or supports your answer to this request.

Response:
Objection, this question seeks a legal conclusion. Without waiving this objection, Staff is unaware of any Arizona statute or rule that defines a specific standard of review association with rate recovery of an Arizona utility's image advertising in calculating the cost of service to establish revenue requirement. Pages 8 and 9 of Mr. Brosch's Direct Testimony explain ACC precedent regarding the disallowance of Qwest/US West corporate image advertising costs.

i) State and explain precisely what burden of proof you believe Arizona utilities must bear in order to include image advertising costs in the calculation of cost of service for purposes of establishing revenue requirement. Identify by specific citation, including page number, the source of Arizona statute, rule, decision or other precedent that informs or supports your answer to this request.

Response:
Objection, this question seeks a legal conclusion. Without waiving this objection, Staff is unaware of any Arizona statute or rule that defines a specific standard of review association with rate recovery of an Arizona utility's image advertising in calculating the cost of service to establish revenue requirement. Pages 8 and 9 of Mr. Brosch's Direct Testimony explain ACC precedent regarding the disallowance of Qwest/U S West corporate image advertising costs. Qwest's "burden of proof" is to convince the Commission that changed circumstances now warrant revision of past regulatory policy in Arizona that excluded corporate image advertising costs.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-7

In answering this request, please refer to Page 9, Lines 16-19 of the Brosch Surrebuttal Testimony.

a) Identify and explain all reasons why Staff could not "simply append seven prescribed adjustments to Qwest's unadjusted, separated intrastate financial reports" if Qwest were to provide its unadjusted separated results of operations.

RESPONSE: 22-7

Staff assumes the intended reference is to page 21 of Mr. Brosch's Surrebuttal Testimony. The reasons Qwest should be required to "simply append seven prescribed adjustments" include the following:

- Qwest possesses the accounting data to accurately and more efficiently calculate and include all seven of the adjustments, while Staff would be required to request and interpret accounting data from the Company each year to quantify some of the adjustments.
- Qwest is more familiar with its accounting data and the extraction of information required to prepare accounting adjustments. Staff consultants who are retained to assist during formal regulatory proceedings are familiar with accounting adjustments, but such consultants are not on retainer to assist between rate proceedings when financial reports are submitted by Qwest.
- If Staff independently prepared complex adjustment calculations to append to Qwest's annual reports, it is likely that Qwest may dispute how such adjustments were quantified and appended. Admittedly, Staff could independently insert the fixed amounts of directory imputation and cash working capital (Brosch Direct, page 6, line 25 and 28) but the other five adjustments are inherently complex and Staff would need to request and evaluate Qwest's detailed accounting data to calculate such adjustments.
- A single, integrated filing of the prescribed data by Qwest would contain information regarding ACC-basis Arizona financial performance that more accurately depicts jurisdictional regulatory policies in one document for which Qwest is entirely responsible, rather than introducing multiple calculations of adjusted financial results to be interpreted and weighed by the Commission.

b) Please identify and explain why it would be an excessive or unreasonable "burden" for Staff to "prepare a few additional prescribed adjustments" to unadjusted separated results of operations supplied by Qwest.

Response:
Please see the response to Part (a), above.

c) Please identify and explain the importance of the resulting annual reports to Staff and the Commission. In particular explain what decisions Staff and or the Commission would likely make with information gleaned from reports of separated results of operations adjusted for seven items that they could not make with separated results of operations that had no adjustments.

Response:
The resulting annual reports could be employed by Staff and the Commission to monitor Qwest's financial performance on a jurisdictional, adjusted basis and have knowledge of Qwest's overall financial performance and financial condition when other issues are before it, such as tariff submissions, customer complaints, service classification proceedings or service quality disputes. Additionally, in any future review of Qwest's Price Cap Plan or any other, new regulatory framework, a series of financial Annual Reports that are prepared on a consistent ACC basis of

accounting to show how Qwest's financial results have changed or trended throughout recent history should be useful in determining what specific, more detailed information is required in such future proceedings.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-8.

In answering this request, please refer to Qwest Data Request No. 15-2(e)(2), and Staffs response to that request.

a) Does being subject to cost of service revenue and rate regulation by the Commission afford Qwest protection from market forces in Arizona? If so, please identify and describe the protection so afforded and provide the facts, data or other evidence that supports your identification and description.

RESPONSE: 22-8

No. However, Qwest is the incumbent LEC in Arizona and is the dominant provider in many markets it serves, as explained in the testimony of Staff witness Fimbres. Certain of Qwest's intrastate services are subject to less competition than others, as evidenced by the service basket classifications within the existing Price Cap Plan. In any event, the purpose of late regulation is not to "protect" the utility, but rather to protect the ratepayers, from the monopoly or market power of the utility, while allowing the utility to chase a just and reasonable rate.

b) Please provide any and all facts, data, or other evidence that shows that cost of service revenue and rate regulation by the Commission protects Qwest from market forces in Arizona.

Response:
Please see the response to part (a).

c) Please identify and provide any and all facts, data, or other evidence that shows that Qwest is not subject to market forces in Arizona.

Response:
Please see the response to part (a), as well as the testimony of Staff witness Fimbres.

d) Please state and explain all reasons why you believe Qwest's competitors are not compelled to produce confidential advertising data in discovery propounded by Staff.

Response:
In its response to Qwest question 15-2(e)(2), Staff stated, "Staff has no reasonable opportunity to derive meaningful Arizona-basis, comparable advertising data for each of Qwest's competitors, given that no public reporting of such data exists. Competitors would undoubtedly view such information to be confidential information they are not compelled to produce in the pending Qwest proceeding." Some of Qwest's competitors are not subject to the jurisdiction of the ACC while others are not parties to Qwest regulatory proceedings. Moreover, there are no prescribed accounting and reporting procedures through which one might reasonably expect non-regulated business that compete with Qwest to have Arizona-basis comparable data that segregates product from corporate-image advertising in the manner required by FCC Part 32 Rules.

e) Please confirm that you believe there is no linkage between incurred costs and pricing for other service providers that compete with the incumbent LEC.

Response:
In its response to Qwest question 15-2(e)(2), Staff stated, "There is no reason to assume any linkage between incurred costs and pricing or revenues for other service providers that compete with the incumbent LEC, because competitors are generally subject to market forces, rather than cost-based pricing." With pricing dictated by market forces, the only linkage to costs in an effectively competitive market would be in deciding whether entry into a market or continuing to offer a given product/service within a competitive market is likely to produce sufficient financial returns.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-9

In answering this request, please refer to Qwest Data Request No. 15-3 and Staffs response to that request.

a) Do you believe that as long as Qwest remains subject to cost of service revenue and rate regulation by the Commission in Arizona, Qwest faces no competitive pressures in Arizona? If your answer is yes, please state the basis for your explanation.

Response:
No. In its response to Qwest question 15-3, Staff stated, "As long as Qwest remains subject to cost-based regulation of its revenues and rates, competitive pressures must be assumed to be insufficient to justify deregulation. The corollary to this view is that Qwest will be free to seek recovery of all costs (including image advertising) as well as an unlimited profit in Arizona at the time competition is determined to be sufficient to justify deregulation of the Company's services." See the testimony of Staff witness Fimbres regarding the competitive pressures faced by Qwest in Arizona.

b) Do you believe that until Qwest is no longer subject to cost of service revenue and rate regulation by the Commission in Arizona, that regulation provides Qwest protection from competitive pressures? Please also state the basis of your explanation in your answer.

Response:
Please refer to Staff's response to Part (a), above.

Respondent: Michael Brosch

REQUEST NO.: Qwest 23-1

In answering this request, please refer to Page 23, Lines 19-22 of the Carver Surrbuttal Testimony.

a) Please identify the jurisdictions in which you have given cost-of service testimony that require by statute or rule the use of an end of period rate base.
b) Please identify the jurisdictions in which you have given cost-of service testimony that require by other than statute or rule the use of an end of period rate base.
c) Please identify the jurisdictions in which you have given cost-of-service testimony that do not require the use of an end of period rate base.

RESPONSE: 23-1

Staff objects to Qwest's discovery request as being overly broad and unduly burdensome. In response to Data Requests UTI 21-8 and UTI 21-9, Qwest objected to providing certain information associated with a discussion of rate base and ratemaking methods appearing at pages 34-35 of Mr. Grate's rebuttal testimony, indicating that:

- The requested information is not reasonably calculated to lead to the discovery of information relevant to this docket.
- The request would require Qwest to research the ratemaking methodologies of 49 states.
- This irrelevant information is as readily available to Staff as it is to Qwest.
- The question would appear to require Qwest to research the other 13 states where Qwest is the ILEC in order to identify those States that employ an historic vs. future or forecast test year. This irrelevant information is a readily available to Staff as it is to Qwest.

a) Without waiving this objection, Mr. Carver has not performed exhaustive research into the ratemaking methodologies of the various regulatory jurisdictions in which he has previously filed testimony for purposes of this proceeding. The cited portion of Mr. Carver's surrebuttal testimony was in response to representations of Mr. Grate at page 34 of his rebuttal testimony. Referring to Attachment SCC-2 (Carver direct testimony), Mr. Carver provided a listing of 13 different jurisdictions and 63 dockets in which he has previously filed testimony.

In the early stages of a regulatory engagement, UTI determines the general ratemaking methodologies and approaches acceptable to that regulatory jurisdiction. Such a determination may take various forms, including: discussions with client representatives, review of prior Commission decisions, reviews of prior client sponsored testimonies, review of utility testimonies, review of Commission rules or regulations, etc. However, Utilitech does not maintain a data base containing the information regarding other state statutes and rules which Qwest seeks.

Moreover, it is the testimony of Qwest witness Grate, not Staff witnesses Carver or Brosch, who has filed extensive testimony seeking to raise and litigate generic ratemaking issues involving the Arizona regulatory process in the pending Price Cap proceeding. We do not have and have not compiled a listing of jurisdictional information responsive to this request. As such, UTI does not possess a summary of the general regulatory approach or methodologies embraced by each jurisdiction (e.g., end-of-period vs. average rate base, historic or forecast test year, etc.). Consequently, the information requested by Qwest is as readily available to Qwest as it is to Staff.

The following information is based upon Mr. Carver's knowledge and belief of the Commission policies in Arizona and other states.

Jurisdiction		Year End		Average		Test Year
Arizona		X				Historic
California				X		Forecast
Florida				X		Forecast
Hawaii				X		Forecast
Indiana		X				Historic
Kansas		X				Historic
Missouri		X				Historic
Nevada		X				Historic
New Mexico				X		Historic
Oklahoma		X				Historic
Pennsylvania		X				Forecast
Utah				X		Historic
Washington				X		Historic

b) See the response to item (a) above.
c) See the response to item (a) above.

Respondent: Steven Carver

REQUEST NO. Qwest 23-2.

In answering this request, please refer to Page 42 Line 27 through Page 43, Line 9 of the Carver Surrebuttal Testimony. Please identify and provide a copy of each and every one of the 14 testimonies Mr. Carver has filed concerning incentive benefit plans.

RESPONSE: 23-2

Staff objects to Qwest's discovery request as being unduly burdensome. Without waiving this objection, Mr. Carver has filed testimony on incentive compensation in the following dockets. Copies are a matter of public record and available at each of the State Commissions. [The "Page # Ref" identifies the starting page of Mr. Carver's direct testimony on this subject.]

Company Name	Docket No.	Year	Page # Ref
US West Communications (AZ)	E-1051-88-146	1989	94
PSI Energy (IN)	40003	Nov 1995	43
GTE Hawaiian Telephone (HI)	94-0298	1996	81
Oklahoma Gas & Electric (OK)	960000116	Oct 1996	68
Arizona Telephone Company (AZ)	U-2063-97-329	Dec 1997	47
US West Communications (UT)	97-049-08	1997	73
Sierra Pacific Power Co. (NV)	98-4062/98-4063	Jan 1999	50
US West Communications (AZ)	T-1051B-99-105	2000	39
US West Communications (NM)	3008	March 2000	78
The Gas Company (HI)	00-0309	2001	65
PSI Energy IN)	42359	Aug 2003	77
Arizona Public Service Co. (AZ)	E-10345A-03-0437	Jan 2004	56
Verizon Northwest (WA)	UT-040788	Nov 2004	26
Qwest Corporation (AZ)	T-01051B-03-0454 T-00000D-00-0672	Nov 2004	36

Respondent: Steven Carver

REQUEST NO. Qwest 23-3

In answering this request, please refer to Qwest Data Request No. 10-20(a)(2) and your response to that request.

a) Please state whether your response to Qwest Data Request No. 10-20(a)(2) is: (1) an unqualified admission; (2) a qualified admission; or (3) a denial.
b) If your response to Qwest Data Request No. 10-20(a)(2) was a qualified admission, please identify and explain each such qualification.
c) If your response to Qwest Data Request No. 10-20(a)(2) was a denial, state in detail and with particularity all of the reasons and factual bases for your denial including but not limited to a detailed explanation of what assumption about the Commission's historical treatment of FAS 106 costs UTI made with regard to treating as non-jurisdictional the deferred taxes associated with this accounting change.

RESPONSE: 23-3

a) The original question [Qwest Data Request 10-20(a)(2)], as posed, sought a conclusory response to a question that oversimplified the ratemaking treatment of FAS 106 costs and related deferred income tax reserves. In responding to the original question, Mr. Carver attempted to provide a thorough response that is relevant to the current proceeding. In the context of tax/ book timing differences associated with transactions that have never been recognized (that is, explicitly disallowed) for ratemaking purposes, Mr. Carver would concur that those deferred income tax reserves are typically considered to be non-jurisdictional for ratemaking purposes. As stated in the response to Qwest Data Request 10-20(a)(2), the recognition of accumulated deferred income tax (ADIT) reserves in rate base follows ratemaking recognition of the underlying transactions giving rise to those tax/ book timing differences. However, Staff Adjustment B-8 does not attempt to recognize deferred income tax reserve balances associated with timing differences that have not been considered in the regulatory process or that arose prior to Docket No. T-1051B-99-0105.

b) See the response to item (a) above.

c) See the response to item (a) above and Staff Adjustment B-8. As Qwest is well aware, Mr. Carver and Mr. Grate disagree as to the recognition of accrual basis FAS106 OPEB costs in the Company's last rate case, Docket No. T-1051B-99-0105. In the current proceeding, Staff calculated the ADIT reserve included in rate base as the tax effect of the excess of cumulative OPEB accruals over PAYGO during the period 1999 through 2003. The net effect of Staff Adjustment B-8 in the current proceeding increases rate base by about $78.7 million, as compared to Qwest's proposed treatment. The Staff's proposed rate base treatment, as computed on Staff Adjustment B-8, does not recognize ADIT impacts associated with the FCC methodology or any OPEB accrual/cash timing differences for any year prior to 1999.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-4

In answering this request, please refer to Qwest Data Request No. 16-5 and your response to that request. Admit that you have no qualifications to evaluate the reasonableness of the performance criteria in Qwest's incentive compensation plans from the perspective held by an employee compensation expert.

_____Admit _____Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

RESPONSE: 23-4

As stated in response to Qwest Data Requests 16-3 and 16-4 as well as at page 42 of his surrebuttal testimony, Mr. Carver is not and has never claimed to be a "Certified Compensation Professional" or a "Certified Benefits Professional." While Mr. Carver has not claimed to be an employee compensation expert, he has clearly and consistently stated that his expertise is as a regulatory expert, with considerable experience in the evaluation of utility expenses for potential ratemaking cost recovery – including the cost of incentive compensation plans. What Mr. Carver concluded in his testimony is that from the perspective of an expert evaluating costs used for ratemaking purposes in a regulatory proceeding, a ratemaking adjustment is warranted.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-5.

In answering this request, please refer to Qwest Data Request No. 16-6(a) and your response to that request. Please admit that you have no evidence demonstrating that the Federal Communications Commission has ever relied on the proposition that the party who benefits from a particular transaction or activity should bear the related financial burden as justification to disallow incentive compensation costs for ratemaking purposes.

_____Admit _____Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit. In particular, please identify, describe and provide a copy of any evidence supporting that the Federal Communications Commission has ever relied on the proposition that the party who benefits from a particular transaction or activity should bear the related financial burden as justification to disallow incentive compensation costs for ratemaking purposes.

RESPONSE: 23-5

As clearly stated in response to Qwest Data Request 16-6 and at surrebuttal page 46, Mr. Carver's direct testimony (pages 42-43) does not claim that the FCC relies or has relied upon the benefit-burden test as justification to disallow incentive compensation costs for ratemaking purposes. The FCC itself has stated that it has been "guided by two historically applied principles – the 'used and useful' standard and the benefit-burden test." Mr. Carver has not conducted any independent research into the vast archives of past FCC decisions, however, to determine when and how the benefit-burden test might have been specifically applied in the past.

In fact, Mr. Carver is unaware of any recent FCC rate case proceeding due to the adoption of price cap regulations for ILECS. Instead, Mr. Carver relied on the FCC's recognition that this "historically applied principle" helped guide its decision in the cited docket.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-6.

In answering this request, please refer to Qwest Data Request No. 16-6(b) and your response to that request. Please admit that you have no evidence to show that Qwest's unadjusted revenue requirement based on the 2003 test year would have been greater had the amounts paid under the 2003 Bonus Plan been paid instead as base salary.

_____Admit _____Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

RESPONSE: 23-6

As indicated in the response to Qwest Data Request 16-6(b), no "evidence" of the form described was important to the Staff's ratemaking treatment of incentive compensation rate recovery. Mr. Carver evaluated the facts surrounding incentive compensation and has not claimed that unadjusted revenue requirement for the 2003 test year would have been hypothetically larger or smaller if the incentive plan amounts been paid instead as base salary.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-7

In answering this request, please refer to Qwest Data Request No. 16-6(c) and your response to that request. Please admit that you have no evidence to show that the level of Qwest's management compensation, including base salary, incentive compensation and non-cash benefits in the test year, was unreasonable when compared with the levels of compensation paid in the prevailing labor market in the United States.

_____Admit _____Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

RESPONSE: 23-7

As indicated in the response to Qwest Data Request 16-6(c), Mr. Carver has not performed or relied upon any studies purporting to compare Qwest's test year management compensation, including base salary, incentive compensation and non-cash benefits, with the levels of compensation paid in some assumed prevailing labor market in the United States. The proposed ratemaking adjustment sponsored by Mr. Carver is not based upon an excessive overall compensation concern.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-8

In answering this request, please refer to Qwest Data Request No. 16-6(d) and your response to that request. Please admit that Staff and its consultants have no evidence to show that employees' pursuit of 2003 Bonus Plan performance targets caused ratepayers direct tangible harm.

_____Admit _____Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

RESPONSE: 23-8

As indicated in the response to Qwest Data Request 16-6(d), Mr. Carver has not claimed that employee pursuit of the 2003 bonus plan targets has caused direct tangible harm or any direct tangible benefit to ratepayers. Mr. Carver has not conducted any analysis of any such harm.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-9

In answering this request, please refer to Qwest Data Request No. 16-7(a) and your response to that request. Please admit that you have no evidence that in establishing revenue requirement under cost of service ratemaking, the Federal Communications Commission disallows test year costs for the reason that the disallowed costs provide ratepayers no direct tangible benefit.

_____Admit _____Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

RESPONSE: 23-9

Mr. Carver possesses no such "evidence," as none was required to support Staff's proposed adjustment to incentive compensation expense. As indicated in the response to Qwest Data Request 16-7, Mr. Carver has not claimed that the FCC has disallowed test year costs based solely upon the fact that they provide ratepayers no direct tangible benefit. The FCC order, cited at pages 42-43 of Mr. Carver's direct testimony, did describe the benefit-burden test as one of two "historically applied principles" that helped guide the FCC's proposal regarding the components of rate base and net income for dominant carriers. While Mr. Carver has not conducted research on the extent of the FCC's past reliance on the benefit-burden test to determine cost recovery, the FCC, did describe said method as a "historically applied principle." Also, see the response to Qwest Data Request 23-5.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-10

In answering this request, please refer to Qwest Data Request No. 16-7(b) and your response to that request.

a) Please admit that your opinion is not supported or informed by any source or sources of scholarly or regulatory authority (including but not limited to text book references, treatises, scholarly articles, court opinions, etc.)

_____Admit _____Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion.

1. State whether or not you have conducted any research on this subject, and if you have, please identify and describe such research.

2. Provide pinpoint citation to any source or sources of scholarly or regulatory authority (including but not limited to text book references, treatises, scholarly articles, etc. and/or court opinions, etc.) that support Mr. Carver's assertion: "Generally, costs that are required for 'compliance' with laws or to perform non-discretionary business functions such as billing, accounting, collections, audits and the fixed, known and measurable costs to compensate employees are judged to be recoverable if reasonable in amount and produce tangible direct benefits to the company and its customers."

b) Provide your definitions of "discretionary business functions" and "non-discretionary business functions."

c) With regard to Qwest's test year, please identify and quantify those costs that are for discretionary business functions and those costs that are for non-discretionary business functions as you define those terms.

RESPONSE: 23-10

a) Staff objects to this question as it is vague and ambiguous and unduly burdensome. Without waiving that objection, Qwest Data Request 16-7(b) lists 42 different types of costs and asks how ratepayers receive a direct tangible benefit from them. The response provided by Staff indicated that it would be necessary to consider the specific facts associated with the listed cost types to apply any direct tangible benefit or benefit-burden test in connection with rate case cost recovery. However, costs that are required for "compliance" with laws or to perform non-discretionary business functions (such as billing, accounting, collections, audits and the fixed, known and measurable costs to compensate employees) are generally considered to be recoverable – if they are reasonable in amount and satisfy specific business requirements associated with regulated services.

This response was based on Mr. Carver's extensive regulatory experience and the general regulatory experience of Utilitech. It was unnecessary for Mr. Carver to research any published texts or regulatory articles, as those documents generally reflect the opinion of the author. Further, the list of regulatory decisions or court decisions requested by Qwest are as equally available to the Company as they are to Staff.

It has long been held in public utility regulation that ratemaking recovery should only be allowed for costs that are both necessary to the provision of regulated service and reasonable in amount. Mr. Carver is advised by Counsel that the legal foundation associated with Staff's revenue requirement positions will be addressed in Staff's Briefs in this Docket, as necessary.

b) The ordinary dictionary definition of "discretionary" is "left to or regulated by one's own judgment or discretion." In this context, discretionary costs would include those costs that are neither necessary nor essential to the utility's business of providing regulated service. Examples of discretionary costs could include: social or athletic club memberships; charitable dues, donations and contributions; recreational, educational or professional sports sponsorships; certain affiliate transactions; lobbying expenses and political activities; etc. Non-discretionary costs are those which are required to comply with legal or regulatory provisions or to meet the day-to-day requirements of providing regulated service. See item (a) above.

c) Staff objects to Qwest's discovery request as being over broad and unduly burdensome. The identification sought by the request would require an extensive special study that has not been conducted nor determined to be necessary for the current proceeding. To the extent that Staff's evaluation of Qwest's asserted revenue requirement uncovered discretionary costs that should not be included in overall revenue requirement, those costs would have been the subject

of separate adjustment and addressed in Staff testimony. The absence of such testimony would indicate that no objectionable discretionary costs were identified.

The response to Qwest Data Request 22-2 states, in part: "In his Surrebuttal response to Mr. Grate's assertion that virtually all costs are as 'discretionary'as corporate image advertising, Mr. Brosch states, 'The employee benefits and various department costs listed by Mr. Grate are representative of costs that do provide tangible, direct benefits to the Company and its ratepayers and are not discretionary to the same extent as the corporate image advertising, legislative affairs and incentive compensation costs that are being challenged by Staff.'" Mr. Carver concurs.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-11

In answering this request, please refer to Qwest Data Request No. 16-8(b). Please identify the data request in which you requested the labor contract.

RESPONSE: 23.11

The subject of Qwest's Data Request 16-8 was page 45, line 3, of Mr. Carver's direct testimony and Qwest's response to Data Request UTI 1-31(d). This portion of the Company's discovery response identified "a description of the 2003 Bonus Award plan (a.k.a. Lump Sum Payments) for occupational employees as provided in the CWA Union contract that was effective beginning August 17, 2003" that was appended as Confidential Attachment E thereto. Confidential Attachment E consists of three pages that appear to be copies of the cover page and Addendum 7 (pages 206 and 207) of the cited labor agreement, not a separate summary or description of the occupational bonus plan.

Data Request UTI 1-31 specifically sought copies of all incentive plans in the form approved by senior management and the Board of Directors and in the form presented to employees. Since the response to Data Request UTI 1-31 contained a copy of the portion of the labor contract relevant to the occupation bonus plan, Mr. Carver had no reason to believe that the information supplied was anything but a complete and fully responsive copy of the portion of the labor agreement relevant to the occupational bonus plan. As such, no separate request for the labor agreement was thought necessary.

In response to Qwest Data Request UTI 16-8(b), Mr. Carver explained that, in addition to the cited portion of his confidential direct testimony, the Company did not meet the financial floor that must be met before any lump sum payments are required to eligible employees. In the final paragraph of the response to Qwest Data Request 16-8(b), Mr. Carver stated: "If Mr. Carver has misinterpreted the terms of the labor contract or the discretionary nature of the occupational payments in 2003, Mr. Carver would reconsider the quantification of Staff Adjustment C-17

based on any revised or updated information Qwest might produce." Thus far, Qwest has provided no additional information for Staff's consideration. In the absence of any additional information, Staff is left to conclude that it has reasonably interpreted Qwest's Confidential Attachment E, which represents a full and complete copy of all provisions of the labor agreement relevant to the occupational bonus plan.

Respondent: Steven Carver

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF WASHINGTON)
) **ss** **AFFIDAVIT OF PHILIP E. GRATE**
COUNTY OF KING)

Philip E. Grate, of lawful age being first duly sworn, deposes and states:

1. My name is Philip E. Grate. I am State Finance Director for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Philip E. Grate

Philip E. Grate

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

LORI E. WHITE
COMMISSION EXPIRES
NOTARY
PUBLIC
7-10-07
STATE OF WASHINGTON

Lori E. White

Notary Public

My Commission Expires: 7/10/07

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-23 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN MAYES
Commissioner

IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REJOINDER TESTIMONY OF

NANCY HELLER HUGHES

ON BEHALF OF

QWEST CORPORATION

JANUARY 27, 2005

TESTIMONY INDEX OF

NANCY HELLER HUGHES

	Page
Summary of Testimony	i
Identification of Witness	1
Purpose of Testimony	1
Methodology	1
Conclusion	4

SUMMARY OF TESTIMONY

The Reproduction Cost New Less Depreciation (RCNLD) study reflecting Qwest's authorized depreciation lives and survivor curves and the use of the Equal Life Group (ELG) depreciation procedure is presented in Exhibit NHH-1R to my rebuttal testimony.

My rejoinder testimony addresses the following issues raised by Staff witness William Dunkel's surrebuttal testimony concerning the RCNLD value.

1. The data in the RCNLD analysis should not be truncated after the remaining life reaches 0.50 year.

2. Qwest's currently authorized average service lives and survivor curves should be used to calculate the RCNLD value, and not the average service lives and survivor curves recommended by Mr. Dunkel.

I recommend that the Commission approve the RCNLD Study filed in my rebuttal testimony and the resulting values shown below:

Reproduction Cost New	$8,348,462,715
Reproduction Cost New Less Depreciation	$3,764,710,307
Condition Percent	45%

IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Nancy Heller Hughes. I am a Senior Director in the Seattle office of R. W. Beck, Inc. My business address is 1001 Fourth Avenue, Suite 2500, Seattle, Washington 98154-1004.

Q. ARE YOU THE SAME NANCY HELLER HUGHES THAT FILED DIRECT AND REBUTTAL TESTIMONY ON BEHALF OF QWEST IN THIS PROCEEDING?

A. Yes, I am.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REJOINDER TESTIMONY?

A. The purpose of my rejoinder testimony is to comment on the surrebuttal testimony of William Dunkel filed on behalf of Staff regarding the Reproduction Cost New Less Depreciation (RCNLD) value of Qwest's plant in service in Arizona as of December 31, 2003.

METHODOLOGY

Q. DID YOU PREPARE THE RCNLD STUDIES PREVIOUSLY FILED BY QWEST IN THIS PROCEEDING?

A. Yes. The RCNLD studies were prepared under my direction. The RCNLD study filed in my direct testimony was based on the vintage group depreciation procedure. The

RCNLD study filed in my rebuttal testimony reflects the use of the Equal Life Group (ELG) procedure for those accounts and vintages where ELG depreciation is approved. Both studies were developed using Qwest's currently prescribed depreciation lives and survivor curves.

Q. WHAT COMMENTS DOES MR. DUNKEL HAVE REGARDING THE RCNLD STUDY FILED WITH YOUR REBUTTAL TESTIMONY?

A. First, Mr. Dunkel continues to recommend that Staff's recommended depreciation lives and survivor curves be used to calculate the RCNLD value and resulting condition percent, instead of the depreciation lives and survivor curves that the Commission prescribed in Qwest's last rate case. Qwest witness Dennis Wu discusses this issue at length in his rebuttal and rejoinder testimony and shows why Qwest's currently prescribed depreciation lives and survivor curves are the appropriate depreciation parameters to use. Second, Mr. Dunkel disagrees with me regarding the issue of truncating the data in the RCNLD analysis after the remaining life reaches 0.5 year, even though there are still surviving vintage plant balances.

Q. PLEASE EXPLAIN YOUR POSITION ON TRUNCATING THE DATA AFTER THE REMAINING LIFE REACHES 0.5 YEAR.

A. I recommend that the remaining life for older plant vintages that are nearly fully depreciated be held constant at 0.50 year as long as there is plant surviving for that vintage. Mr. Dunkel would permit the remaining life for older vintage plant to be equal to zero, even though there is still plant surviving for that vintage. As discussed at pages 4 and 5 of my rebuttal testimony, the effect of truncating the data after the remaining life

reaches 0.50 year is to eliminate the value of this remaining plant from the RCNLD value, thus understating the RCNLD value of Qwest's Arizona plant in service.

Q. WHAT EFFECT DOES TRUNCATING THE DATA HAVE ON THE RCNLD VALUE BASED ON QWEST'S DEPRECIATION LIVES AND SURVIVOR CURVES?

A. If the data is truncated after the remaining life equals 0.50 year, the RCNLD value based on Qwest's depreciation lives and survivor curves would be reduced by $9,386,925.

Q. WHAT REASONS DOES MR. DUNKEL GIVE FOR TRUNCATING THE DATA IN HIS ANAYSIS?

A. The only reason Mr. Dunkel gives for truncating the data in his analysis after the remaining life equals 0.5 year is that I did the same thing in the initial RCNLD study presented in my direct testimony and, therefore, Mr. Dunkel claims this is not an issue for rebuttal. (Dunkel Surrebuttal Testimony at Page 13, Line 7.) Mr. Dunkel is correct that I truncated the data after 0.50 year in my initial study. However, in preparing my rebuttal testimony and revising the RCNLD study to reflect ELG depreciation (in response to Mr. Dunkel's direct testimony), I discovered the problem with truncating the data after the remaining life reaches 0.50 year. My recommendation is that the remaining life be held constant at 0.50 year until the plant in a vintage is retired. I believe that this is the correct method to use in the analysis.

CONCLUSION

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS TO THE COMMISSION REGARDING THE RCNLD VALUE OF QWEST'S ARIZONA PLANT IN SERVICE AS OF DECEMBER 31, 2003.

A. I recommend that the results of my RCNLD study presented in Exhibit NHH-1R be adopted by the Commission. This study is based on 1) Qwest's currently prescribed depreciation lives and survivor curves, 2) the use of the ELG procedure for those accounts and vintages that are depreciated using ELG, and 3) the remaining life for older vintages with surviving plant balances assumed to be equal to 0.50 year (i.e., no truncation of data). The results of my RCNLD study are shown in the table on the following page in the column titled "At Qwest Prescribed Lives."

Replacement Cost New Less Depreciation Value as of December 31, 2003

	At Qwest Depreciation Lives	At Staff Depreciation Lives
Reproduction Cost New	$8,348,462,715	$8,348,462,715
RCNLD	$3,764,710,307	$4,550,943,228
Condition Percent	45%	55%

For comparison purposes, the RCNLD value based on 1) Staff's recommended depreciation lives and survivor curves, 2) ELG depreciation and 3) no truncation of data after the remaining life equals 0.50 year, is also shown in the table in the column titled

"At Staff Recommended Lives." I recommend that the Commission adopt the results shown in the table above using Qwest's depreciation lives and survivor curves.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF WASHINGTON)
) **ss** **AFFIDAVIT OF NANCY HELLER HUGHES**
COUNTY OF KING)

Nancy Heller Hughes, of lawful age being first duly sworn, deposes and states:

1. My name is Nancy Heller Hughes. I am Senior Director of R. W. Beck, Inc., in Seattle, Washington and am appearing on behalf of Qwest Corporation. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Nancy Heller Hughes

SUBSCRIBED AND SWORN to before me this 19th day of January, 2005.

LINDA L. ROSS
STATE OF WASHINGTON
NOTARY --•-- PUBLIC
MY COMMISSION EXPIRES 4-05-06

Linda L. Ross
Notary Public

My Commission Expires: 4-5-06

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-24 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REJOINDER TESTIMONY

OF

SCOTT A. MCINTYRE

QWEST CORPORATION

JANUARY 27, 2005

TABLE OF CONTENTS

TOPIC	PAGE
I. IDENTIFICATION OF WITNESS	1
II. PURPOSE OF TESTIMONY	1
III. TESTIMONY OF MR. THOMAS REGAN	2
IV. TESTIMONY OF MR. TIMOTHY J. GATES	3
V. TESTIMONY OF MR. DON PRICE	7
VI. TESTIMONY OF MR. DEL SMITH	10
VII. SUMMARY OF REJOINDER TESTIMONY	14

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND PLACE OF EMPLOYMENT.

A. My name is Scott A. McIntyre. I work for Qwest Services Corporation ("Qwest"). My title is Staff Director – Public Policy. My responsibilities include developing marketing and pricing strategies for Qwest and supporting these strategies in the regulatory arena. My business address is 1600 7th Avenue, Room 3214, Seattle, Washington 98191.

Q. HAVE YOU FILED TESTIMONY PREVIOUSLY IN THIS CASE?

A. Yes, I filed direct testimony on May 5, 2004 and rebuttal testimony on December 20, 2004.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. The purpose of my testimony is to respond to the surrebuttal testimony of Mr. Thomas Regan filed on behalf of the Arizona Commission Staff on January 12, 2005, as it relates to Qwest's intrastate switched access rates. I will also address the

1 surrebuttal testimony of Timothy J. Gates for Time Warner, Don Price for MCI and
2 Del Smith for the Utilities Division.
3

4 **III. TESTIMONY OF MR. THOMAS REGAN**

5

6 **Q. WHAT IN MR. REGAN'S TESTIMONY WOULD YOU LIKE TO**
7 **ADDRESS?**
8 A. On page 34 of his surrebuttal testimony, Mr. Regan states that revenue
9 decreases as a result of reductions in Qwest's switched access rates can
10 be offset with increases in Qwest's Basket 3 services. This is not an offset
11 and will result in an overall loss of revenue. Such a proposal will only
12 exacerbate Qwest's earnings problem in Arizona.

13 **Q. CAN BASKET 3 SERVICE PRICES BE INCREASED TO GENERATE**
14 **ADDITIONAL REVENUE AS MR REGAN SUGGESTS?**
15 A. Only to a limited degree. The services in Basket 3 are competitive services.
16 Increasing their prices will create competitive losses that will offset the price
17 increases. This means that increasing prices for Basket 3 services is not an
18 option for offsetting switched access reductions. If Qwest must reduce
19 switched access rates and revenues more than the $5 million already
20 proposed by Qwest in this case, the only reasonable offset must be
21 increases in residence basic exchange rates.

IV. TESTIMONY OF MR. TIMOTHY J. GATES

Q. WHAT, IN MR. GATES' TESTIMONY WOULD YOU LIKE TO ADDRESS?

A. I would first like to address how Mr. Gates has changed his position from the direct testimony he filed on November 18, 2004. Once these changes have been identified, Mr. Gates' testimony becomes essentially moot.

Q. HAS MR. GATES CHANGED HIS TESTIMONY FROM THE DIRECT TESTIMONY HE FILED IN THIS CASE?

A. Yes. In his direct testimony, Mr. Gates claimed on page 11 that Qwest is "**the monopoly provider** of special access services" in Arizona (emphasis added). Again on page 11 he refers to Qwest as "the **sole provider** of these services" (emphasis added). In his latest testimony, he now claims that Qwest "is the only alternative available in **many** locations" (emphasis added). His claim has now diminished to "pockets" of monopoly control.

Q. DOES QWEST HAVE "POCKETS" WHERE QWEST IS THE ONLY ALTERNATIVE FOR SOME CUSTOMERS OF SPECIAL ACCESS?

A. While I will still contend there are options to Qwest service in any situation, I will agree that there are locations where these options may be somewhat

1 impractical. "Pockets" where such situations exist however is significantly
2 different than the case Mr. Gates was trying to make in his initial misleading
3 testimony in this case.

4 **Q. WHERE ARE THESE "POCKETS" OF QWEST DOMINANCE**
5 **DESCRIBED BY MR. GATES?**
6 A. Typically, these "pockets" are in low density areas where customers are few
7 and far between and there is insufficient revenue to attract competitive
8 facility investments. These pockets do not exist in metropolitan areas or
9 anywhere there are significant clusters of customers. Competitors are
10 drawn to areas where many customers can be served by relatively few
11 facility routes. Such situations provide the maximum opportunity for good
12 return on network investments.

13 **Q. ON PAGES 4 AND 5 OF HIS TESTIMONY, MR. GATES SUGGESTS**
14 **THAT QWEST'S PRICES DO NOT REFLECT THE MOST COST**
15 **EFFICIENT NETWORK POSSIBLE AND THIS RESULTS IN HIGHER**
16 **PRICES. IS HIS SUGGESTION REASONABLE?**
17 A. No. Mr. Gates has missed the point entirely. In my rebuttal testimony I
18 stated that under certain circumstances, customers may provide their own
19 facilities less expensively than they can purchase them from Qwest.
20 Qwest's rates are based on state-wide averages. These averages include
21 low volume, high cost areas as well as high volume low cost areas. A
22 customer needing service in one of the high volume, low cost areas may
23 very easily be able to provide their own facilities and beat Qwest's state-

wide average rates. Such customers may also be able to purchase service from competitors that only serve customers in such high volume, low cost areas.

Q. HAS MR. GATES ALSO CHANGED HIS TESTIMONY ABOUT WHETHER TIME WARNER PROVIDES ITS OWN FACILITIES IN SOME SITUATIONS?

A. Yes. In his direct testimony, Mr. Gates claimed that Time Warner must purchase special access services "solely from Qwest" (Page 5, line 19). He has now backed away from that position and acknowledges on page 5 of his surrebuttal that Time Warner does use its own facilities if it can. His argument now is that this is not "always" possible.

From Gates surrebuttal; Question: **DO YOU DISPUTE MR. MCINTYRE'S SUGGESTION THAT TWTA DOES PROVIDE ITS OWN FACILITIES IN CERTAIN AREAS? (MCINTYRE AT 14)**

Answer. No.

Q. ON PAGE 10 OF HIS REBUTTAL, MR. GATES DISCUSSES INCREASES IN SPECIAL ACCESS/PRIVATE LINE RATES AT THE FEDERAL LEVEL. IS THIS RELEVANT IN THIS CASE?

A. No. While Qwest has made some recent price increases for certain products in the FCC tariff, this does not reflect the fact that Qwest has had some of the lowest rates in the nation for these services for many years. Mr.

Gates is referring to rates regulated by the FCC which are not at issue in Arizona. Over 98% of the special access/private line circuits purchased by carriers in Arizona are purchased through the FCC tariff. The rates for these services are regulated by the FCC and the revenues are not included in any analysis of Qwest's financial position represented in this proceeding.

Q. HAS QWEST INCREASED RATES IN ARIZONA FOR SPECIAL ACCESS/PRIVATE LINE SERVICES USED BY CARRIERS?

A. No. The last increase in Arizona was for low speed voice grade services which are not typically used by carriers for special access. These increases came as a result of the last rate case which resulted in the establishment of competitive Basket 3 services. Qwest was given pricing headroom in Basket 3 and had little choice but to raise the prices for some services. The low speed services which were increased in price were among the least utilized of Qwest's private line services. They include alarm circuits, low speed data services and analog voice channels that are not typically purchased by carriers. Services such as DS-1 and DS-3 which are commonly used for special access applications have not increased in price for many years.

Q. SINCE SPECIAL ACCESS/PRIVATE LINE SERVICES IN ARIZONA HAVE BEEN CLASSIFIED COMPETITIVE OR FLEXIBLY PRICED AS PART OF QWEST'S BASKET 3 SERVICES, HAS ANY PARTY CONTESTED THIS CLASSIFICATION?

1 A. No.

2 **V. TESTIMONY OF MR. DON PRICE**

3

4 **Q. WHAT TESTIMONY OF MR. DON PRICE FOR MCI WOULD YOU LIKE**
5 **TO ADDRESS?**

6 A. Mr. Price discusses the nature of regulation at some length. He concludes
7 that since rate of return regulation is no longer valid, Qwest should reduce
8 switched access rates with no revenue offset.

9 **Q. DOES MR. PRICE'S ANALYSIS OF RATE OF RETURN REGULATION**
10 **APPLY IN THIS CASE?**

11 A. No. The Commission determined that Qwest's earnings and revenue
12 deficiency was an essential part of the information it needed to evaluate
13 Qwest's price plan proposal. Regardless of which analysis you choose in
14 this case, reductions to switched access without a revenue offset only
15 inflates Qwest's revenue shortfall.

16 **Q. DOES MR. PRICE SUGGEST ANY SOURCE FOR OFFSETTING**
17 **SWITCHED ACCESS REDUCTIONS?**

18 A. Yes. At the end of his testimony, on page 25, he suggests that shifting the
19 recovery of revenue from switched access to Basket 3 services might be
20 allowable.

Q. IS BASKET 3 AN APPROPRIATE SOURCE FOR REVENUES NOW RECOVERED THROUGH SWITCHED ACCESS RATES?

A. No. First of all, the current policy for pricing switched access was established to keep basic exchange rates low. If this policy is to be reversed and past support for basic exchange service is to be eliminated, it is exactly those services which must now bear that revenue burden. Making another policy shift which creates another artificial pricing mechanism is inappropriate.

Secondly, shifting revenue recovery from switched access to basket 3 is not a revenue "shift" because the revenue cannot be automatically collected through Basket 3 services. Basket 3 services are competitive. Increasing prices for Qwest's most competitive services will only cause a loss of market share. This market share loss offsets any increase in price and no additional revenue is recovered. A shift of revenue recovery from switched access to Basket 3 services will have the same result as merely eliminating this revenue stream and this will make Qwest's revenue shortfall even worse.

Q. AREN'T QWEST'S SWITCHED ACCESS REVENUES ALSO SUBJECT TO COMPETITIVE LOSS IF SWITCHED ACCESS RATES REMAIN HIGHER THAN FCC RATES?

A. Yes. There are alternatives to Qwest's switched access service and these alternatives threaten this revenue as well. Losing customers to competitive local service providers results in lost switched access minutes and

revenues. Bypassing switched access through the use of special access/ private line circuits also results in lost minutes and revenues. Customers are also using wireless services for toll calling and this too, results in lost switched access revenues.

Q. THEN WHY IS QWEST PROPOSING LIMITED REDUCTIONS IN SWITCHED ACCESS RATES IN THIS PROCEEDING?

A. There are no longer any safe mechanisms for recovering this revenue. Local service competition is increasing, wireless competition is eroding toll and switched access revenues and bypass remains a cost effective solution for many customers. While all revenues are now at risk, the most reliable source of revenue at this time is basic exchange service. Since low basic exchange rates were the original goal of high switched access pricing, basic exchange is the proper place to recover this revenue requirement. Qwest believes that a policy where the Arizona Commission shifts the recovery of access revenues back to basic exchange services should be established, but until then, the current policy should be maintained and the revenue recovery mechanism should continue to be switched access. While there is a risk to Qwest in maintaining this rate structure, it is the most reasonable risk to take at this time in Arizona's circumstance.

In addition, there are many local service providers that charge for switched access service for calls completed to or originating from their customers. These competitors may also use switched access revenues to help support low local service rates. In fact, there are many CLEC switched access rates

that meet or exceed Qwest's rates[1]. If the Commission were to investigate switched access with an intent to reform the current artificial pricing structure, Qwest would support such a proceeding. In absence of such an industry-wide investigation, there is no reason to single out Qwest for extreme rate rebalancing.

VI. TESTIMONY OF MR. DEL SMITH

Q. IS MR. SMITH NOW CLAIMING THAT HE HAS NOT PROPOSED CHANGES TO QWEST'S PERFORMANCE OBJECTIVES FOR ACCESS TO QWEST'S CALL CENTERS?

A. Yes. On page 1 of his Surrebuttal Testimony he asks the question "**Was a change to the performance objective for the residence, business and repair centers proposed in Staff's testimony as suggested by Mr. McIntyre's rebuttal restimony (sic)?** Answer : "**No**".

Q. HAS HE, IN FACT, PROPOSED CHANGES TO THESE OBJECTIVES?

A. Yes.

---

[1] **Qwest** Switched Access Rates: Originating Local Switching: $0.0173, Terminating Local Switching: $0.0173, Originating CCL: $0.006244, Terminating CCL: $0.014153 **Allegiance** Local Switching (O & T): $0.0173, CCL (O) $0.0100, (T): $0.0242; **Level 3** Local Switching (O & T): $0.0173, CCL (O & T): $0.0242 **Eschelon** Local Switching (O): $0.03856, (T): $0.0681369 **AT&T** Local Switching (O): $0.0273, (T): $0.0415 **Cox** Local Switching (O & T): $0.041588 **MCI** Local Switching (O): $0.050274, (T): $0.071148 **Xo** Local Switching (O): $0.027402, (T): $0.041602
All rates above are charged on a per minute basis

Q. CAN YOU PROVIDE A SIMPLE EXAMPLE OF INCREASED PENALTIES UNDER MR. SMITH'S PROPOSAL?

A. Yes. Currently if Qwest performs at a 70.01 to 75% performance level, there are no penalties. Under Mr. Smith's proposal this same performance level will result in $1000 per day in penalties. This is clearly an increase in penalties.

Q. DID YOU PROPOSE ANY CHANGES TO THE SERVICE QUALITY STANDARDS IN YOUR INITIAL TESTIMONY IN THIS PROCEEDING?

A. No. Mr. Smith brought up this issue and proposed increasing the penalties.

Q. WHY DID YOU INTRODUCE THE CONCEPT OF AVERAGE WAIT TIME AS A BETTER MEASUREMENT OF SERVICE QUALITY IN YOUR REBUTTAL TESTIMONY?

A. Since Mr. Smith brought up the subject of call center performance, I felt obligated to inform the Commission that a better measurement mechanism exists and has been advocated by Qwest for quite some time.

Q. WHO PROVIDED THE INITIAL MEASUREMENT SCHEME OF 80% OF CALLS ANSWERED IN 20 SECONDS?

A. Qwest did, many years ago. This was a measurement scheme used by Qwest internally and this internal measurement plan was extrapolated to the regulatory world.

Q. IS AVERAGE WAIT TIME A BETTER MEASUREMENT SCHEME?

A. Yes, as I explained in my rebuttal testimony.

Q. WHY DOES MR. SMITH RESIST A CHANGE TO A BETTER MEASUREMENT STANDARD?

A. He has seen no "proof" that it is a better standard, relies on the fact that Qwest can produce both measurements and relies on the fact that other states in Qwest territory require a similar measurement scheme.

Q. WHAT IS YOUR PROOF THAT AVERAGE WAIT TIME IS A "BETTER" STANDARD?

A. The proof is rather simple. Qwest believes it is a better measurement tool and prefers to use it for internal measurements. Qwest has expert personnel managing call centers and this expertise should be relied upon for such judgment. The average wait time measurement is more direct and provides better information to Qwest managers about how they are performing. Qwest initially proposed the current measurement scheme and it was accepted by regulators in all states. Qwest's proposal for new measurements should also be accepted. Although it is not "intuitively" a better scheme to Mr. Smith, (Smith surrebuttal, page 3, line 10), it seems obvious that measuring the hold times for ALL calls is a better standard than measuring and reporting on only 80% of the calls.

Q. ARE AVERAGE HOLD TIME PERFORMANCE STANDARDS THE REGULATORY STANDARD IN OTHER QWEST STATES?

A. Yes. Utah, Washington and New Mexico have converted to this new standard.

Q. CAN QWEST PRODUCE BOTH MEASUREMENTS AS MR. SMITH CLAIMS?

A. Yes, but why should Qwest have to produce both measurements? This is wasteful. Qwest is only producing results in the 80% measurement scheme because regulators are resistant to change. Qwest should not have to produce archaic measurements simply to satisfy this resistance.

Q. MR. SMITH LOOKS TO THE IDAHO STAFF FOR SUPPORT FOR HIS CONCLUSION THAT AN AVERAGE WAIT TIME IS NOT APPROPRIATE. IS THIS APPROACH VALID?

A. No. First of all, Qwest is not required to file this information with the Idaho Commission. Qwest's provision of this data is completely voluntary. Second, there is no mathematical calculation that can compare one measurement to the other. This is because the 80/20 standard only measures 80% of the calls while the average wait time measurement measures all of the calls. The fact that there is no an algorithm to convert from one measurement to the other is further proof that duplicate reporting is inappropriate.

VII. SUMMARY OF REJOINDER TESTIMONY

Q. WOULD YOU PLEASE SUMMARIZE YOUR REJOINDER TESTIMONY?

A. Yes. Both Mr. Regan and Mr. Price suggest that switched access rates should be reduced and the revenue requirement shifted to Basket 3 competitive services. Since Basket 3 services are highly competitive, this is not a valid revenue source. Increasing prices in basket 3 services will cause customers to make other choices for these services. This will result in revenue losses and will not provide the intended offset to switched access reductions. Since many other carriers have switched access rates as high as or higher than Qwest's, there is no reason to single out Qwest for significant access restructuring in this proceeding.

Mr. Smith is attempting to deny that he has proposed increases to Qwest's performance penalties, but he clearly has done so. Even though he stated in his initial testimony that Qwest's overall performance in service quality has improved he is pursuing increased penalties. There is no reason to increase penalties while Qwest continues to improve service levels. Rewarding improved service with increased penalties is grossly inappropriate.

Mr. Gates has greatly backed away from the inaccurate statements he made in his initial testimony but still expects the Commission to still cling to the solutions that he has proposed. Continuing to support solutions to

problems that he now acknowledges do not exist is amazing. Over 98% of the special access/ private line circuits purchased by carriers are purchased out of the FCC tariff and are not at issue in this case. This proceeding is large enough and complicated enough without diverting effort to non-existent problems or issues beyond the scope of this Commission.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF WASHINGTON)
) **ss** **AFFIDAVIT OF SCOTT A. MCINTYRE**
COUNTY OF KING)

Scott A. McIntyre, of lawful age being first duly sworn, deposes and states:

1. My name is Scott A. McIntyre. I am Staff Director – Public Policy for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Scott A. McIntyre

SUBSCRIBED AND SWORN to before me this 21st day of January, 2005.

LORI L. WHITE
COMMISSION EXPIRES
NOTARY
PUBLIC
7-10-07
STATE OF WASHINGTON

Lori L. White
Notary Public

My Commission Expires: 7/10/07

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-25 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REJOINDER TESTIMONY

OF

TERESA K. MILLION

QWEST CORPORATION

JANUARY 27, 2005

TESTIMONY INDEX

EXECUTIVE SUMMARY 1

IDENTIFICATION OF WITNESS 1

PURPOSE OF TESTIMONY 1

TESTIMONY OF MR. THOMAS REGAN 2

TESTIMONY OF MR. F. WAYNE LAFFERTY 11

EXECUTIVE SUMMARY

Current Responsibilities:

My title is Staff Director - Service Cost. My responsibilities include preparing expert testimony and testifying about the cost of service for all products and services that Qwest offers, including its traditional retail services and more contemporary wholesale services.

Purpose of Testimony:

My testimony rebuts the testimony of Mr. Thomas Regan and Mr. F. Wayne Lafferty regarding Qwest's proposal for the Arizona Universal Service Fund (AUSF). In addition, my testimony rebuts Mr. Lafferty's testimony regarding the calculation of price floors based on Qwest's TSLRIC studies.

Summary of Testimony:

My testimony further explains why Mr. Regan's interpretation of the AUSF rules, which assumes that no loop or port cost should be included in calculating the funding need, does not make sense and is inconsistent with the universal service fund determinations of other states in Qwest's region.

My testimony addresses Mr. Lafferty's continuing concerns regarding the appropriate calculation of Qwest's retail price floors using TSLRIC. In addition, I address Mr. Lafferty's apparent recommendation against awarding AUSF funding to Qwest despite his calculation of a $24.5 million shortfall in Zones 2 and 3.

IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Teresa K. (Terri) Million. My business address is 1801 California Street, Room 2050, Denver, Colorado 80202. I am employed by Qwest Services Corporation as a Staff Director, Service Costs, in the Public Policy Department. In this position, I am responsible for preparing testimony and testifying about Qwest's cost studies in a variety of regulatory proceedings.

Q. ARE YOU THE SAME TERESA MILLION WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony rebuts the direct testimonies of. Thomas Regan on behalf of the Staff of the Arizona Corporation Commission (ACC) and F. Wayne Lafferty on behalf of Cox Arizona Telcom regarding Qwest's proposal for the AUSF. In addition, my testimony rebuts Mr. Lafferty's testimony regarding the calculation of price floors based on Qwest's TSLRIC studies.

Testimony of Mr. Thomas Regan

Q. MR. REGAN CLAIMS QWEST'S RESPONSES TO HIS DATA REQUEST [WDA 19-13 (A & B)] CONTRADICT YOUR TESTIMONY THAT QWEST'S DECISION TO INVEST IN ADDITIONAL LOOP AND PORT FACILITIES IS BASED ON THE PROVISIONING OF LOCAL DIAL TONE TO CONSUMERS. PLEASE COMMENT.

A. It is true that whenever Qwest provides its basic local exchange service to a customer, it hopes to garner revenues from other sources (such as vertical services, switched access and toll). In some instances, those revenues are considered in Qwest's decision whether to provide service to a particular customer. Indeed, for its unregulated services, Qwest commonly performs the type of business case analysis that Mr. Regan suggests. However, such an analysis does not drive Qwest's decision to invest in additional loop and port facilities in the majority of its network. The reason for this is simple. In those areas where Qwest has an existing customer base within its authorized service territory, Qwest has an obligation to serve all of the customers in that area. One need only look at the penalties the ACC imposes on Qwest for orders that are considered "held" (i.e., orders that cannot be completed in a timely manner due to lack of facilities) to understand that Qwest is required to invest in and provide facilities in those areas whether customers ever intend to purchase more than basic dial tone or not. Under these circumstances, Qwest does not have the luxury of determining the revenue potential of its basic exchange customers in considering whether to invest in loop and port facilities, unless it is willing to face the imposition of significant regulatory penalties by the State. The most revenue that Qwest can count on from

its customers is basic local exchange revenue. In some cases, as substitution from wireless services increases, Qwest cannot count on receiving even basic local exchange revenues from all potential customers in spite of its obligation to invest in facilities in order to have them ready and available for those customers who may want service. Therefore, except in cases where Qwest is considering serving a single customer in a remote location or determining whether to expand into previously unserved areas, Qwest only hopes that it will have an opportunity to earn additional revenues from vertical services, switched access and toll, in order to cover the cost of its facilities. It does not, however, depend on them in its decision to invest.

Q. WHAT DO YOU CONCLUDE FROM YOUR DISCUSSION ABOVE?

A. I can only conclude that Mr. Regan's suggestion that the appropriate way to calculate Qwest's TSLRIC cost for basic exchange service is to exclude the cost of the loop and port. This suggestion entirely ignores the regulatory environment in which Qwest operates. Until the ACC is willing to eliminate the penalties that Qwest pays for held orders and acknowledges that in the face of competition Qwest no longer has an obligation to serve all of the customers in its local calling areas, Qwest does not have the luxury of analyzing revenues when determining when and where to place facilities to make dial tone available to its potential customers. Therefore, under the current regulatory environment which continues to reflect a historical mindset that requires telephone service to be available

ubiquitously as if it were an inalienable right of all citizens, it is inconceivable that the TSLRIC cost of basic local exchange service would not include the cost of the loop and port.

Q. DO YOU DISPUTE MR. REGAN'S ASSERTION THAT AS LONG AS A SERVICE IS PRICED EQUAL TO OR ABOVE ITS TSLRIC, THE SERVICE IS NOT RECEIVING A SUBSIDY?

A. No. However, I do take issue with Mr. Regan's exclusion of loop and port costs from the TSLRIC of basic local exchange service. Further, I would clarify that where I have referred to the "implicit subsidies" inherent in Qwest's current pricing scheme, I am not describing economic subsidies in the strictest sense. Rather, I am referring to the contributions necessary from all products and services in order to cover all of Qwest's costs, including its common costs. It is important to keep in mind that merely covering the TSLRIC of a service does not provide for contribution toward the recovery of the common costs or overheads of a company. In the long run, just as with any other company, if Qwest is unable to recover all of its costs of doing business, eventually it will be unable to remain in business. Thus, to the extent that Qwest's price for basic local exchange service in high-cost zones either covers the TSLRIC of the service (including the loop and port costs) or does not cover the TSLRIC, the only way to recover Qwest's overall costs is through contributions from other services. And, as pointed out in Mr. Teitzel's testimony, in the face of increasing competition the sources of other revenues Qwest has to draw on for contribution to those common costs continues to

dwindle. Therefore, if it is truly the intent of the Commission to keep the price of basic exchange service affordable for all of Arizona's citizens, then in light of such growing competition the best way for the Commission to ensure its goal continues to be met is to allow Qwest and its qualified competitors to receive AUSF funding in the high-cost zones.

Q. ON PAGE 29 OF HIS REBUTTAL TESTIMONY MR. REGAN DISTINGUISHES THE COMMISSION'S DECISION IN THE MIDVALE AUSF WAIVER REQUEST FROM QWEST'S AUSF FUNDING REQUEST BY POINTING OUT THAT MIDVALE WAS SEEKING FUNDS TO PROVIDE NEW SERVICES IN UNSERVED AREAS. DOES THAT DISTINCTION MATTER?

A. No. Mr. Regan's rebuttal misses the point of Mr. Teitzel's and my discussion about the Midvale waiver. Our point was that there is precedent established by this Commission that allows for waiver of the specific requirements for AUSF funding in circumstances where the Commission finds it in the public interest to do so. In the case of Midvale the scope was admittedly smaller and the purpose for the requested waiver was different. Nevertheless, the Commission determined that in order to bring service to previously unserved areas it was willing to overlook the specific rules and allow Midvale to obtain AUSF funding.

In Qwest's case the request for AUSF funding is related to its high-cost of continuing to serve rural customers in Zones 2 and 3, as well as encouraging competition in high-cost areas. No party in this case disputes the fact that Qwest's costs to serve rural customers are high. Further, in the face of increasing

competition in Phoenix and Tucson as described by Mr. Teitzel, it becomes increasingly difficult for Qwest to find contribution margins from other products that enable it to continue to serve those rural customers at its current retail prices. Thus, Qwest is merely pointing out that in analyzing the AUSF funding issue and deciding how to properly calculate Qwest's funding requirement, the Midvale case provides precedent that allows the Commission to consider the public interest in maintaining low rates while encouraging competition as it makes its determination.

Q. MR. REGAN PURPORTS TO EXPLAIN WHY HIS USE OF THE UNE LOOP AND PORT RATES IN HIS OVERALL ANALYSIS ARE CORRECT. PLEASE COMMENT.

A. Mr. Regan simply confuses the issue with his discussion about the fact that as UNEs, the loop and port are not retail services. Clearly, the loop and port are not in themselves retail services; however, just as clearly, they are part of the facilities that make up the retail service known as basic local exchange. If the purpose of Mr. Regan's analysis is to compare the revenues for retail basic local exchange services to the overall costs for those services, then those revenues and costs should match up. In other words, the revenues for retail services should be matched against the costs for the organizations and activities that support those revenues. For example, by using the UNE loop and port rates in his analysis, Mr. Regan avoids recognizing the cost to Qwest of advertising its retail products. This is because, as wholesale products, the UNE loop and port receive no loading for advertising in their rates as the Commission has previously determined in other

cost proceedings that there are no advertising costs associated with the sale of UNEs. Yet there can be no doubt that Qwest incurs advertising costs in order to sell its retail products. Thus, because the loop and port make up the majority of the overall cost of a 1FR, and there are no advertising costs included in the UNE rates for the loop and port, by using the UNE rates Mr. Regan is able to avoid including those costs in his analysis. In addition, the factors used to load expenses for categories such as product management, uncollectibles and customer operations are based on the expenses Qwest incurs to support its wholesale business, and have no relationship to the organizations, experience and activities that are the result of supporting its retail business. Furthermore, the expense loadings that are included in the UNE rates for loop and port that Mr. Regan uses have purposely excluded any expenses that are associated with Qwest's retail operations according to the HAI documentation filed in the wholesale cost docket. Therefore, a large portion of the expense loadings included in the costs that Mr. Regan uses to offset the retail revenues in his analysis have nothing to do with the retail products he purports to analyze.

Q. DID THE ADJUSTMENT THAT YOU PROVIDED TO MR. REGAN'S ANALYSIS CORRECT THIS MISMATCHING OF EXPENSES AND REVENUES?

A. Yes. By using fully allocated costs from the retail cost studies for the basic local exchange services, my adjustment eliminates the wholesale expenses from the calculation and substitutes the retail expenses into the comparison. It also still effectively imputes the ACC-determined cost of a loop into the comparison

because, as I stated in my rebuttal testimony, the only real difference between a retail and wholesale cost study are the expense loadings applied to the underlying investment. The investment used in determining the fully allocated costs of the retail basic local exchange services is the same investment determined by the ACC for the loop and port in the wholesale cost docket. The way Mr. Regan calculates the intrastate costs, i.e., using UNE rates for the loop and port instead of calculating retail costs based on the underlying investment determined by the ACC, results in some retail expenses and a majority of wholesale expenses being compared to retail revenues.

Q. IS THERE ANY SIGNIFICANCE TO MR. REGAN'S CONCERN THAT QWEST'S RETAIL FACTORS HAVE NOT BEEN APPROVED BY THE ACC?

A. No. Mr. Regan's comment about Qwest's retail factors not receiving ACC approval is again an attempt to confuse the issue. If anything, Qwest's retail factors (as calculated in a forward-looking cost study) are understated when compared to the actual expenses Qwest incurs in support of its retail operations. This is because the retail factors are often applied against an investment amount that is less than the embedded investment used to generate the actual expenses associated with the revenues analyzed by Mr. Regan. In addition, productivity and inflation factors are applied to Qwest's actual expenses in order to estimate those expenses on a forward-looking basis. This too results in retail factors that typically reflect less expense than Qwest's actual incurred retail expenses. Of course by using the UNE rates, based on wholesale expenses, Mr. Regan's analysis produces a lower

cost that when compared to revenues, does not result in an AUSF funding requirement. In contrast, when retail revenues are properly matched with retail expenses by using the fully allocated basic local exchange costs from the TSLRIC study a shortfall continues to exist that justifies AUSF funding for Qwest.

Q. DOES MR. REGAN'S OVERALL ANALYSIS PROPERLY MATCH "TOTAL INTRASTATE REVENUES TO TOTAL INTRASTATE COSTS" AS HE CLAIMS ON PAGE 25 OF HIS REBUTTAL TESTIMONY?

A. No. As I have discussed above, Mr. Regan's analysis results in a mismatch of revenues and costs because he improperly compares intrastate retail revenues with costs that include the expenses associated with Qwest's wholesale operations and exclude expenses associated with its retail operations.

Q. MR. REGAN POINTS OUT THAT QWEST DOES NOT RECEIVE FEDERAL UNIVERSAL SERVICE FUNDING AND THEREFORE SHOULD NOT BE ENTITLED TO AUSF FUNDING UNDER A.A.C. R14-2-1202.A. DO YOU AGREE?

A. No. Although the rule cited by Mr. Regan requires AUSF funding to be provided "net of any universal service support from federal sources," it does not say that a carrier must receive support from federal sources before being eligible for AUSF funding. If this result was what the ACC intended, it could have written the rules to require a carrier to actually obtain federal funding before becoming eligible to receive AUSF funds. Instead, the rules provide that "federal funding should be pursued…." The fact is Qwest should not be penalized in its efforts to obtain support for its high-cost zones simply because the method of distributing federal

universal service funds is flawed. Indeed, Congress is considering legislation to correct the problems with the way the federal fund currently works. Under the existing method, only a few states (mostly located in the southern part of the United States) receive federal funds for non-rural carriers. This result is unfair and discriminatory. The greatest expanses of rural territory in the United States are located in the West and are primarily in Qwest's service area, including Arizona. There is no dispute over the fact that Qwest serves a significant number of high-cost rural customers in Arizona. According to Mr. Regan's own analysis, nearly 38% of Qwest's intrastate revenues are derived from its high-cost rural customers in Zones 2 and 3. Clearly, Qwest's rural customers in Arizona are no different than the rural customers served by independent carriers. Yet under the flawed federal system, Qwest receives no support for its Arizona services while independent carriers are award significant federal USF funds for this State. It would be patently unjust to Qwest in the current competitive environment for the AUSF system to be applied in the same discriminatory manner.

Q. MR. REGAN QUOTES DR. JOHNSON AS SAYING "THERE IS NO LOGICAL REASON TO IMPOSE THE ENTIRETY OF THESE [LOOP] COSTS ONTO JUST ONE OF THE SERVICES BENEFITING FROM THEM." IS IT ANY MORE LOGICAL TO ENTIRELY EXCLUDE THE LOOP COSTS FROM THE BASIC LOCAL EXCHANGE SERVICES AS MR. REGAN HAS?

A. No. Yet Mr. Regan's "Code Analysis" does just that by assuming that *none* of the cost of the loop and port should be included, while *all* of the revenues from basic local exchange service are included. In addition, *all* of the interstate EUCL is

included, despite the fact that on Page 21 of his rebuttal testimony, Mr. Regan argues that the "USF being addressed in this proceeding is an intrastate USF." At least my proposal to include 100% of the cost of the retail basic local exchange service in his "Overall Analysis" is consistent with my proposal to also include the interstate EUCL in the revenues being analyzed.

Q. DO OTHER STATES IN QWEST'S REGION INCLUDE THE COST OF THE LOOP AND PORT IN THEIR CALCULATION OF USF FUNDING REQUIREMENTS?

A. Yes. For example, Colorado, Oregon, Nebraska and Wyoming (the only other states in Qwest's region to provide intrastate USF funds) all include the cost of the loop and port in their calculations of USF funding requirements. Those states recognize, as discussed in my rebuttal testimony, that USF funds should address the high cost of providing service in sparsely populated rural areas, as compared to the cost of the loops in dense, urban areas. In those states, Qwest receives USF funding to recover the high cost of the loop in rural areas.

Testimony of Mr. F. Wayne Lafferty

Q. MR. LAFFERTY STATES THAT HE DOES NOT PROPOSE THE ACC AUTHORIZE AUSF FUNDS FOR QWEST IN SPITE OF HIS CALCULATION OF A $24.5 MILLION SHORTFALL IN ZONES 2 AND 3. PLEASE COMMENT.

A. It is surprising that Mr. Lafferty so readily dismisses the idea of Qwest drawing funds from the AUSF in light of the fact that Qwest's proposal includes a provision for making the funds portable to all qualified carriers serving customers in high-

cost zones. On the other hand, his position is not surprising when one considers that as a competitive carrier Cox (like other competitive carriers) has no obligation to serve customers in high-cost areas. Thus, unlike Qwest, Mr. Lafferty's employer can choose not to serve high-cost customers wishing to purchase only basic exchange services and is therefore free to focus its marketing efforts on only those customers whom it may serve profitably without the need for AUSF funding. Nevertheless, as the representative of a competitive carrier, Mr. Lafferty appears to recognize that in calculating the proper AUSF funding amount using TSLRIC, it is appropriate to include the loop and port in the cost. Presumably this is because Mr. Lafferty recognizes, as does Qwest, that despite differing economic theories, practically speaking it only makes sense for a carrier to include its loop and port costs in its calculation of an AUSF funding requirement because those costs are legitimately a part of any carrier's cost to provide service to its customers.

Q. MR. LAFFERTY CONTINUES TO EXPRESS CONCERNS IN HIS REBUTTAL TESTIMONY WITH QWEST'S USE OF TSLRIC STUDIES TO DETERMINE ITS PRICE FLOOR. ARE HIS CONCERNS JUSTIFIED?

A. No. As I described in my direct and rebuttal testimonies, Qwest has made a proper imputation of the UNE elements into its TSLRIC costs for the studies that it has filed. Any method in which the entire UNE cost is imputed into the cost results in a mismatch of wholesale expenses with the retail product represented by the TSLRIC study, as discussed in my response above to Mr. Regan's rebuttal testimony. In addition, the rule in Arizona for pricing of competitive

1 telecommunications services states specifically that a telecommunications
2 company "may price a competitive telecommunications service at any level at or
3 below the maximum rate stated in the company's tariff on file with the Commission,
4 provided that the price for the service is not less than the company's *total service*
5 *long-run incremental cost* of providing the service."[1]

6 As Mr. Lafferty points out in his discussion of my calculation of Qwest's AUSF
7 funding requirement, the TSLRIC of a product is not the same as the fully allocated
8 cost of a product. The TSLRIC represents the direct and directly attributable costs
9 of a product, while the fully allocated cost includes the common overhead costs of
10 the firm that must be recovered in order for the firm to remain in business over the
11 long run. The TELRIC calculation for an unbundled element also results in the
12 common overhead costs for the *wholesale* portion of the firm being included in the
13 UNE rate. Therefore, Mr. Lafferty's suggestion that the proper calculation of the
14 price floor for *retail services* is the "sum of the prices of the unbundled network
15 elements that are utilized to provision the service..." is incorrect. In fact, the
16 section of the rules that refers to the imputation of prices in the price floor does so
17 in reference to the calculation of the "*retail price* of each telecommunications
18 service...."[2] Thus, by definition, Qwest's method of imputing UNE investments into
19 TSLRIC studies that utilize retail expense loadings and produce the *retail price* of

[1] A.A.C. R14-2-1109. Pricing of Competitive Telecommunications Services. Emphasis added.
[2] A.A.C. R14-2-1310 C. Pricing Imputation. Emphasis added.

each service is more correct than Mr. Lafferty's method, which produces a price that includes Qwest's wholesale expense loadings and common overheads.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF COLORADO)
) **ss** **AFFIDAVIT OF TERESA K. MILLION**
COUNTY OF DENVER)

Teresa K. Million, of lawful age being first duly sworn, deposes and states:

1. My name is Teresa K. Million. I am Staff Director – Public Policy for Qwest Corporation in Denver, Colorado. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Teresa K Million
Teresa K. Million

SUBSCRIBED AND SWORN to before me this 19th day of January, 2005.

Marjorie M Hetten
Notary Public

My Commission Expires: 3/6/05

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-26 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	DOCKET NO. T-01051B-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	DOCKET NO. T-00000D-00-0672

REJOINDER TESTIMONY

OF

DENNIS PAPPAS

QWEST CORPORATION

JANUARY 28, 2004

TABLE OF CONTENTS

		Page
I.	INTRODUCTION	1
II.	SURREBUTTAL OF MR. DEL SMITH	2
III.	CONCLUSION	8

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Dennis Pappas. My business address is 700 Mineral Ave., Room MN H 20.13 in Littleton, CO 80120.

Q. WHAT IS YOUR CURRENT POSITION?

A. I am a Director in Qwest's Public Policy organization representing Local Network Operations.

Q. ARE YOU THE SAME DENNIS PAPPAS THAT PRESENTED REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. I am.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My rejoinder testimony addresses the requests of Staff witness Mr. Del Smith to leave the Service Quality rules in Arizona in effect - for perpetuity apparently. As demonstrated in my rebuttal testimony, the need for rules in the areas of held orders, out-of-service measurements and trouble report rates have run their course and Qwest is performing well within the thresholds that have been set in the Service Quality rules. While Mr. Smith proposes to keep these rules in place just to make sure Qwest does not back-step, Qwest asserts that the competitive market in Arizona is an effective "hammer," which is now in place to assure service quality and can be relied upon by this Commission instead of rules.

II. SURREBUTTAL OF MR. DEL SMITH

Q. STAFF WITNESS DEL SMITH CONTINUES TO RECOMMEND THAT THE SERVICE QUALITY RULES STAY IN PLACE. HAS HE PROPOSED A TIME WHEN THESE RULES MAY EXPIRE?

A. He has not and Qwest finds that very troubling. Apparently, Mr. Smith believes that these rules need to stay in place for an extended period of time in the future. If not, he surely would have proposed a timeframe in which the rules would lapse due to the competitive nature of telecommunications, especially in Arizona, as well as in every state in Qwest's region.

Q. DOES QWEST HAVE AN ONGOING INCENTIVE TO PROVIDE QUALITY SERVICES TO END USERS IN ARIZONA WITHOUT THE SERVICE QUALITY RULES?

A. Yes we do. Today, Qwest is experiencing competition in nearly every facet of our business, including an immense degree of facilities-based competition. As stated in my earlier testimony, as of November 30, 2004, CLECs have established collocation in more than 50% (69) of our 131 central offices and have access to more than 80% of the unbundled loops within the state. The CLECs also have acquired more than 41,000 UNE-Loops and more than 153,000 UNE-P customers. This, of course, is only a small fragment of the end users lost to competitors in Arizona, compared to wireless and other facilities-based alternatives. One only has to walk through the Paradise Valley mall or the Sky Harbor airport to see the number of end users currently using mobile phone

services – many customers now finding wireless as a total substitution for wireline service. My point is that with competition being so prevalent in Arizona, any back sliding by Qwest in performance (measured or not) can and will result in an end user seeking other alternatives from among the many available. Qwest's witness Mr. Dave Teitzel goes into much greater detail on the level of competition that currently exists in the state.

Q. WHAT EFFECT DOES THE EXISTENCE OF LOCAL COMPETITION HAVE ON THE ROLE OF SERVICE QUALITY REGULATION?

In both his Rebuttal and Surrebuttal testimony, Mr. Smith has repeatedly agreed with Qwest's position that Qwest's service not only has improved but has been maintained at levels higher than required by the Service Quality Plan Tariff. The fact that Qwest is providing higher quality of service levels than are required by the plan indicates that other forces are motivating Qwest's behavior - such as the forces of market competition. For example, if Qwest does not install an order for a landline service on the date requested, both recurring charges and potential access charge revenues are at risk. If the delay is extended beyond customer expectations, the customer will simply choose to order service from a competitor or completely bypass landline service altogether in favor of a wireless solution. Moreover, the impacts go far beyond just losing the local service to a competitor. Customers that are not happy with Qwest's local service are also not likely to choose Qwest's long distance service. Competition already exists in many forms, and Qwest is committed to providing high quality service without the need for government-imposed service quality incentive programs. These facts support the

removal of regulatory standards and penalties, as they are no longer needed to protect the public interest since Qwest is already providing a higher level of protection on its own accord.

Q. IN TURN, WHAT EFFECT DOES THE KIND OF SERVICE QUALITY REGULATION MR. SMITH ADVOCATES CONTINUING HAVE ON THE INDUSTRY?

Mr. Smith continues to promote an outdated and outmoded regulatory model of standards and penalties designed to provide an ongoing incentive to maintain service quality performance. Retaining the penalty provisions of the Service Quality Plan Tariff sends the wrong message and incentive. If the penalty aspects are not eliminated, despite Qwest's excellent quality above required levels, the message to Qwest is that it is unwise to improve its level of service, since the regulatory response in the future will likely be to raise standards and penalties to reflect the improved performance, thus imposing upon Qwest a heightened level of risk, fines for violations, and removing any competitive advantage Qwest may have gained in the marketplace by improving their service quality above that of their competitors.

Q. PLEASE RESPOND TO MR. SMITH'S REFERENCE TO THE TESTIMONY OF STAFF WITNESS FIMBRES, ATTEMPTING TO EXPLAIN AWAY THE EXISTENCE OF COMPETITIVE ALTERNATIVES.

Merely stating that Qwest remains the primary provider of wireline service in its service territory is like saying that England still controls 100% of the British

1 Empire. It was once said that the sun never set on the British Empire, so large
2 was its breadth and scope. While England may still control 100% of that empire
3 today, the fact is that the British Empire is a small shadow of its former greatness.
4 Statements such as witness Fimbres' ignore the erosion of Qwest's wireline
5 services caused by competitive alternatives provided by CLECs, cable
6 companies, wireless companies and VoIP service providers. In light of
7 burgeoning competition, Qwest believes that customer demand, choice, and
8 expectations – not regulation – should decide the nature and degree of service
9 quality that is necessary.

10 **Q. IN YOUR OPINION, HAS THE CONCEPT OF SERVICE QUALITY TAKEN A**
11 **BACK SEAT TO THE COST OF SERVICES?**

12 A. I continue to be amazed at the tolerance subscribers have for relatively poor
13 levels of cell phone service quality over the years. If the PSTN were to drop as
14 many calls as the wireless network, this Commission would be flooded with
15 complaints. Yet, the convenience of talking on the go outweighs having to redial a
16 telephone number and apologize to the person on the other end for the
17 inadequacies of the cell phone company. Early on, VoIP technology experienced
18 similar issues and many brought into question the quality of VoIP calls and
19 asserted that call quality remained below that provided on traditional wireline
20 phones. At that time, market analysts had readily admitted that the sound quality
21 of VoIP calls are "awfully close" to that of a wireless call. No one will dispute that
22 the sound quality of wireless calls is far less than that provided by wireline
23 carriers, such as Qwest, yet customers have flocked by the millions to wireless

service and increasingly to the newer service known as VoIP. Exhibit DP-1 is an article written by Urvaksh Karkaria on the Fort Wayne Indiana home page discussing Vonage, an IP telephony company, and their current foot-hold in the VoIP market. It is projected that between 2003 and 2008, the number of VoIP residential VoIP subscriptions to grow from nearly 1 million by the end of 2005 to an estimated 11.7 million by 2008. These estimates were based on research conducted by Analysys – the consulting firm. Clearly, customers are willing to accept and try newer, different quality services in exchange for some other benefit, such as price or convenience. The point is that consumers have increasingly become more price sensitive than performance sensitive because they have become accustomed to lesser service quality due to inter-modal competition such as wireless. Often time wireless performance is less than satisfactory but the convenience of being able to make the call at that moment takes the sting away of having the call dropped numerous times. For this Commission to continue with measurements that, first, Qwest has seldom had to worry about, and second, are not even important to many subscribers, seems ludicrous in light of the market conditions and trends.

It also seems odd for anyone to suggest that the Commission might even consider retaining outdated service quality standards, conceivably set to reflect minimum performance levels that currently exceed the minimum performance that customers evidently increasingly accept. Imposing regulatory hoops in areas that are not presently a concern of our customers provides no benefits to those

customers and only adds operational, administrative and economic burdens on Qwest.

Q. MR. SMITH STATES ON PAGE 4 OF HIS SURREBUTTAL THAT THE SERVICE QUALITY PLAN AND ITS ASSOCIATED PENALTIES WERE ESTABLISHED TO ADDRESS QWEST'S PAST PERFORMANCE. PLEASE ELOBORATE ON QWEST'S PAST PERFORMANCE.

A. Over that past 18 months, Qwest has reported held orders numbers in the single digits or low teens across the state. Exhibit DP-2 illustrates the general trend in held orders since October of 2000. Based on this "past performance," it appears that the service quality plan has served its purpose. Confidential Exhibit DP-3 illustrates those held orders which have gone for longer than 30 days and, once again, it is easy to see that Qwest's "past performance" is not an issue – in fact, in the past 24 months, Qwest has only had one order held for a period of 30 days or longer.

Exhibit DP-4 provides a snap shot of Qwest's out-of-service measurements and as the chart demonstrates, Qwest's "past performance" has exceeded the standard in 9 of the last 12 months and has not dropped below the standard in any two consecutive months during that period. In fact, since December 2000, Qwest has NEVER had two consecutive months below the standard. Once again, past performance does not appear to be an issue for this measurement either. Confidential Exhibit DP-5 demonstrates, again, that Qwest has remained well below the trouble report rate of 8 reports per 100 across the State since this

measurement was put in place. If one believes what Mr. Smith is saying about the penalties addressing past performance, indeed, Qwest's past performance has been very good, in fact two aspects of these rules have NEVER been triggered. For that reason, the service quality measurements for held order, out-of-service and trouble report rates should be abandoned.

III. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	DOCKET NO. T-01051B-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	DOCKET NO. T-00000D-00-0672

REJOINDER EXHIBITS

OF

DENNIS PAPPAS

QWEST CORPORATION

JANUARY 28, 2004

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation - DP-1
Rejoinder Exhibits of Dennis Pappas
January 27, 2005

VONAGE
THE BROADBAND PHONE COMPANY™

Internet Phone Service Race
Date: Saturday, July 03 @ 00:00:00 EDT
Topic: Vonage News

FortWayne
FORT WAYNE'S HOME PAGE

Rivals Line Up For Internet Phone Service Race

July 12, 2004

By Urvaksh Karkaria

As Gulliver stirs, the Lilliputians in the nascent Internet phone service business are bracing for a not-so-even showdown.

Verizon Communications plans to invest about $3 billion over the next two years to beef up its broadband service, which will include launching nationwide phone service using Voice over Internet Protocol, or VoIP.New York-based Verizon could be viewed as the powerful sea captain from the novel "Gulliver's Travels" as the company lumbers into the high-speed Internet phone business, attempting to fend off the cable competitors and Lilliputian startups snipping at its market share.

"We're in the final stages of testing this," Verizon spokeswoman Bobbi Henson said.

A national rollout of the service is expected to begin later this summer, but Henson remained mum on which cities might get the service first or when it would trickle down to the northeast Indiana market.

This is Verizon's "competitive counterpunch," said Richard Heidemann Jr., telecommunications analyst with National City's Private Client Group in Cleveland.

By offering Internet phone service, Heidemann said, Verizon will be able to hold onto some customers who might ditch their conventional telephone connection for the more hip technology.

VoIP player Vonage, which claims to have 55 percent market share, is putting on a brave face and adopting a bring-it-on attitude.

Internet phone service is the latest way in which technology is changing the way people communicate. And judging from Verizon, it's changing the way companies that keep us in touch operate.

While conventional calls are transmitted through a labyrinth of high-maintenance cables, switches and copper wires, VoIP uses technology that packages voice calls as data and sends them over a broadband connection such as cable modems or DSL.

The technique is less expensive because it avoids some access charges inherent in the traditional phone network. And it opens up new features, such as Web-based management of voice mail.

The standard price for VoIP packages from AT&T Corp. and Cablevision Systems Corp. is $34.99 a month for unlimited local and long-distance calling, voice mail and call forwarding – but that doesn't include a broadband connection, which typically costs at least $30 a month.

Verizon's local and long-distance packages for traditional calling range from $49.95 to $64.95 a month.

The Web interface offers additional features and gives users more control over how they make calls and receive messages, said Michael Kende, principal consultant at Analysys, a U.K.-based telecommunications strategy consulting company.

"It's much more interactive," Kende said from Analysys' Washington, D.C., office.

The market for high-speed Internet phone service, so far, has been dominated by startups such as Vonage. The Edison, N.J.-based company, which launched VoIP service in the Fort Wayne area in July

2003, has about 200,000 customers nationwide including nearly 1,000 in Indiana. At least half of Vonage customers have cut the cord to their landlines, the company said.

So far, Vonage's market infiltration is likely not forcing Verizon chief Ivan Seidenberg to reach for the aspirin. With annual sales of $67.8 billion, Verizon is unarguably the 800-pound gorilla in the telecommunications business.

But Vonage could be just the tip of a slippery slope. Better-financed and recognized rivals in the cable and telecommunications worlds are also stepping in to wrestle customers away.

VoIP technology "lowers the barrier to competition" in the local telephone business, Analysys' Kende said.

Until now, offering local phone service was cost-prohibitive because it required expensive cables and copper wire infrastructure, he said. But by using VoIP, new entrants in the market can bypass the expensive infrastructure and offer local telephone service through broadband connections.

Using VoIP, cable companies such as Comcast Corp. can also offer "what's called a triple play of voice video and data" on their cable infrastructure, which will increase their competitiveness, Kende said.

Comcast, whose cable infrastructure passes through more than 153,000 homes in the Fort Wayne area, hopes to squeeze more revenue from its customers. Comcast anticipates offering Internet phone service to all its customers by the end of 2006.

And long distance-carrier AT&T says it expects to have 1 million VoIP customers by the end of next year.

Henson said competitive threats are a reason Verizon is going down the VoIP road.

"Certainly it will help us retain customers (who) are looking for this kind of service," she said. "And more and more customers are looking for this service."

Verizon is also betting that Internet phone service will entice more people to sign up for its DSL connections.

"This is actually a part of our broadband strategy as much as it is part of our voice strategy," Henson said. "Voice is becoming more and more of an application."

Improvements in call quality and blistering demand for broadband connections have piqued Verizon's interest, too.

"This is a technology that's come into its own," Henson said. "Now the technology and the market have intersected."

Until recently, calling over the Internet - while easy on the wallet - was hard on the nerves. Callers had to deal with dropped connections, echoes and static.

But new compression technology and faster connection speeds have reduced the hassle factor.

Today the sound quality of VoIP calls are "awfully close" to that of a wireless call, National City's Heidemann said.

The market for Internet-based calling has also expanded as more American households upgrade to fast broadband Internet connections.

At the end of 2003, about 24 million U.S. homes had broadband connections, Heidemann said. That number is forecast to climb to about 65 million in 2008.VoIP adoption is expected to reach 17 percent of broadband-enabled U.S. households in 2008 - growing from fewer than 1 million at the end of this year to 11.7 million in 2008, according to Analysys, the consulting firm.

The Internet phone service is expected to be adopted by 23 percent of broadband-enabled small businesses - increasing from fewer than 100,000 this year to 800,000 in 2008.

Together, consumers and small businesses are expected to provide almost 13 million VoIP subscriptions and $5.7 billion in annual revenues in 2008, Analysys said.

But even as Verizon trains its guns on the VoIP business, Vonage is not flinching.

Vonage will continue to compete on price and offer innovative products, Louis Holder, executive vice

president of product development, said.

While the average household spends about $75 a month on conventional phone service, "with (Vonage's VoIP service) you can get a plan as low as $15 a month or as high as $30 a month," Holder said.

Rather than cower before the much bigger competitors, Holder welcomes it. Verizon's entry into the VoIP business, he said, will bring brand-name cache to the fledgling technology.

The bundles of dollars Verizon will throw at marketing its service will help create awareness and benefit all service providers, Holder said.

Vonage also has a 2 1/2 -year headstart in the business.

"We've ironed out a lot of the bugs," Holder said, adding the new entrants will have to play catch-up.

And Vonage's Lilliputian size allows it to react more quickly to competitive threats and stay on top of the competition, Holder said.

The battle for this latest frontier in the telecommunication's business will pitch the financial muscle of Gulliver against the strategic nimbleness of the Lilliputians. The bugle call, marking the start of that battle, has only just been sounded.

This article comes from Vonage VoIP Forum
http://www.vonage-forum.com

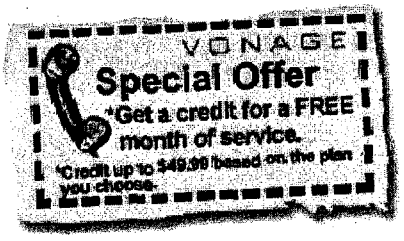
The URL for this story is:
http://www.vonage-forum.com/modules.php?name=News&file=article&sid=1018

VONAGE
THE BROADBAND PHONE COMPANY®

Main Menu

- Vonage Forum
- Feedback
- How It Works
- Members List
- Official Vonage Sites
- Private Messages
- Recommend Us
- Search
- Submit News
- Top 10
- Vonage Area Codes
- Vonage FAQ
- Vonage Forums
- Vonage News
- Vonage News Archive
- Vonage Reviews
- Vonage Sign Up Info

SAVE $49.99 On Vonage® VoIP Service
Get The Vonage Rebate Coupon BEFORE You Sign Up.



Covad Small-Business VoIP
Integrate Voice & Data Lines, save up to 40% and increase productivity

VoIP phones
VoIP telephones and gateway solutions. Find out more!

Ads by Google

Vonage VoIP Forum: Access Denied

You are trying to access a restricted area.

We are Sorry but this section of our site is for *Subscribed Users Only.*

- Your Account

[Go Back]

Members & Visitors

Forum_Members
Newest **Mademarco**
New_Today **29**
New_Yesterday **25**
Total_Members **4943**

Who_Is_On_Site
Visitors **130**
Members **12**
Total_Online **142**

You_Are_Anonymous

VoIP Speed Test

VoIP Speed Test

Vonage Website

Vonage FAQS

Vonage Faq

FAQ (Frequently Asked Questions)

Categories

- Top Ten Vonage Questions FAQs
- Vonage Area Codes

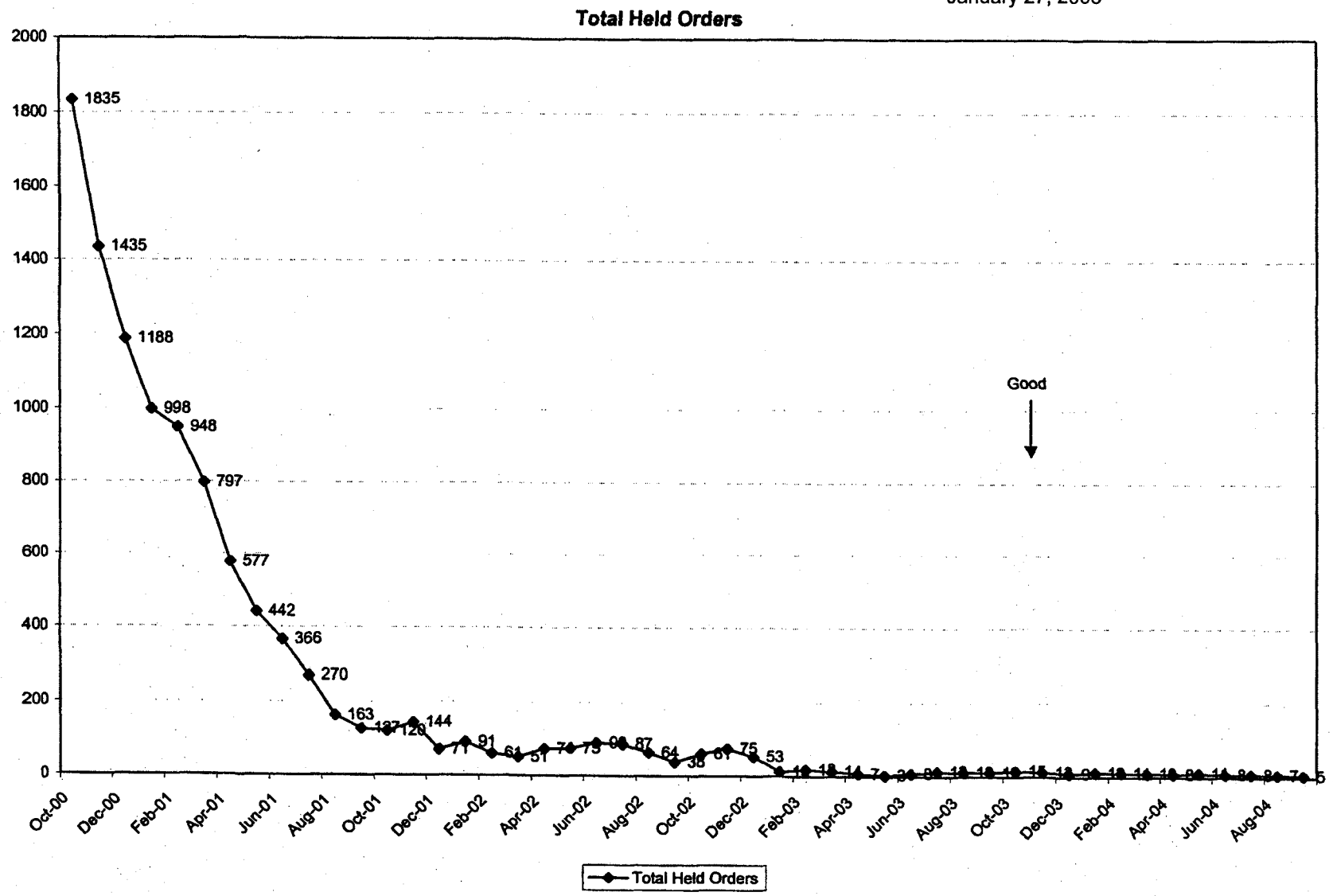
Vonage faqs

Site Navigation

Vonage | VoIP Speed Test | Vonage Review | Vonage Forums | VoIP | Vonage Internet Phone | Vonage Promotion | Vonage Broadt
Vonage Free Month | Vonage VoIP | Vonage Phone Service | Vonage Rebate | Vonage Phone | Vonage Forum | Page 2, 3, 4, 5, 6, 7, 8, 9
13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, Vonage Website Forum | Vonage Website | Report A Bug | General Chat | Th
Vonage Press Release | Vonage Area Code | Vonage In The News | Vonage News | March 03 | April 03 | May 03 | June 03 | July 03 |
September 03 | October 03 | November 03 | February 04 | March 04 | April 04 | May 04 | June 04 | July 04 | August 04 | September 04
| November 04 | December 04 | January 05

Web site engine's code is Copyright © 2002 by PHP-Nuke. All Rights Reserved. PHP-Nuke is Free Software released under the GNU/GI
Page Generation: 0.191 Seconds
www.vonage-forum.com is not an official Vonage® website & is independently operated. Vonage VoIP Forum is an authorized reseller c
VoIP phone service. We provide The Vonage phone free month offer - a Vonage sign up discount promotion; in an effort to offset our cos
all content is Copyright © 2003, 2004 by 4Sight Media, LLC. Vonage - The Broadband Phone Service Company, offers residential broadb
small business telephone - VoIP - Internet phone service. Have a Vonage Problem? We offer Vonage Help for your Vonage Trou
Vonage® VoIP Forum - SAVE Up To $49.99 BEFORE Signing Up With The Vonage Rebate Coupon. Vonage News, Reviews, FAQ's & Di

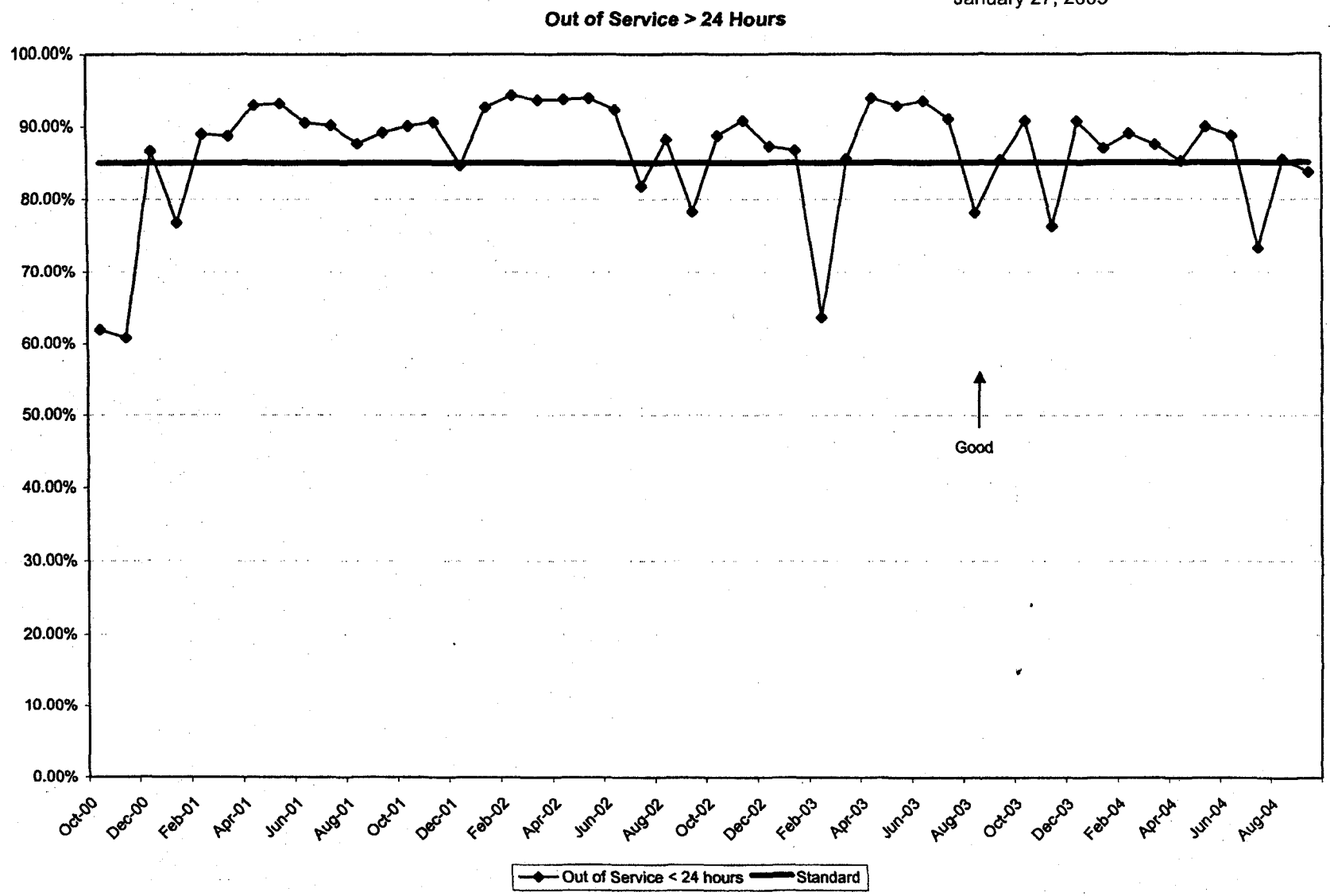
Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation - DP-2
Rejoinder Exhibits of Dennis Pappas
January 27, 2005



Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation – Confidential Exhibit DP-3
Rejoinder Exhibits of Dennis Pappas
January 27, 2005

REDACTED

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation - DP-4
Rejoinder Exhibits of Dennis Pappas
January 27, 2005



Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation – Confidential Exhibit DP-5
Rejoinder Exhibits of Dennis Pappas
January 27, 2005

REDACTED

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF COLORADO)
) **ss** **AFFIDAVIT OF DENNIS PAPPAS**
COUNTY OF DENVER)

Dennis Pappas, of lawful age being first duly sworn, deposes and states:

1. My name is Dennis Pappas. I am Staff Director – Public Policy for Qwest Corporation in Denver, Colorado. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Dennis Pappas

SUBSCRIBED AND SWORN to before me this 24th day of January, 2005.

Stephanie Jiron
Notary Public

My Commission Expires: 6-17-2006

STEPHANIE JIRON NOTARY PUBLIC STATE OF COLORADO
MY COMMISSION EXPIRES JUNE 17, 2006

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-27 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REJOINDER TESTIMONY

OF

HARRY M. SHOOSHAN III

ON BEHALF OF QWEST CORPORATION

January 27, 2005

TABLE OF CONTENTS

I. IDENTIFICATION OF WITNESS. 1

II. PURPOSE AND SUMMARY OF REJOINDER TESTIMONY. 1

III. RESPONSE TO RUCO WITNESS JOHNSON 2

IV. RESPONSE TO STAFF WITNESS ROWELL 10

V. SUMMARY AND CONCLUSION 13

1 **I. IDENTIFICATION OF WITNESS.**

2

3 **Q1. ARE YOU THE SAME HARRY M. SHOOSHAN III WHO PROVIDED**
4 **DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?**

5 **A1.** Yes.

6

7 **II. PURPOSE AND SUMMARY OF REJOINDER TESTIMONY.**

8

9 **Q2. WHAT IS THE PURPOSE OF YOUR REJOINDER TESTIMONY IN THIS**
10 **PROCEEDING?**

11 **A2.** The purpose of my rejoinder testimony is to respond to the positions taken
12 by Matthew Rowell on behalf of Staff and Ben Johnson on behalf of
13 RUCO regarding competition in Arizona and construct of the price cap
14 plan.

15

16 **Q3. WHAT SPECIFIC ISSUES RAISED BY THOSE WITNESSES DO YOU**
17 **ADDRESS IN YOUR REJOINDER TESTIMONY?**

18 **A3.** In this rejoinder testimony, I reiterate my objections to Staff's and RUCO's
19 proposals to treat any of Qwest's Basket 3 services differently than the
20 comparable offerings of competitors. I also reiterate my concerns about
21 RUCO's complex and radical restructuring of baskets which would be a

giant step backwards for this Commission at a time when we need to take the evolutionary "next step" that is reflected in Qwest's proposal. I also continue to oppose Dr. Johnson's recommendation to retain an inflation-minus-productivity mechanism. Dr. Johnson has largely failed even to respond to my criticisms of his approach. I believe that the same objectives—reasonable constraints on the price of basic service and incentives for increased productivity—can be achieved without penalizing the Company. Finally, I respond to Dr. Johnson and Mr. Rowell regarding the issue of elasticity of supply, which I raised in response to their efforts to define "effective competition" in terms of market share statistics and concentration ratios.

III. RESPONSE TO RUCO WITNESS JOHNSON

Q4. DR. JOHNSON CONTINUES TO CLAIM THAT THE HHI IS THE CORRECT FACTOR TO CONSIDER IN DETERMINING WHETHER THE MARKET IS COMPETITIVE. JOHNSON AT 3-6. HOW DO YOU RESPOND?

A4. I continue to point out that static measures tend to belie the reality of the situation. Such market concentration or market share information does not consider the fact that many competitors (as described in Mr. Teitzel's

1 testimony) are present and have access to either Qwest facilities or their
2 own facilities in order to serve customers in the market. As I have noted,
3 effectiveness of competition really turns on elasticity of supply and basic
4 entry conditions—not what actually results market-share wise at a given
5 moment in time, which is, in part, simply a matter of chance and historical
6 circumstance.
7
8 Q5. **DR. JOHNSON ASSERTS THAT YOU BELIEVE THAT MARKET**
9 **SHARE MEASURES SHOULD BE BASED ON MINUTES OF USE**
10 **RATHER THAN LINES. JOHNSON AT 7.[1] IS THIS YOUR POSITION?**
11 A5. No. Dr. Johnson misunderstands my testimony. I am, in general, not in
12 favor of basing determinations of competition on market share statistics,
13 whether the unit of measure is lines or usage. In my rebuttal testimony, I
14 pointed out that Dr. Johnson's reliance upon lines also misses the
15 movement of actual usage and traffic to other networks from Qwest's.
16 The simple point is that a firm could lose "only" 20 percent of its lines but,
17 say, 80 percent of the total usage if, as can be expected, that 20 percent
18 represents primarily the high-volume users. I reiterate that many factors
19 must be considered regarding productive capacity when considering the

[1] Staff witness Fimbres makes a similar statement. Fimbres Surrebuttal at 2.

extent of competition in a market. Simply looking at market share however it is measured misses much of the picture.

Q6. WHAT OTHER LIABILITIES ARE THERE IS PLACING TOO MUCH WEIGHT ON MARKET SHARE STATISTICS?

A6. Consider the following. Suppose regulation keeps the market price below the efficient competitive level. Now observed competitor market shares (say, those of CLECs) will understate how much share competitors would take at (higher) competitive prices. It is only at the competitive equilibrium price that the observed market shares will be unbiased in this sense. Viewed from this perspective, market shares in local telephony significantly understate the actual degree of competitiveness. A regulatory regime that seeks to keep local rates below the competitively efficient level, while at the same time supplying strong, but indiscriminate, incentives for entry, distorts the market and renders practically irrelevant any observation of market share. An appropriate economic interpretation of conditions in local telephony imply that it is *more* competitive than might be implied by a simple reading of share information, particularly, shares of lines served as opposed to actual or potential productive capabilities.

Q7. DR. JOHNSON CLAIMS THAT, IN SPITE OF THE PRESENCE OF COMPETITORS' FACILITIES, THERE WOULD STILL BE BARRIERS TO ENTRY. JOHNSON AT 7. HOW DO YOU RESPOND?

A7. The Commission's responsibilities are to remove legal and regulatory barriers to entry and allow the market forces to play out; that is, allow the various competitors and platforms to compete for the business of the consumer. However, the freedom to enter does not mean that entry is costless. Even when nothing prevents a firm from entering a market, it still has to produce a product and cover all of the costs of doing business. Regulators should not attempt to repeal the fundamental laws of economics. Where demand is low or costs are high, entry will be limited. This is not a competitive failure.

Moreover, with the current asymmetric regulation of Qwest, competitive forces are not able to play out fully in Arizona. The current competition is one-sided in that competitors can respond to Qwest's tariffed rates, but Qwest's ability to respond as quickly and as freely as its competitors is lacking under current regulations. When Qwest is granted the same pricing freedom for its competitive services that its competitors have, the Commission can expect even more vigorous competition, including more price competition, in what has historically been Qwest's service area in Arizona.

Q8. DR. JOHNSON "STRONGLY DISPUTE[S]" YOUR ASSERTION THAT THE RUCO PRICE CAP PLAN IS "MUCH MORE COMPLEX." JOHNSON AT 12-14, 25. WHY HAVE YOU SAID THAT DR. JOHNSON'S PROPOSED PLAN IS "MUCH MORE COMPLEX" THAN THE CURRENT PLAN OR QWEST'S PROPOSAL IN THIS PROCEEDING?

A8. I have said that Dr. Johnson's proposed plan is "much more complex" than the current plan or Qwest's proposal because it seeks to reassign from scratch the distribution of Qwest services among the baskets; it adds additional baskets; it potentially may re-regulate Qwest services that have already been assigned to Basket 3; and it would mix retail and wholesale services in the same basket, unlike the current plan.[2]

Dr. Johnson's proposal is indeed far more complex than the current plan which has one basket for basic/noncompetitive services, a second basket for wholesale services, and a third basket for competitive/flexibly-priced services. What purpose do these greater complexities really serve? What benefit do they really provide? In my opinion, no discernable benefit is gained by designing such a detailed and intricate classification plan. I continue to believe Dr. Johnson's recommended approach is an effort on

[2] In response to this last concern, Dr. Johnson says he would be willing to create even more baskets (at 13).

the part of RUCO to throw sand into the wheels of price cap regulation it did not support in the first place.

Q9. DR. JOHNSON CLAIMS THAT HIS PROPOSAL DOES NOT GO AGAINST THE "SPIRIT" OF PRICE CAP REGULATION BECAUSE IT DOES BREAK THE LINK BETWEEN COST AND PRICES. JOHNSON AT 13-14. DO YOU AGREE?

A9. No. Price cap regulation, besides moving to break the cost-price link, is intended be more efficient and less costly to administer than traditional rate of return regulation.[3] Dr. Johnson's proposal for detailed criteria and multiple baskets to reflect multiple degrees of "competitiveness" hardly meets this criterion. His proposal is regressive and draconian.

Q10. HOW DOES DR. JOHNSON'S PROPOSED ARRAY OF BASKETS AND COMPETITIVE CRITERIA COMPARE WITH THE REGULATION OF SERVICES OF QWEST'S COMPETITORS?

A10. As I described in my Rebuttal Testimony (at 4), this proposal perpetuates, and may indeed exacerbate, the asymmetric regulation of Qwest. Contrary to Dr. Johnson's representations, his proposal would leave Qwest with even less pricing freedom than its competitors for the same or

[3] James C. Bonbright, Albert L. Danielsen, and David R. Kamerschen, *Principles of Public Utility Rates: Second Edition* (1988, Public Utilities Reports, Inc.; Arlington, VA) at 587-588.

similar set of services. There is no rationale for continuing this asymmetric regulation.

Q11. DR. JOHNSON CONTINUES TO ADVOCATE THE INCLUSION OF A PRODUCTIVITY OFFSET IN THE PRICE CAP PLAN. JOHNSON AT 29. HOW DO YOU RESPOND?

A11. I continue to recommend that the Commission eliminate the productivity offset in the price cap plan. First, it is important to consider the price cap plan as a whole, taking into account elements such as basket structure and the various price control mechanisms that might be used (i.e., caps on basket revenues). The efficiency gains we hope to achieve—for both the company and for regulators—are a product of the plan as a whole. Dr. Johnson wants to make the basket structure much more complex, *while at the same time retaining the productivity offset*. This is a prescription for undermining, not enhancing efficiency.

We also know much more about price cap regulation than we did a decade ago. We do not need to tie up scarce regulatory resources debating the calculations and components of a productivity offset, the effects of which can be obtained much more simply and directly. This is why the elimination of the inflation-minus-productivity mechanism is a step

forward in price regulation methods in Arizona—and consistent with the trend in the U.S. in general.

Q12. HOW WILL THE REVENUE CAP ON BASKET 1 SERVICES ACHIEVE THE COMMISSION'S DESIRED GOALS?

A12. As I described at length in my Direct Testimony in this proceeding (at 7-11), I believe that Qwest's proposal contains adequate incentives for achieving *reasonable* productivity gains while still providing adequate protection for ratepayers. While Basket 1 services are capped, the nominal prices of Qwest's services will remain constant while their real prices will decrease as Qwest faces inflation (just like the rest of the economy). Unlike unregulated firms, Qwest will not be able to raise nominal prices for the services in Basket 1 to compensate for inflation.

It is but another step backward to continue to impose an inflation-minus-productivity mechanism, which typically has the primary objective of forcing prices downward, both nominally and in real terms. This is precisely the wrong direction to be going at this time in Arizona.

Q13. IS DR. JOHNSON CORRECT THAT A PRODUCITIVY MEASURE SHOULD REFLECT THE TELECOMMUNCATIONS INDUSTRY AS A WHOLE? JOHNSON AT 29-30.

A13. No, he is not. In my Rebuttal Testimony, I discussed a number of reasons why a nationwide measure of productivity may not appropriately capture the trends in Arizona. Shooshan Rebuttal at 11-13. Further, I know of no definitive agreement among economists or regulatory experts as to what would be the "correct" method of arriving at a measure of productivity as a component of a price cap plan. Indeed, if every one agreed, few resources would have to be wasted on such a debate. In fact, Dr. Johnson's concern that a company-specific productivity offset may re-establish ties between the company's cost and prices, and is thus contrary to the spirit of price cap regulation, is misplaced. Indeed, the linkage is broken by the capping of revenues in Basket 1. As I am sure Dr. Johnson would agree, inflation is an exogenous factor over which Qwest has no control. Qwest will have to adjust its prices to remain within the revenue cap regardless of its costs.

IV. RESPONSE TO STAFF WITNESS ROWELL.

Q14. STAFF WITNESS ROWELL CLAIMS THAT STAFF IS NOT CHANGING THE TREATMENT OF BASKET 3 SERVICES IN A WAY THAT RUNS COUNTER TO THE COMMISSION'S INTENT. ROWELL AT 6. DO YOU AGREE?

1 **A14.** No. I continue to disagree. As I stated in my Rebuttal Testimony (at 3),:
2 "[I]t is contrary to the original intent of Basket 3 which was to give Qwest
3 flexibility in pricing services and packages of services which had either
4 been found to be competitive or which are discretionary in nature." The
5 inclusion of services that have heretofore resided in Basket 1 in no way
6 changes that reasoning, as Mr. Rowell claims. If a service or package of
7 services is placed in Basket 3 because it has been found to be
8 competitive, then Qwest should have the same ability as its competitors to
9 set the prices for that service or package of services. To constrain Qwest
10 in ways its competitors (e.g., Cox) are not in pricing its services to market
11 is unwise and goes against the spirit underlying the existing price cap
12 plan. Further, as I discussed in my Rebuttal Testimony (at 3-4), with
13 regard to packages in Basket 3, consumers are protected by the
14 continued availability of the basic/noncompetitive product on a standalone
15 basis in Basket 1.
16
17 **Q15. MR. ROWELL COMPLAINS [AT 7] THAT YOU DID NOT PROVIDE ANY**
18 **QUANTIFICATION OF THE ELASTICITY OF SUPPLY AND THAT YOU**
19 **ARE SIMPLY PLAYING A GAME OF SEMANTICS. WHY HAVE YOU**
20 **NOT PRESENTED SUCH EVIDENCE IN THIS PROCEEDING?**
21 **A15.** I have not presented evidence regarding the elasticity of supply because
22 that is not the reclassification standard that Qwest is proposing in this

proceeding. Further, my point regarding the relevance of elasticity of supply as an indicator of the competitiveness of a market was made in response to Dr. Johnson's urging the Commission to rely on a variety of static measures (i.e., market share data and concentration ratios) in order to reclassify a Qwest service from Basket 1 to Basket 3. Finally, as I stated in Qwest response to Staff Data Request STF 37-1, the elasticity of supply "is primarily approached as a qualitative assessment of a market," rather than strictly a mathematical exercise. Nonetheless, in this proceeding, Mr. Teitzel has provided substantial data on the presence of competitors in Qwest's service area, including those that have deployed their own facilities. Competitors are able to lease from Qwest certain parts of its network or resell Qwest services at a discount in order to extend their reach to serve new customers. While I have not offered a formal analysis of the elasticity of supply in this case, I do believe that these facts are indicators that there is a high degree of elasticity of supply in Qwest's service area in Arizona.

V. SUMMARY AND CONCLUSION.

Q16. PLEASE SUMMARIZE YOUR REJOINDER TESTIMONY.

A16. The Commission should approve the price cap plan proposed by Qwest in this proceeding. The Commission should discontinue the cap on revenues of Basket 3 services so that Qwest competitive services may be treated in the same manner as its competitors' services. The creation of additional sub-constraints in the baskets undermines the incentives for achieving greater economic efficiency which an appropriate price-regulation plan can provide. The renewed plan need not include a productivity-inflation adjustment mechanism. Finally, the Commission should resist suggestions that it rely on static measures of competition, especially since such measures—when applied in this context—are likely to understate significantly the competitive effectiveness of the local market.

Q17. DOES THAT CONCLUDE YOUR REJOINDER TESTIMONY?

A17. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF NEW HAMPSHIRE)
) **ss** **AFFIDAVIT OF HARRY M. SHOOSHAN**
COUNTY OF HILLSBOROUGH)

Harry M. Shooshan, of lawful age being first duly sworn, deposes and states:

1. My name is Harry M. Shooshan. I am a principal in Strategic Policy Research, Inc. located in Bethesda, Maryland and am appearing on behalf of Qwest Corporation. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Harry M. Shooshan

SUBSCRIBED AND SWORN to before me this 21st day of January, 2005.

Notary Public

My Commission Expires: PATRICIA A. LETOURNEAU NOTARY PUBLIC STATE OF NEW HAMPSHIRE My commission expires Jan. 21, 2009

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-28 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REJOINDER TESTIMONY

OF

DAVID L. TEITZEL

QWEST CORPORATION

JANUARY 27, 2005

TESTIMONY INDEX

		Page
Executive Summary		i
I.	Identification of Witness	1
II.	Structure of Rejoinder Testimony	1
III.	Staff	
	a. Tom Regan	2
	b. Matt Rowell	7
	c. Armando Fimbres	10
IV.	Department of Defense	22
V.	Cox Communications	24
VI.	Time Warner	33
VII.	RUCO	36
VIII.	MCI	40
IX.	Conclusion	44

EXECUTIVE SUMMARY

My rejoinder testimony focuses on issues raised in this docket in the testimonies of Staff, RUCO, Department of Defense ("DOD"), MCI, Time Warner and Cox Communications regarding issues discussed in my direct and rebuttal testimony. While witnesses for these parties raise a number of issues that are addressed in detail in the body of my rejoinder testimony that follows, there are three primary themes that recur in the intervenors' testimonies regarding Qwest's advocacy that require clarification to ensure the Commission is not left with a misunderstanding. The three primary intervenor themes are: 1) forms of competition other than full bypass competition can be largely disregarded, 2) intermodal competition (e.g., wireless and Voice over Internet Protocol) is not significant and should be disregarded and 3) Qwest does not need Arizona Universal Service Fund ("AUSF") support to defray the cost of serving customers in high cost areas. The following summarizes and clarifies Qwest's advocacy on each point:

CLEC Competition

Qwest has lost in excess of 25% of the Arizona local exchange market to various forms of competition, including competition from CLECs utilizing their own facilities, CLECs utilizing unbundled network elements and CLECs utilizing resale. In each instance, the competitive loss for Qwest is real and causes Qwest to lose the retail relationship with the end user and

eliminates Qwest's opportunity to maintain and grow the revenue stream associated with that relationship. While Qwest receives a fraction of the prior retail revenue when losing a customer to a CLEC using UNEs or resale, these losses essentially eliminate the margin used to recover costs Qwest incurs to serve high cost areas that CLECs choose not to serve. Further, it is very important for the Commission to recognize that these forms of competition are not, in effect, being "legislated out of existence" by the FCC in its Triennial Review Order ("TRO"). To the extent that local switching is not available after a defined point in the future, that is because the FCC has determined that CLECs have either switches of their own they can use to serve customers or that they can obtain that technology as easily as Qwest. In addition, numerous CLECs have taken advantage of an alternative commercially-available product entitled Qwest Platform Plus ("QPP") for those CLECs who wish to continue to use Qwest's loops and switching on a wholesale basis to serve their customer base. There is no reason to believe that CLEC competition will decline, as has been implied by the parties, and every reason to believe that it will continue to grow.

Intermodal Competition

In its Competitive Zones proposal in this docket, Qwest is not relying on intermodal competition as a "competitive trigger" to classify a particular wire center as a competitive zone. However, the Arizona competitive market is very dynamic and the mix of competitive alternatives has changed substantially even since this docket was initiated. Wireless

customers are relying on their wireless services to an ever greater degree and VoIP service is now widely available from multiple providers to any Arizona customer with a broadband internet connection. As customer perception of these services as viable alternatives to traditional telephone service continues to expand, these intermodal services represent an ever-increasing form of price constraining competition to Qwest. To the extent the Commission, after reviewing the evidence in this docket, determines that sufficient CLEC competition exists in a particular wire center to warrant designation of that wire center as a competitive zone, the reality of intermodal competition should give the Commission additional comfort that competitive forces will properly regulate Qwest's rate levels there.

AUSF Support

Qwest's costs to provide service to customers in high cost wire centers are indisputably higher than Qwest's costs to provide service in low cost (primarily urban) wire centers. Rather than supporting Qwest's proposal to utilize AUSF funding to defray the cost of serving customers in high cost areas, Qwest's opponents suggest that Qwest should use margins from profitable services (such as optional calling features, intraLATA toll, switched access and business local exchange services) to defray the cost of serving those customers. Absent competitive realities, the intervenors' model might be viable (and actually closely aligns with the manner in which prices were set prior to the Telecommunications Act of 1996). However, in reality, the "margin" associated with profitable products is being quickly eroded by competition. Significant local and long

distance usage is being shifted from Qwest's network to wireless networks, eroding Qwest's toll and switched access revenue base. CLECs are successfully winning high value business customers from Qwest, especially in urban areas of Arizona. CLECs, such as Cox and MCI, are successfully winning residential optional feature revenue from Qwest by offering attractive local service and feature packages, again, largely in urban and suburban areas of the state. The Commission no longer has the "monopoly" era luxury of using margins from high value services to underwrite the provision of local exchange service in high cost areas. This model fails in the face of competition.

An important feature of Qwest's AUSF proposal is that funding is "competitively portable," meaning that it is available to Qwest's competitors who choose to compete with Qwest to win customers in high cost areas. This allows Qwest's competitors to expect to earn a reasonable return on such customers and encourages the growth of competition in areas where competition has been slow to emerge. Rejection of Qwest's AUSF proposal means that customers in high cost areas are not likely to soon enjoy the fruits of competition.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is David L. Teitzel. I am employed by Qwest Corporation ("Qwest") as Staff Director-Public Policy. My business address is 1600 7th Avenue, Room 3214, Seattle, WA, 98191.

Q. DID YOU SUBMIT DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. Yes. I filed direct testimony in this docket on May 20, 2004 and rebuttal testimony on December 20, 2004.

II. STRUCTURE OF REJOINDER TESTIMONY

Q. HOW IS YOUR REJOINDER TESTIMONY STRUCTURED?

A. My rejoinder testimony is generally organized by intervening party and witness representing that party. In most instances, only one witness is associated with an intervening party. However, my testimony responds to three Staff witnesses: Matt Rowell, Tom Regan and Armando Fimbres.

III. STAFF

a. Tom Regan

Q. AT PAGE 5, MR. REGAN POINTS OUT THAT QWEST RECEIVES REVENUES FROM A RANGE OF SERVICES THAT "CONTRIBUTE TO THE TOTAL COST OF SERVING ITS CUSTOMERS." WOULD YOU COMMENT?

A. In any business, a firm's total revenues received from its customers should exceed the firm's total costs if the firm expects to remain solvent. However, Mr. Regan suggests that certain Qwest costs should be recovered from services that historically have had high margins, such as optional calling features, long distance, switched access and business services. The fatal flaw in his logic is that he ignores the effects of competition: the relatively high margins in certain services are being "competed away" as Qwest's competitors focus on those services. As competitors continue to win an increasing proportion of the high margin services from Qwest, the margin available to recover costs as Mr. Regan defines them is being substantially reduced.

Another problem with Mr. Regan's logic is that it is focused only on his view of how Qwest should recover its costs. In suggesting that Qwest price its services in a certain fashion, especially local exchange services in high cost areas, he is

apparently suggesting that Qwest's competitors should also view cost recovery in the same manner. Mr. Regan's logic would suggest that CLECs should be eager to provide local exchange services to customers located in high cost areas, since they are equally able as Qwest to use margins from high-margin services to defray the cost of providing local service in these areas. Unfortunately, Mr. Regan's logic does not comport with reality. CLECs choose to focus on geographic areas where the greatest margin is available.

Q. DOES QWEST'S AUSF PROPOSAL ADDRESS THE FLAWS IN MR. REGAN'S LOGIC?

A. Yes. Qwest's AUSF proposal provides a source of sustainable funding targeted specifically to the provision of local exchange service to customers in high cost areas. Qwest's proposal is also "competitively portable" and provides a source of funding to Qwest's competitors considering whether provision of local exchange service to high cost areas is economically viable.

Q. AT PAGE 12, MR. REGAN ALLEGES THAT HE OVERLOOKED THE EFFECTS OF DIRECTORY REVENUE IMPUTATION IN HIS ANALYSIS OF REVENUES AND COSTS OF PROVIDING QWEST LOCAL EXCHANGE SERVICE IN THE THREE UNBUNDLED NETWORK ELEMENT (UNE) LOOP

ZONES, AND THAT HIS ORIGINAL ANALYSIS IN HIS SCHEDULE TMR-3 "IS NO LONGER A VALID SCHEDULE." WOULD YOU COMMENT?

A. Yes. In his "corrected analysis" in Schedule TMR-S1, Mr. Regan adds $72m of directory revenue, which he asserts Qwest agreed to impute to its intrastate Arizona operations in the Qwest Dex sale settlement, into his "margin calculation" for local exchange service in each of the three UNE zones. However, as discussed in the direct and rebuttal testimony of Qwest witness Phil Grate, Qwest has a revenue requirement of over $400m in Arizona (on a fair value rate base), excluding effects of directory imputation. Even after deducting $72m of imputed directory revenue from this figure, a very significant positive revenue requirement remains. Mr. Regan assumes that the Commission will agree with Staff's revenue requirement adjustments in his margin analysis, thereby choosing to ignore the revenue requirement discussed by Mr. Grate. Instead, he simply uses the directory imputation value, in isolation, as a "lever" to bring the average local exchange customer revenue in high cost zones above "cost" as defined by Mr. Regan. In fact, should the Commission determine that Qwest indeed has a significant positive revenue requirement, even after accounting for the $72m of directory imputation discussed by Mr. Regan, that finding generally means that Qwest's overall revenues in Arizona are insufficient to cover its costs. The relationship of Qwest's rates for local exchange service in high cost areas as compared to its costs of providing service in those areas is contributing to this

shortfall. Since Mr. Regan simply assumes that Staff's revenue requirement will be adopted by the Commission, he ignores the overall revenue requirement issue entirely.

Q. AT PAGE 26, MR. REGAN STATES "IT IS NOT CLEAR HOW OR WHY QWEST'S COMPETITORS COSTS WOULD BE USED TO CALCULATE AUSF SUPPORT NEEDS FOR QWEST." HAS QWEST USED ITS COMPETITORS' COSTS TO ESTIMATE ITS AUSF FUNDING REQUIREMENT?

A. No. In fact, Mr. Regan misses my point entirely, which is that Qwest's AUSF proposal is competitively portable. From a policy perspective, the Commission should be allowed to consider the consumer benefit of Qwest's AUSF proposal to encourage competition in rural areas of Arizona. In fact the Commission's rules contemplate precisely that circumstance in Rule 14-2-1206(E), as follows:

> R14-2-1206 E. If the Commission approves AUSF support to a provider of telecommunications service for a defined area, such AUSF support shall also be available to competitive providers of basic local exchange service in the same defined area that are contributing to the AUSF, and that are willing to provide service to all customers in the specific AUSF support area as defined by the Commission. The AUSF support to which the competitive provider is eligible shall be calculated on a per-customer basis, at the same level at which the incumbent provider of telecommunications service receives AUSF support, and shall not result in an increase in the total AUSF support available for the specific census block groups or study area.

Should Qwest be allowed to receive AUSF in its highest cost service areas, CLECs considering serving customers in those areas would include the effects of

AUSF support in calculating whether serving such customers is economically feasible.

Q. AT PAGE 34, MR. REGAN SUPPORTS STAFF'S PROPOSAL "TO INCREASE THE REVENUE CAP ON BASKET 3 TO ACCOUNT FOR STAFF'S PROPOSED SWITCHED ACCESS REDUCTION." IS THIS USEFUL?

A. No. In fact, Mr. Regan's position in this instance is emblematic of the overall problem with his advocacy: he would have Qwest attempt to recover additional revenues to address Qwest's costs and overall revenue requirement from services that are highly competitive. His proposal is tantamount to having Qwest and its shareholders essentially "eat" the revenue loss and make the loss up in margins from services that are already being competed away. The logic simply does not work in a competitive market where demand is elastic.

Q. AT PAGE 40, MR. REGAN ARGUES THAT THE EXISTING DIRECTORY ASSISTANCE (D.A.) RATES ARE ABOVE COST. IS HE CORRECT?

A. No. In fact, Qwest has continued to provide the first D.A. call by a customer each month without charge. Since that call is "free," it is certainly below cost. At a minimum, customers making two or more D.A. calls per month are underwriting the cost of the customer who makes only one D.A. call. The existing "free" call allowance is simply a vestige of the monopoly era, when customers were not

assessed an incremental charge for optional services such as operator services and directory assistance.

b. Matt Rowell

Q. AT PAGE 2, MR. ROWELL CONTRASTS THE COMPETITIVE EVIDENCE QWEST HAS SUPPLIED IN THIS DOCKET IN SUPPORT OF ITS COMPETITIVE ZONES PROPOSAL WITH THE FEDERAL STANDARD WHEREBY CABLE TELEVISION PROVIDERS CAN BE REMOVED FROM RATE REGULATION AND SUGGESTS THAT QWEST'S EVIDENCE DOES NOT RISE TO THE LEVEL OF THAT REQUIRED OF CABLE TELEVISION PROVIDERS. WOULD YOU COMMENT?

A. In my direct testimony, I provided extensive evidence regarding the presence of CLEC competition in the Phoenix and Tucson markets,[1] showing these markets to be highly competitive. In fact, in contrast to the cable television requirements that (1) at least two unaffiliated other providers be offering service in the market, (2) each must be able to serve at least 50% of the customers in the market, and (3) together the other providers actually serve at least 15% of the customers in the market, Qwest's data shows that its Phoenix and Tucson markets are much more competitive than would be defined by the cable television requirements. In

addition, Qwest does not possess highly proprietary access line information at the wire center level for competitors, such as Cox, not utilizing Qwest's network on a wholesale basis to serve customers, and Qwest's competitive data is therefore understated.

While Qwest disagrees that any specific "market share" test is reasonable in defining the competitiveness of a market, since it is the fact that competitors are present and actively and successfully competing that should define market "openness," it is noteworthy that Staff witness Armando Fimbres and RUCO witness Ben Johnson both maintain that Qwest's competitive zones proposal should not be granted in any particular wire center until Qwest has lost far in excess of 15% of the local exchange market there.

Q. AT PAGE 4, MR. ROWELL STATES "IN RESPONSE TO STAFF 35-003, QWEST INDICATED THAT THEY HAVE NOT QUANTIFIED THE COST OF BASING COMPETITIVE ZONES ON ZIP CODES." DOES MR. ROWELL CAPTURE THE FULL CONTEXT OF QWEST'S RESPONSE?

A. No. In fact, this is a mischaracterization of Qwest's full response to Staff 36-003, which was as follows:

---

[1] For example, Confidential Exhibit DLT-17 shows the effects of local exchange competition for each Qwest wire center in the Phoenix and Tucson markets.

> "Qwest disagrees that the zip code based Competitive Zone structure in Arizona is appropriate and has therefore not commissioned a special study to quantify the implementation cost of such a structure. However, Staff's proposed structure would require an extensive reprogramming of Qwest's retail billing system, since this structure would be unique in Qwest's 14 state Region."

As stated in this response, a special study would be required, involving a large number of man hours, to quantify the overall cost of implementing such a change to Qwest's regional billing systems. A unique structure such as that proposed by Staff would be extraordinarily cumbersome and costly to implement. Since Qwest has no intention of implementing such a structure, investment in the special study is not warranted.

Q. AT PAGE 6, MR. ROWELL ARGUES THAT YOU WERE INCORRECT IN STATING THAT THE STAFF'S RECOMMENDED APPROACH TO COMPETITIVE ANALYSIS IS IMPRACTICAL. WOULD YOU CLARIFY YOUR POSITION?

A. Yes. My concern is largely one of process. For example, if Qwest, as the petitioning party, bears the burden of proof to show that particular wire centers are sufficiently competitive to warrant reclassification as competitive zones, Qwest will simply not be able to provide the range and depth of information suggested by Staff. In fact, much of this data is highly confidential and proprietary customer in-service data held only by the CLECs. Staff's proposal would require competitive in-service data for each specific service in a defined

geographic area from each competitor offering such services. Only then would Staff have the information it maintains is necessary for its analysis. Not only is this process hugely resource intensive and time consuming, it is doubtful non-parties to such a docket would be willing to provide the information to Staff (let alone to Qwest, a significant competitor). If my concerns are valid, the result of such a complex process would be that a finding on Qwest's petition for competitive zones would be significantly delayed pending pursuit of an extensive analysis that ultimately will likely be incomplete, hindering Qwest's ability to compete in an increasingly competitive market.

c. Armando Fimbres

Q. IN HIS EXECUTIVE SUMMARY, MR. FIMBRES QUANTIFIES THE SCOPE OF HIS ANALYSIS OF QWEST'S RETAIL SERVICE PROPOSALS AS ENCOMPASSING 2,020 PAGES AND SUGGESTS THAT QWEST MAY NOT HAVE FULLY REVIEWED HIS ANALYSIS. IS HE CORRECT?

A. Qwest does not quarrel with the Staff regarding the fact that its analysis was extensive and appreciates Staff's efforts to assess the competitive Arizona market. In fact, much of the data included in the analysis Mr. Fimbres references was developed and supplied by Qwest, and in most instances, by myself in response to the approximately 250 Staff data requests (excluding sub parts) to

Qwest in this proceeding. Contrary to Mr. Fimbres' contention, I did, in fact, review each piece of data and associated analysis provided by Staff to Qwest relevant to the proposals outlined in my direct and rebuttal testimony in this docket.

Qwest's concerns with Mr. Fimbres' analysis lie not in the quality and extent of the analyses, but in the assumptions on which the analyses are based. For example, Mr. Fimbres relies heavily on the use of white pages directory listings as a basis for estimating the size of the customer bases of Qwest and its competitors, and emphasizes that the white pages data is "highly accurate." He is correct that, since the white pages data for Qwest and CLECs is fed directly by listings information fed into the Qwest white pages database by service order activity and is updated daily, the database accurately reflects what is input to it. However, he neglects to recognize that many CLEC customers with multiple lines elect to list only the first line. For example, a business customer with 10 lines will typically elect to have only the first line in the system appear in the white pages listings. In this instance, a CLEC serving such a customer will likely issue an order to Qwest for a listings appearance for the first line only. There is no obligation on the part of the CLEC to communicate to Qwest that the remaining nine lines are non-listed. This is a major problem with the use of white pages listings as a

determinant of relative market sizes of Qwest and its competitors: it understates the relative market size of CLECs as compared to Qwest.

Q. ALSO IN HIS EXECUTIVE SUMMARY, MR. FIMBRES COMPLAINS THAT IT IS NOT CLEAR WHY WIRELESS AND VOIP COMPETITION IN ARIZONA IS EMPHASIZED IN MY REBUTTAL TESTIMONY. WOULD YOU COMMENT?

A. Yes. As stated in my executive summary, I want to be very clear: Qwest is <u>not</u> relying on the presence of wireless and VoIP competition as competitive triggers in its competitive zones proposal. Rather, Qwest <u>is</u> relying on the competitive data presented in my direct and rebuttal testimonies regarding the scope of CLEC competition in the Phoenix and Tucson markets as evidence that competition for Qwest's retail services in these markets is robust and that Qwest's proposal is appropriate.

The competitive telecom market in Arizona is very dynamic and is continuing to quickly evolve, even as this docket progresses. New communications options are regularly coming on line and are growing quickly in significance. For example, Vonage, one of the most visible and aggressive independent VoIP providers in the nation, announced:

> Vonage, the leading broadband telephony provider, today announced it has exceeded 400,000 total lines on its network, doubling its subscriber base in less than six months since reaching the 200,000 line mark. The

company ended 2004 with more than 390,000 lines in service having added 115,000 lines in Q4 2004 alone.[2]

As discussed at page 10 of my rebuttal testimony, the FCC has found that the percentage of customers now relying solely on wireless service for their telecommunications needs is at least 6%, and related research by the Yankee Group in 2004 shows that 40% of U.S. households with both wireless and landline phones expect their wireless phones to completely replace their landline phones. Other new forms of telecommunications competition are either in the market now in Arizona or are currently being trialed. WiFi broadband "hotspots" are now common in such locations as coffee shops and public libraries and a broadband over power lines ("BPL") trial is currently underway in Cottonwood, Arizona.[3]

As discussed in my executive summary, the key point is that, as intermodal competition becomes increasingly entrenched, it represents a real form of price constraining competition in the Arizona market. To the extent the Commission, after reviewing Qwest's competitive evidence in this docket, determines that sufficient competition exists that certain wire centers should be classified as competitive zones, the existence of intermodal competition should give the

[2] Vonage press release, January 5, 2005.

[3] A technical trial of BPL is being conducted by the Arizona Public Service power utility. Source: United Power Line Council presentation, December 16, 2004 (entitled "BPL Ready for Prime Time").

Commission additional comfort that market forces, not artificial regulatory constraints, will properly govern Qwest's rate levels.

Q. AT PAGE 2, MR. FIMBRES STATES "THE EVIDENCE TO SUPPORT SUBSTANTIAL AND SUSTAINABLE CLEC COMPETITION HAS DECLINED." WOULD YOU COMMENT?

A. I disagree. There is no evidence in the record in this docket that suggests that CLEC competition in Arizona is in decline. Mr. Fimbres may be referring to FCC data showing the rate of CLEC access line growth as of June 2004 reflected a lower percentage growth than was reflected in the December 2003 data. However, the FCC's report shows that CLEC access lines in Arizona increased by over 106,000 in the six months between December 2003 and June 2004 and now number over 814,000. This data does not suggest a market in decline: it suggests the opposite.

Q. ALSO AT PAGE 2, MR. FIMBRES IMPLIES THAT QWEST WAS LESS THAN FORTHCOMING IN ITS DATA REQUEST RESPONSES, AND STATES "QWEST DID NOT PROVIDE RESPONSES TO STAFF'S DATA REQUESTS 3.18 AND 6.2 THAT REQUESTED MOU INFORMATION." WOULD YOU COMMENT?

A. Yes. Staff data request STF 3.18 asked Qwest to supply usage information unavailable to Qwest regarding local usage for CLECs and wireless providers that is tracked and retained only by the CLECs and wireless providers in their local switches. Qwest was fully forthcoming in its responses, and supplied data available to it and in its possession.

Q. AT PAGE 4, MR. FIMBRES ATTEMPTS TO BOLSTER HIS STATEMENT THAT "COMPETITIVE GAINS IN THE NEARLY 9 YEAR WINDOW SINCE THE 96 TELECOM ACT WAS PASSED HIGHLIGHT SLOW PROGRESS WITH LITTLE TO SUPPORT THAT ACCELERATION IS IMMINENT" BY NARROWING HIS FOCUS TO AN EXAMINATION OF MARKET PENETRATION OF FULL FACILITIES-BASED CLECS. WOULD YOU COMMENT?

A. Yes. At page 17 of his surrebuttal testimony, Mr. Fimbres acknowledges that the FCC reported that, as of June 2004 (over six months ago), CLECs have captured over 25% of the local exchange market in Arizona. This is very significant by any measure. In fact, this percentage understates the level of competition in certain areas of the state, such as Phoenix and Tucson, since it is a statewide average that encompasses rural Qwest territory as well as Independent service areas with little CLEC presence. Mr. Fimbres also fails to acknowledge the actual presence of intermodal competition as a serious competitive factor, even in the face of

1 market deployments of VoIP telephony services by major CLECs such as MCI
2 and AT&T which are now available to any customer with a broadband internet
3 connection in Arizona and of the ever-increasing utility of wireless service as a
4 viable replacement for Qwest wireline services.
5
6 By his statements in testimony, it appears that Mr. Fimbres would have the
7 Commission find a geographic area to be competitive only when multiple
8 facilities-based CLECs have each installed overlaying networks to serve
9 customers. That is an extremely high competitive standard, is not required in any
10 Arizona statute or rule relevant to this docket and ignores the full range of
11 competitive communications alternatives now available in Arizona.
12
13 **Q. AT PAGE 6, MR. FIMBRES STATES: "MR. TEITZEL REMINDS PARTIES BY**
14 **HIS REBUTTAL TESTIMONY THAT ARIZONA HAS A MORE ROBUST**
15 **COMPETITIVE ENVIRONMENT THAN IDAHO, IOWA, MONTANA, NEW**
16 **MEXICO, NORTH DAKOTA, SOUTH DAKOTA AND WYOMING." WOULD**
17 **YOU COMMENT?**
18 A. Yes. Since I did not outline share comparisons between Arizona and other
19 Qwest states in my rebuttal, this is an inaccurate characterization of the record.
20 In fact, as is reinforced by Table 1 of Dr. Johnson's surrebuttal testimony, at
21 25.2%, Arizona has easily the highest CLEC share in any of the Qwest in-Region

states, and is significantly higher than the national CLEC share average of 17.8%. Mr. Fimbres' attempt to minimize the extent of the competitive environment in Arizona should be dismissed.

Q. AT PAGE 10, MR. FIMBRES STATES: "I NOTE THAT THE LISTINGS INFORMATION UPDATES REQUESTED IN AUGUST 2004 WERE NOT MADE AVAILABLE TO STAFF, WHILE QWEST WAS ABLE TO PROVIDE SEPTEMBER 2004 LISTINGS INFORMATION FOR ITS OWN USE." IS HIS CONCERN FOUNDED IN FACT?

A. No. In fact, Mr. Fimbres is referencing Qwest's response to Staff data request STF 18-1, served on Qwest on August 12, 2004, in which Staff requested a report of white pages listings data for August 2004. Qwest's standard tracking reports are typically not available until approximately the 15th of the month following month end. As stated in Qwest's response to STF 18.1, the data was not available for August when Staff requested it, since the month had not yet closed. In contrast, the Arizona statewide September 2004 white pages listings counts were filed in my rebuttal testimony on December 20, 2004, nearly three months after September 2004 month end. This is another instance in which Mr. Fimbres attempts to portray Qwest as less than forthcoming, when in fact, the opposite is the case.

1 **Q. DO YOU HAVE OTHER CONCERNS REGARDING THE ACCURACY OF**
2 **STATEMENTS IN MR. FIMBRES' SURREBUTTAL TESTIMONY?**
3 A. Yes. For example, at Page 16, he states: "what is very clear is that AT&T and
4 MCI have expressed intentions not to actively market to new residential
5 customers." This statement is plainly incorrect. In fact, MCI has signed a "QPP"
6 agreement with Qwest as a replacement for its current UNE-P service
7 arrangement as well as an agreement with McLeod to use McLeod's network to
8 serve residential customers,[4] and continues to market its residential packaged
9 service entitled "The Neighborhood" in Arizona and other states.[5] In addition,
10 both MCI and AT&T have embraced VoIP as a strategy to continue to serve
11 mass market customers. In its 3rd Qtr 2004 earnings statement, MCI CEO
12 Michael Capellas said: "Going forward, our focus will be on delivering next-
13 generation IP-based products and services, providing industry-leading service
14 quality and further improving our cost structure." On May 17, 2004, AT&T
15 announced its CallVantage VoIP service deployment in four western states,
16 including Arizona. AT&T Senior Vice President Cathy Martine stated "AT&T
17 already provides traditional residential local service to more than 4 million
18 households nationwide, but AT&T CallVantage Service marks the beginning of
19 an exciting new era in voice communications that gives customers another

[4] "McLeod reached a three year renewable wholesale agreement with MCI whereby McLeod will enable MCI to provide local residential services to its residential customers using McLeodUSA facilities" (http://biz.yahoo.com/bw/041216/165795_1.html)
[5] http://consumer.mci.com/TheNeighborhood/res_local_service

competitive choice."[6] AT&T has also formed partnerships with Best Buy, Circuit City and Staples to market its CallVantage service to residential customers.[7]

It is clear that both MCI and AT&T are implementing new market strategies to serve residential customers and that both are, in fact, actively marketing telecommunications services to new residential customers as well as continuing to service their existing customer bases.

Q. AT PAGE 17, MR. FIMBRES POINTS OUT THAT STAFF IDENTIFIED MORE COMPETITIVE LOCAL SWITCHES IN PLACE IN ARIZONA THAN WERE IDENTIFIED BY QWEST. IS HE CORRECT?

A. I do not dispute Mr. Fimbres' findings that the Local Exchange Routing Guide ("LERG") shows a significant number of competitive local switches in place in Arizona. This shows that there is additional competitive switching capacity in the state to support even more CLEC access line growth. However, I did not rely on LERG data as a "trigger" for classification of a particular wire center as a competitive zone in the Phoenix and Tucson areas. Rather, the evidence I relied on, as presented in my direct testimony and associated exhibits, was on wire center-level data showing that CLECs are actually serving customers in those wire centers.

[6] Yahoo! Finance, May 17, 2004.

Q. AT PAGE 20, MR. FIMBRES STATES THAT WIRELESS SERVICE IS SIMPLY NOT A SUBSTITUTE FOR LOCAL EXCHANGE SERVICE BECAUSE IT TAKES LONGER FOR A WIRELESS CUSTOMER TO PLACE AN E911 CALL THAN IT DOES A LANDLINE CUSTOMER. IS THIS A PROPER CRITERION BY WHICH TO JUDGE WHETHER WIRELESS SERVICE IS A SUBSTITUTE FOR LANDLINE SERVICE?

A. Clearly not. In fact, this is nonsense, especially for those customers who have already "cut the cord," which the FCC has determined to be at least 6% of the wireless subscribers. These customers have already made the decision, after considering the functional differences, that wireless service is a completely acceptable substitute for landline service. In another perspective on Mr. Fimbres discussion about placing a call to E911, consider this: for the elderly person who is concerned about falling and not being able to reach the landline telephone mounted on the wall to call for help, the small cell phones available today can easily be carried in the pocket and are an additional safety measure for the elderly who may, for example, fall and break a hip and be unable to reach the standard telephone to call 911.

[7] PR Newswire, January 6, 2005, Telogical Residential Alert, September 29, 2004.

Importantly, neither Qwest, nor any other entity of which Qwest is aware, has maintained that wireless service is considered to be a substitute for landline service by 100% of the customers in any state. However, to the extent wireless service is considered to be a substitute by a significant subset of the customer base, it clearly represents an additional form of price constraining competition in the market.

Q. AT PAGE 25, MR. FIMBRES COMPLAINS THAT QWEST HAS NOT PROVIDED ESTIMATES OF THE COST TO MODIFY QWEST'S REGIONAL BILLING SYSTEMS TO ACCOMMODATE STAFF'S PROPOSED COMPETITIVE ZONES STRUCTURE AS DEFINED BY ZIP CODES. WOULD YOU COMMENT?

A. Yes. As addressed earlier in my rejoinder testimony regarding Qwest's response to Staff data request STF 35-3, Qwest clearly informed Staff that modification of Qwest's regional billing systems to accommodate a complex pricing structure that is unique to a single state would be extremely costly, and that expending programming resources to assess the required changes would involve a labor-intensive and costly special project. Since Qwest does not intend to implement a "zip code" competitive zones structure, expenditure of these resources is simply not warranted.

Given Mr. Fimbres' previous work history in the telecommunications industry, we believe he is well aware that implementation of the massive changes he proposes to Qwest's regional CRIS system, for a lone state, would be unduly costly.

IV. Department of Defense ("DOD")

Q. AT PAGE 2, DEPARTMENT OF DEFENSE WITNESS RICHARD LEE DISAGREES WITH YOUR STATEMENT AT PAGE 47 THAT QWEST IS NOT PROPOSING PRICING FLEXIBILITY FOR BASKET 1 SERVICES. WOULD YOU COMMENT?

A. Yes. Mr. Lee takes my testimony out of context. The full cite from page 47 of my rebuttal testimony is as follows:

> "Qwest is not proposing additional pricing flexibility for Basket 1 services in this docket. Rather, Qwest is proposing that specific wire centers that are now subject to robust competition be classified as Competitive Zones, within which Qwest's retail services would be afforded Basket 3 pricing flexibility. In those areas, competition rather than regulation will govern the appropriate market price of the competitive services. With respect to services remaining in Basket 1, Mr. Lee's recommendation to limit price increases to 10% is not necessary."

In other words, my testimony focused on the additional pricing flexibility associated services afforded "Basket 3" competitive pricing flexibility in Qwest's proposal as geographic areas are reclassified to reflect the high degree of

competition in the Phoenix and Tucson areas. Services in Basket 1 will remain under Commission jurisdiction, and the Commission will retain authority to regulate Qwest's rate levels for services in that basket.

Q. AT PAGE 6, MR. LEE STATES: "BOTH WIRELESS AND VOIP SERVICES IMPACT (OR MAY IMPACT) THE MARKET FOR BASIC LOCAL SERVICES, BUT NEITHER SHOULD BE THE BASIS FOR COMPETITIVE ZONE DETERMINATION." DO YOU AGREE?

A. Yes. As stated earlier in my rejoinder, Qwest is not relying on either wireless or VoIP service as a "trigger" in determining whether a particular wire center should be reclassified as a competitive zone. However, the existence of these competitive alternatives is real and should give the Commission additional comfort that price constraining competition, beyond that represented by CLECs, is present in areas designated as competitive zones.

V. COX COMMUNICATIONS

Q. AT PAGE 1 OF HIS SURREBUTTAL TESTIMONY, COX WITNESS WAYNE LAFFERTY STATES THAT COX IS A "FACILITIES-BASED PROVIDER OF LOCAL TELECOMMUNICATIONS SERVICES IN ARIZONA." WHY IS THIS IMPORTANT?

A. Cox is a very significant local exchange competitor in Qwest's service territory in the Phoenix and Tucson areas, and serves it customers primarily via switches and network facilities owned by Cox. As such, Cox is not reliant on UNEs purchased from Qwest to serve its residential and business customers. Yet, a great deal of Mr. Lafferty's surrebuttal testimony focuses on what the Commission should do in considering Qwest's proposals and how UNE-based competition should factor into the Commission's decisions in this regard. It is not clear from his testimony what is driving Mr. Lafferty's passion to advance the cause of UNE-based competition, when it would seem that position is not relevant to the efforts of his client to increase the size of its customer base in Arizona.

Q. AT PAGE 2, MR. LAFFERTY STATES THAT CLECS USING UNE-P (AND THE REPLACEMENT QPP PRODUCT) WILL NO LONGER BE ABLE TO

PROFITABLY COMPETE IN THE ARIZONA LOCAL EXCHANGE MARKET. WOULD YOU COMMENT?

A. Mr. Lafferty is incorrect. For example, consider MCI's "The Neighborhood Complete" residential local exchange package service, which is currently offered at a recurring price of $49.99 in Arizona. At pages 7 and 8 of his surrebuttal testimony, Mr. Lafferty lists the QPP rates for Zones 1, 2 and 3 that will be available to CLECs in 2005 and 2007. If one accepts Mr. Lafferty's summary as accurate,[8] the following tables show MCI's margin opportunity in 2005 and 2007 (assuming no price increase to the MCI Neighborhood package price):

2005

	Zone 1	Zone 2	Zone 3
QPP Rate	$14.51	$20.30	$41.90
15% cost additive (marketing, billing and collections)	X 1.15	X 1.15	X 1.15
QPP rate plus 15%	$16.99	$23.35	$48.19
The Neighborhood recurring price	$49.99	$49.99	$49.99
Gross Margin	$33.30	$26.64	$1.80

2007

	Zone 1	Zone 2	Zone 3
QPP Rate	$15.25	$21.14	$42.74
15% cost additive (marketing, billing and collections)	X 1.15	X 1.15	X 1.15
QPP rate plus 15%	$17.54	$24.31	$49.15
The Neighborhood recurring price	$49.99	$49.99	$49.99
Gross Margin	$32.45	$25.68	$0.84

Clearly, in Zones 1 and 2, where the preponderance of the residential customers are located in Qwest's Arizona service territory, there is a significant margin opportunity for MCI through the use of the QPP product in the residential market. Although the margins shown in Zone 3 are slimmer by comparison, there is even a positive margin available in that zone. While one can argue with the 15% cost additive estimate used for the above comparisons, even if that estimate is doubled, there is still a very significant margin opportunity for MCI in Zones 1 and 2.

[8] Mr. Lafferty appears to have listed a 2007 local port rate of $4.84, which is inaccurate. The correct 2007 port rate

1 **Q. AT PAGE 2, MR. LAFFERTY OPINES THAT WIRELESS SERVICE IS NOT**
2 **COMPARABLE TO LANDLINE SERVICE AND IS THEREFORE NOT A**
3 **VIABLE SUBSTITUTE. WOULD YOU COMMENT?**
4 A. Yes. As I discussed in my earlier rejoinder regarding Staff's position on this
5 issue, for those customers who have already substituted (and those stating they
6 are likely to substitute in the near future, Mr. Lafferty's opinion is simply wrong.
7 In fact, Cox itself has acknowledged that it has lost residential access lines to
8 wireless substitution. Without revealing confidential Cox information, in response
9 to Qwest data request 6.4, Cox answered "yes" to the following question:
10 "Have Cox customers ever indicated that they were terminating Cox
11 service in favor of wireless service?"
12
13 Again, without revealing confidential information supplied by Cox in its response
14 to this question, Cox reported that a significant number of Cox local exchange
15 telephone numbers had been ported to wireless carriers in Arizona.
16
17 **Q. AT PAGE 5, MR. LAFFERTY STATES: "THE GROWTH IN THE COMPETITIVE**
18 **LEC MARKET SHARE ALSO DECREASED BY OVER 50% FROM THE PRIOR**
19 **YEAR." WOULD YOU COMMENT?**
20 A. Mr. Lafferty's statement is very misleading. Read another way, his statement is
21 confirming that the number of CLEC access lines in Arizona actually continues to

---

for Arizona is $4.60, as listed in Qwest's Arizona QPP agreements.

increase at a significant pace. The problem with Mr. Lafferty's implication is that it leads the reader to conclude that competition is waning, when his percentage calculation is simply a mathematical artifact. For example, assume that the number of competitive lines in Arizona grows in a year from 1 line to 2 lines. In that instance, the rate of growth, as expressed as a percentage, is 100%. Assume that, in the following year, the number of competitive access lines in Arizona increased from 2 to 3. In that instance, the rate of growth, as expressed as a percentage, is 50%. Although the absolute growth in competitive lines in this example is constant, the percentage growth of 100% in the first year and 50% in the second would make it appear as if the in-service base grew at a significantly lesser rate year over year. Additionally, Mr. Lafferty has chosen to ignore entirely dynamics in the competitive market whereby alternatives other than CLEC services are available to customers and are representing a portion of the growth in competitive lines in service.

Q. AT PAGE 7, MR. LAFFERTY STATES: "BASED ON INFORMATION IN THE FCC'S DECEMBER 15, 2004 PUBLIC NOTICE, IN CERTAIN MARKETS HIGH CAPACITY UNBUNDLED LOOPS (DS1 AND DS3 LEVELS) WILL NO LONGER BE AVAILABLE AT TELRIC RATES." IS HE CORRECT?

A. Again, Mr. Lafferty's statement is misleading and is made without accompanying factual support. In fact, the FCC's notice regarding DS1 and DS3 loops states

that DS1 UNE loops will continue to be available at TELRIC rates in wire centers with fewer than 60,000 business access lines *and* fewer than four fiber-based collocators, and DS3 UNE loops will continue to be available at TELRIC rates in wire centers with fewer than 38,000 business access lines *and* fewer than 3 fiber-based collocators. These are very high thresholds, and assuming they remain unchanged when the FCC releases its actual TRO order, will affect very few Qwest wire centers.

Q. AT PAGE 7, MR. LAFFERTY ARGUES THAT QWEST DOES NOT OFFER AN ALTERNATIVE TO UNE-P. IS HE CORRECT?

A. No. In fact, Mr. Lafferty discusses the Qwest Platform Plus ("QPP") product at some length at pages 7 and 8 of his surrebuttal testimony. This product is clearly an alternative to UNE-P that is available to any CLEC that chooses to avail itself of this service.

Q. AT PAGE 9, MR. LAFFERTY STRONGLY STATES THAT "IN ALL CASES, QPP RATES WILL BE HIGHER THAN QWEST'S $13.18 1FR RATE." WOULD YOU COMMENT?

A. His statement is misleading. By his statement, he chooses to ignore other charges that are assessed to customers in addition to the monthly 1FR rate. For example, all 1FR customers pay a $6.30 End User Common Line ("EUCL")

monthly charge, and customers in Zones 1 or 2 are assessed "zone increment" charges of $1 or $3 in addition to the EUCL charge. He also ignores in his statement that a wide range of optional calling features are provided at no additional charge in the QPP service, while 1FR customers must pay for these services on either an ala carte basis or as part of a calling package. Finally, Mr. Lafferty ignores the fact that CLECs utilizing UNE-P or QPP receive any switched access revenue associated with their customers' long distance calls. His comparison of "stand-alone" 1FR prices to QPP rates is badly flawed and misleading.

Q. AT PAGE 10, MR. LAFFERTY STATES: "MR TEITZEL SUGGESTS THE FCC'S DETERMINATION THAT COMPETITORS ARE NOT IMPAIRED WITHOUT ACCESS TO INCUMBENT LEC UNBUNDLED SWITCHING IS A CONCLUSION THAT COMPETITION IS FLOURISHING." WOULD YOU COMMENT?

A. Mr. Lafferty mischaracterizes my rebuttal testimony at page 52. My actual rebuttal testimony at page 52, which Mr. Lafferty chose to paraphrase, is as follows:

> "In fact, any final decisions to withdraw the requirement for BOCs to provide any given unbundled network element can <u>only</u> be based on a finding that the element no longer meets the FCC's competitive impairment test."

1 Neither the FCC nor I used phrases such as "flourishing," and I simply noted in
2 the above passage of my rebuttal testimony that the FCC will consider the
3 evidence available to it and determine whether CLECs are impaired without
4 access to a given unbundled network element.
5
6 **Q. AT PAGE 13, MR. LAFFERTY OPINES THAT VOIP SERVICE IS MORE**
7 **EXPENSIVE THAN QWEST WIRELINE SERVICE AND SHOULD THEREFORE**
8 **BE DISMISSED AS A VIABLE ALTERNATIVE. IS HE CORRECT?**
9 A. No. For example, a relatively recent entry into the VoIP market in Arizona is
10 SunRocket, which currently serves the Phoenix market and offers an "all
11 inclusive" VoIP telecommunications service for $24.95 per month.[9] SunRocket
12 promotes this price point as being the only price their customers must pay
13 (includes all fees and applicable taxes), and their service includes unlimited
14 calling anywhere within the U.S., ten free calling features, up to 100 minutes of
15 international calling per month and two free directory assistance calls per month.
16 A comparable Qwest service, Qwest Choice Home, is $32.99 (including the End
17 User Common Line charge), plus long distance charges, taxes and fees (which
18 can total $15.00 or more). For the residential customer that already has a
19 broadband internet connection (in which case the incremental charge for the
20 connection is a "sunk" cost for the customer and can be excluded from such a

[9] www.sunrocket.com

pricing comparison), this VoIP price point is clearly lower than what a Qwest customer would pay for comparable service.

Q. AT PAGE 16, MR. LAFFERTY SUGGESTS THAT COMPETITIVE ZONES COULD BE DEFINED AS "CITIES OR TOWNS" RATHER THAN WIRE CENTERS OR ZIP CODES, AS ADVOCATED RESPECTIVELY BY QWEST AND STAFF. WOULD YOU COMMENT?

A. Mr. Lafferty's suggested competitive zones geographic definition is certainly broader than Staff's granular zip code approach. However, it would constrain Qwest in its ability to fairly compete. For example, it is possible that a particular competitor may choose to enter only a portion of the Phoenix market with a competitive service priced to undercut Qwest's rates in Phoenix. Under Mr. Lafferty's proposal, Qwest would be forced to respond to such competition with a price cut across its entire Phoenix service area, while a more targeted competitive response is appropriate. Qwest's competitive zones proposal would enable Qwest to implement a more targeted response in a manner that can be accommodated by its billing systems.

Q. AT PAGE 24, MR. LAFFERTY SUGGESTS THAT, AS LONG AS THE COMMISSION DETERMINES QWEST'S RATES MUST BE ARTIFICIALLY

CONSTRAINED, THE MARKET CAN NOT REALLY BE COMPETITIVE AND THERE WOULD BE NO REASON TO DECLARE IT SO BY DESIGNATING AN AREA AS A "COMPETITIVE ZONE." DO YOU AGREE?

A. Yes. If the Commission finds that competition exists at a level sufficient to classify a certain geographic area as a "competitive zone," that designation means that price-constraining competition exists. In this instance, the market rather than regulation will determine the appropriate price levels for Qwest's services.

VI. TIME WARNER

Q. AT PAGE 7, TIME WARNER'S WITNESS, TIM GATES, SUGGESTS THAT THE COMMISSION SHOULD CONSIDER ONLY FULL FACILITIES-BASED CLEC COMPETITION IN DETERMINING WHETHER COMPETITIVE ZONE DESIGNATION IS APPROPRIATE IN A PARTICULAR WIRE CENTER. IS HE CORRECT?

A. No. As stated in my rejoinder regarding Staff's positions, Qwest loses the retail relationship with any customer choosing to leave Qwest for a CLEC, regardless of the means by which the CLEC chooses to provide the competitive service. In this instance, Qwest no longer has the ability to offer packages and bundles of services, including DSL, satellite television, long distance calling, etc. that it can

offer to its local exchange customers. There can be no dispute that customers are demanding the ability to purchase packages and see high value in receiving such packages from a single provider on a single bill. Competitive losses by Qwest to intramodal CLEC providers (regardless of the manner in which the CLECs serve their market) and intermodal competition are all real losses to Qwest and harm Qwest's ability to execute its business plan in Arizona.

Q. AT PAGE 8, MR. GATES OFFERS HIS OPINION THAT CLEC SERVICES PROVIDED VIA UNE-P OR RESALE ARE NOT "FUNCTIONALLY EQUIVALENT AND SUBSTITUTABLE" AS COMPARED TO QWEST RETAIL SERVICES. WOULD YOU COMMENT?

A. Mr. Gates' opinion is misguided. In fact, CLEC services based on resale of Qwest's retail services or on a UNE-P platform are certainly "functionally equivalent and substitutable" for Qwest services, as they are precisely the same (in the case of resale) or very similar (in the case of UNE-P) as Qwest's retail services. From the retail customer's perspective, the CLEC services and Qwest services are very "functionally equivalent and substitutable."

Q. AT PAGE 12, MR. GATES APPEALS TO THE COMMISSION FOR A REDUCTION IN QWEST'S SPECIAL ACCESS RATES AND SUGGEST THAT

QWEST SHOULD SIMPLY "EAT" THE ASSOCIATED REVENUE REDUCTIONS. WOULD YOU COMMENT?

A. I can certainly understand Time Warner's perspective on this point: it would directly benefit Time Warner and harm Qwest. Mr. Gates ignores the fact that, in this docket, the Commission has required Qwest to file information regarding its significant intrastate revenue requirement, meaning, very simply, that Qwest's overall revenues in Arizona are insufficient to recover its overall costs in the state. Qwest's intrastate Special Access services contribute to Qwest's overall revenue stream in Arizona. To the extent rates for these services are reduced, as advocated by Time Warner, Qwest's cost-recovery problem is exacerbated.

Q. AT PAGE 19, MR. GATES CRITICIZES YOUR CONTENTION THAT COMMISSION RULES WILL PROTECT COMPETITORS FROM INAPPROPRIATE PRICING BY QWEST. WOULD YOU COMMENT?

A. The Commission has established specific rules (after carefully considering their obligations to protect fair competition) governing pricing of telecommunications services such as those offered by Qwest, such as the imputation guidelines established in R14-2-1310C. Those are the "rules of the game" set in place by the Commission and Qwest is bound to abide by those rules until they are changed. If Mr. Gates disagrees with the current rules and feels that they should be changed, he is free to bring forward such a request for a rulemaking

proceeding. However, his arguments are not appropriate or relevant in this docket.

VII. RUCO

Q. AT PAGE 3, RUCO WITNESS DR. BEN JOHNSON STATES THAT MAJOR TELECOMMUNICATIONS CARRIERS HAVE "ABANDONED" THE MARKET. IS HE CORRECT?

A. With respect to major carriers such as AT&T and MCI, he is plainly incorrect. As discussed earlier in my rejoinder regarding Staff testimony, I provided clear evidence that both of these major carriers continue to serve the mass market, and that they are now proceeding with implementation of strategies to serve the market in additional ways by deploying VoIP services.

Q. AT PAGE 10, MR. JOHNSON ECHOES STAFF'S COMMENT THAT "WIRELESS IS PRIMARILY A COMPLEMENT" TO LOCAL EXCHANGE SERVICE. IS HE CORRECT?

A. For those customers who have already made the decision to substitute wireless for landline service, he is incorrect, since they have already weighed the attributes of each service and concluded that one is a full substitute for the other. Like Staff, it would appear that Dr. Johnson would have the Commission ignore

wireless service as a competitive factor until all landline customers conclude that wireless service is a complete substitute for landline service. This position ignores market realities, and is tantamount to saying that, since a hamburger isn't the same thing as a hot dog, they should not be considered substitutes when one is hungry. In this example, all hungry people will not view hamburgers and hot dogs as acceptable substitutes, but they are clearly considered to be acceptable substitutes by a large number of hungry people. If the price of hamburgers were to suddenly double in a market, it is highly likely that the demand for hot dogs in that same market would rise.

Q. AT PAGES 14, 26 AND 27, DR. JOHNSON ADVOCATES FOR AN ASSESSMENT OF SPECIFIC SERVICES IN INDIVIDUAL WIRE CENTERS IN DETERMINING WHETHER THOSE SERVICES SHOULD BE PLACED IN "MODERATE," HIGH" OR "TOTAL" PRICING FLEXIBILITY BASKETS. WOULD YOU COMMENT?

A. Yes. Essentially, Dr. Johnson splits the existing Basket 3 into two categories (high pricing flexibility and total pricing flexibility) and argues that services in each wire center at issue should be assigned to these categories based on a combination of Herfindahl-Hirschmann Index ("HHI") values and market share for each service in each wire center. In fact, he argues that for a Qwest service to qualify for "total pricing flexibility," it should have a "market share of less that

33%, a 4-firm concentration ratio of less than 75% and an HHI of less than 1,800." His recommendation ignores market realities and focuses on a very narrow definition of the "market" (e.g., Qwest vs. CLECs) and represents an extremely complex and granular evidentiary process. His recommendation also ignores the unique characteristics of the Arizona market, where, in many wire centers, Qwest has lost a very significant share of the market to a single competitor. If, for example, Cox and Qwest were the only competitors providing residential service in a wire center and if Cox had captured 50% of that market, Dr. Johnson's criteria would preclude residential service in that wire center from being classified as fully competitive since Qwest's share exceeds 33%, fewer than four firms are actively competing, and the HHI would be higher than 1,800. Dr. Johnson's suggestions represent an extremely high competitive threshold that Qwest would be required to meet and are simply not reasonable.

Q. AT PAGE 33, DR. JOHNSON STATES: "MR. TEITZEL CONTENDS THAT THE MONOPOLY ERA SYSTEM OF IMPLICIT SUBSIDIES SHOULD BE CONTINUED IN PERPETUITY IN ARIZONA." IS THIS CITE TO YOUR REBUTTAL TESTIMONY CORRECT?

A. No. The correct cite at page 67 of my rebuttal testimony is as follows:

> "Essentially, Dr. Johnson is suggesting that the monopoly era system of implicit subsidies should be continued in perpetuity in Arizona."

This statement in my rebuttal testimony addressed Dr. Johnson's Table 2, in which he displayed an analysis he created purportedly showing, based on his assumptions, that Qwest's residential services are profitable in the net, after including revenues from services such as features and long distance.

Q. AT PAGE 36, DR. JOHNSON OFFERS AN OPINION THAT THERE SHOULD BE NO REVENUE CAP ON "BASKET 3" SERVICES. DO YOU AGREE?

A. Yes. If the Commission finds that sufficient competition exists that a particular wire center should be classified as a competitive zone (which places all retail services in that zone into Basket 3), or that sufficient competition exists for a particular service statewide that the service should be moved in to Basket 3, market forces instead of regulation will drive Qwest's prices for Basket 3 services to the appropriate level.

Q. AT PAGE 38, DR. JOHNSON ESSENTIALLY AGREES WITH QWEST THAT WIRE CENTERS ARE THE APPROPRIATE GEOGRAPHIC DEFINITION OF COMPETITIVE ZONES. WOULD YOU COMMENT?

A. After considering the possible alternatives, Dr. Johnson states: "it is exactly this granular, wire center-based line data that I recommend using to identify markets where increased pricing flexibility can appropriately, and safely, be granted,"[10]

[10] Surrebuttal testimony of Dr. Ben Johnson, January 12, 2005, P. 38

and "Qwest wire centers are relevant to all competing carriers, including those who primarily rely on their own facilities."[11] Qwest agrees with Dr. Johnson's conclusions in this regard and shares Dr. Johnson's concern that the logistics associated with collection and analysis of data at the sub-wire center level for all services offered by all telecommunications competitors in Qwest's service territory in Arizona represents a monumental task and one that is not warranted.

VIII. MCI

Q. AT PAGE 2, MCI WITNESS DON PRICE STATES: "THE TRENDS LEADING TO CONVERGENCE CLEARLY INDICATE THAT TELECOMMUNICATIONS CAN NO LONGER BE THOUGHT OF AS A TRADITIONAL UTILITY SERVICE THAT SHOULD BE SUBJECT TO STATE REGULATION." WOULD YOU COMMENT?

A. Yes. Qwest's proposals in this case, such as its Competitive Zones proposal, recognize that Arizona market is dynamic and that the trend toward "convergence" is continuing to accelerate. In a "converged" market, television services, wireless services, internet service and telephone services are offered by multiple providers and can each be used to serve market needs that previously were served by these services in isolation. Additional service

[11] Surrebuttal testimony of Dr. Ben Johnson, January 12, 2005, P. 39.

alternatives, such as wireless broadband and broadband over power lines (BPL) are early in their respective life cycles but will likely contribute to the continuing trend toward convergence. Traditional utility regulation simply does not work in a converged market. Qwest agrees with MCI on this point and asks the Commission to implement pricing flexibility where competition is demonstrated to exist in an Arizona market continuing to move toward convergence.

Q. AT PAGE 8, MR. PRICE SUGGESTS THAT THE COMPETITIVE RETAIL TELECOMMUNICATIONS COMPETITIVE ENVIRONMENT IS CHANGING SO QUICKLY THAT "THE COMMISSION SHOULD REFRAIN FROM FURTHER RETAIL REGULATION AND INSTEAD SIMPLY MONITOR RETAIL PRACTICES TO ASSURE THAT QWEST (OR OTHER PROVIDERS WITH MARKET POWER) DO NOT TAKE ADVANTAGE OF THEIR REMAINING MARKET POWER BY IMPROPERLY RAISING RATES OR RESTRICTING OUTPUT." DO YOU AGREE?

A. Yes. As discussed in my direct and rebuttal testimonies, the Phoenix and Tucson markets are particularly competitive and customers now have choices of alternative carriers there. In those markets, Basket 3 pricing flexibility for Qwest's services is appropriate. As suggested by Mr. Price, the Commission has a continuing role in protecting the public interest in such markets, and should the Commission find that market conditions change or that Qwest has unreasonably

"raised rates or restricted output," it retains the authority to reinstitute Basket 1 classification for those services and/or areas.

Q. AT PAGE 25, MR. PRICE STATES THAT QWEST'S LOCAL RATES RECOVER 100% OF THE LOOP AND PORT COSTS AS WELL AS OTHER DIRECT COSTS "ON A STATEWIDE AVERAGED BASIS." WHAT IS THE PROBLEM WITH HIS STATEMENT?

A. The problem with his statement is that, like similar statements of other intervenor witnesses in this docket, it is an indication that Mr. Price still yearns for the monopoly-era system of establishing rates and ignores the effects of competition. Mr. Price fails to recognize that the Commission required an analysis of Qwest's revenue requirement in this proceeding. After losing its argument that such an analysis was not necessary, Qwest complied with the Commission directive and has identified a very significant revenue requirement in this docket. If the Commission agrees that such a revenue requirement exists, that means that Qwest has a need for additional revenue opportunity to recover its Arizona costs. As Qwest continues to face competitive losses, especially in services such as features, toll and business local exchange services, this shortfall is exacerbated.

Q. AT PAGE 25, MR. PRICE SUGGESTS THAT HIS RECOMMENDED SWITCHED ACCESS RATE REDUCTIONS SHOULD BE OFFSET BY

ALLOWING QWEST TO RECOVER FOREGONE REVENUE FROM INCREASES TO PRICES OF SERVICES IN BASKET 3. WOULD YOU COMMENT?

A. MCI's recommendations in this regard are completely self-serving. Mr. Price recommends that revenue decreases in switched access can be replaced by revenue associated with price increases in Qwest's most competitive services and the outcome will have no financial effect on Qwest. In reality, the effect of Mr. Prices's recommendation will likely be a significant financial gain for MCI from potentially lower costs of service and less revenue for Qwest.

Services have been placed in Basket 3 because they have long been found to be competitive and discretionary, and competitive forces will truncate Qwest's ability to recover revenue losses. Significant increases in Basket 3 service rates will likely result in one of two outcomes: customers will shift to alternative services of Qwest's competitors (including MCI) or will discontinue using the service. In this case, MCI's agenda is to force one of its primary competitors (Qwest) into losing significant revenue while it simultaneously increases its own profitability.

IX. CONCLUSION

Q. PLEASE SUMMARIZE YOUR REJOINDER TESTIMONY.

A. In my rejoinder testimony, I addressed issues raised by Staff, RUCO, DOD, Time Warner, Cox Communications and MCI in their rebuttal testimonies in this proceeding. As discussed in my direct, rebuttal and rejoinder testimony, the Arizona telecommunications market is now subject to significant intramodal and intermodal competition and the Phoenix and Tucson markets are particularly competitive. However, intervening parties in this docket would have the Commission believe that competition is not yet sufficient to warrant additional pricing flexibility for Qwest. In fact, the parties would essentially have the Commission ignore any competition except that represented by facilities-based CLECs. To the contrary, Arizona is one of Qwest's most competitive states, and Qwest has already lost in excess of 25% of its access line base in Arizona to CLECs of all types (a percentage that is understated since it does not account for the effects of intermodal competition nor new customers who initially establish service with a CLEC without ever subscribing to Qwest service) and no party has presented evidence to show that Qwest will not continue to absorb competitive losses. Whenever Qwest loses a retail customer, it loses the opportunity to generate ongoing retail revenue from the relationship with that customer and the

opportunity to increase its revenue through the sale of additional services to that customer. As competition causes loss of customers that purchase high margin services, Qwest's ability to utilize revenues from those services to cover costs of providing service to all customers in its serving area is undermined.

Parties have expressed confusion about the role of intermodal competition as a factor in this docket. To be very clear, in its Competitive Zones proposal in this docket, Qwest is not relying on intermodal competition as a "competitive trigger" to classify a particular wire center as a competitive zone. However, the Arizona competitive market is very dynamic and the mix of competitive alternatives has changed substantially even since this docket was initiated. Wireless customers are relying on their wireless services to an ever greater degree and VoIP service is now widely available from multiple providers to any Arizona customer with a broadband internet connection. As customer perception of these services as viable alternatives to traditional telephone service continues to expand, these intermodal services represent an ever-increasing form of price constraining competition to Qwest. To the extent the Commission, after reviewing the evidence in this docket, determines that sufficient CLEC competition exists in a particular wire center to warrant designation of that wire center as a competitive zone, the reality of intermodal competition should give the Commission additional comfort that competitive forces will properly regulate Qwest's rate levels there.

Finally, the parties challenged Qwest's need for AUSF funding to support the provision of local exchange service to customers located in high cost areas of the state. Qwest's costs to provide service to customers in high cost wire centers are indisputably higher than Qwest's costs to provide service in low cost (primarily urban) wire centers. Rather than supporting Qwest's proposal to utilize AUSF funding to defray the cost of serving customers in high cost areas, Qwest's opponents suggest that Qwest should use margins from profitable services (such as optional calling features, intraLATA toll, switched access and business local exchange services) to defray the cost of serving those customers. Unfortunately, this model, which echoes back to the manner in which prices were set in the "monopoly" era, is no longer viable. Since competitors are logically attracted to markets and services with high margins in Arizona, the revenues associated with Qwest's "high margin" services are rapidly dwindling, undermining Qwest's ability to fully recover its costs in the state

An important feature of Qwest's AUSF proposal is that funding is "competitively portable," meaning that it is available to Qwest's competitors who choose to compete with Qwest to win customers in high cost areas. This allows Qwest's competitors to expect to earn a reasonable return on such customers and encourages the growth of competition in areas where competition has been slow

to emerge. Approval of Qwest's AUSF proposal means that competitors will have an additional incentive to compete with Qwest in high cost areas and that customers there will have improved prospects of competitive choice.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF WASHINGTON)
) **ss** **AFFIDAVIT OF DAVID L. TEITZEL**
COUNTY OF KING)

David L. Teitzel, of lawful age being first duly sworn, deposes and states:

1. My name is David L. Teitzel. I am Staff Director – Public Policy for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

David L. Teitzel

SUBSCRIBED AND SWORN to before me this 21st day of January, 2005.

LORI L. WHITE
COMMISSION EXPIRES
NOTARY
PUBLIC
STATE OF WASHINGTON

Lori L. White
Notary Public

My Commission Expires: 7/10/07

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-29 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER – CHAIRMAN
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNCATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

REJOINDER TESTIMONY OF

KERRY DENNIS WU

ON BEHALF OF

QWEST CORPORATION

JANUARY 27, 2005

TABLE OF CONTENTS

	TOPIC	PAGE
I.	EXECUTIVE OVERVIEW	i
II.	IDENTIFICATION OF WITNESS	1
III.	PURPOSE OF TESTIMONY	1
IV.	SERVICE LIVES	2
V.	STRAIGHT-LINE METHOD OF DEPRECIATION	5
VI.	FCC DEPRECIATION LIFE RANGES	6
VII.	QWEST'S COMPETITORS' LIVES ARE RELEVENT TO QWEST	9
VIII.	RUCO DEPRECIATION RECOMMENDATIONS	10
IX.	ARIZONA CONCLUSIONS	11

I. EXECUTIVE OVERVIEW

A key question before this Commission is, what does the future look like and how will that future affect depreciation lives? According to Mr. Dunkel, competitors' lives are not relevant and Arizona's prescribed depreciation lives should be (with the exception of one account) returned to levels first suggested by the FCC ten years ago. Mr. Dunkel effectively wants to "roll back the clock" and ignore competitive landscape and technology changes that continue to rapidly transform Arizona's telecommunications environment. Qwest believes the Commission was prescient when it issued its May 2000 depreciation order. Thus, Qwest's proposal requests no change from currently approved depreciation lives.

Mr. Dunkel states

> The Qwest proposal violates the ACC [sic] and Uniform System of Accounts (USOA) utility depreciation requirements. The ACC [sic] and USOA both require that investments be depreciated over their "service life." The "service life" ends when the investments retire from service. However for the purposes of calculating the depreciation rates, Qwest ends the investments alleged "life" before they actually retire, so Qwest is not depreciating the investments over their "service life."

My rebuttal testimony states that according to the above, Mr. Dunkel says that service lives should be based solely on historical retirement data. Mr. Dunkel says that this conclusion is a misrepresentation of his testimony. I will show the inconsistency on this issue between Mr. Dunkel's direct and surrebuttal testimony.

Mr. Dunkel alleges that my rebuttal testimony states that I disagree with the "straight-line method" of depreciation. He is incorrect. The straight-line method of depreciation is embedded in every Qwest proposal in this docket and in the information provided to Mr. Dunkel. The purpose of that section of my rebuttal was to highlight Mr. Dunkel's selective deletion of the word "may" from his USOA Part 32 quotation.

Mr. Dunkel says his recommendation relies upon the FCC's 1999 depreciation life ranges. With the exception of one equipment category, all of the approximately 30 life ranges were initially established in 1994/1995. By saying he relies upon the FCC's 1999 depreciation life ranges, he does not fully acknowledge where the FCC's life ranges originated and Arizona's changed telecommunications environment.

Mr. Dunkel claims competitor's depreciation lives are not relevant when considering Qwest's. Competitors compete with Qwest for the same customers and have had a significant negative effect on Qwest's market share. Although competitors may use differing depreciation methodologies, their depreciation lives represent the time period their management expects to recover investment costs. For this reason, competitors' lives are relevant.

Mr. Dunkel implies RUCO does not concur with Qwest's use of Commission prescribed depreciation lives and parameters. This is not correct. RUCO's direct testimony states, "...There is no difference between the annual accruals calculated by the Company and those calculated by RUCO. Accordingly, I have made no adjustments to proforma depreciation expense."

II. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Kerry Dennis Wu. My title is Staff Director - Capital Recovery for Qwest Corporation. My business address is 1600 7th Avenue, Room 3006, Seattle, Washington 98191.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I filed direct and rebuttal testimony in this case and testified before this Commission in depreciation Docket T-01051B-97-0689.

III. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my rejoinder testimony is to address certain issues in Staff consultant Mr. Dunkel's direct and surrebuttal testimony.

Q. WHAT ISSUES WILL YOU ADDRESS?

A. I will discuss the following:

(1) Staff's Mr. Dunkel states that my rebuttal testimony misrepresents his testimony regarding service lives and what he means. Mr. Dunkel's testimony is inconsistent on this issue.

(2) Mr. Dunkel alleges that my rebuttal testimony states that I disagree with the "straight-line method" of depreciation. He is incorrect.

(3) Mr. Dunkel says that he relies upon the FCC's 1999 depreciation life ranges, not their 1995 life ranges. With a single exception of one life

range, the FCC life ranges he relies upon were effectively established in 1994/1995.

(4) Mr. Dunkel claims competitor's depreciation lives are not relevant when considering Qwest's depreciation lives. This claim ignores the fact that competitors continue to erode Qwest's market share and that competitors' depreciation lives represent the time periods competitors expect to recover their investment costs.

(5) Mr. Dunkel's surrebuttal testimony implies that RUCO does not agree with Qwest's use of Commission prescribed lives and parameters. On the contrary, RUCO's direct testimony states that it agrees with Qwest's depreciation calculation results; therefore, RUCO must agree with the factors that produced those same results.

IV. SERVICE LIVES

Q. WHAT DID MR. DUNKEL SAY IN HIS DIRECT TESTIMONY ABOUT QWEST'S USE OF PRESCRIBED DEPRECIATION LIVES AND SERVICE LIVES?

A. In his direct testimony, Mr. Dunkel states,

> The Qwest proposal violates the ACC [sic] and Uniform System of Accounts (USOA) utility depreciation requirements. The ACC [sic] and USOA both require that investments be depreciated over their "service life." The "service life" ends when the investments retire from service. However for the purposes of calculating the depreciation rates, Qwest ends the investments alleged "life" before they actually retire, so Qwest is not depreciating the investments over their "service life."[1]

[1] Direct Testimony and Schedules of William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, November 2004, p. 36.

Q. WHAT IS QWEST'S DEPRECIATION LIFE PROPOSAL?

A. As stated in my rebuttal testimony, "In this Docket, Qwest did not request any change to the Commission prescribed depreciation lives or parameters."[2] In other words, Qwest's proposal utilizes the same depreciation lives, salvage values and survivor curve shapes as ordered by the Commission in May 2000.

Q. HOW CAN QWEST'S PROPOSAL BE IN VIOLATION OF ARIZONA ADMINISTRATIVE CODE (AAC) FOR UTILIZING FACTORS THAT COMPLY WITH THE COMMISSION'S CURRENTLY PRESCRIBED DEPRECIATION ORDER?

A. Qwest's proposal is not in violation of the AAC as Mr. Dunkel alleges. Mr. Dunkel's direct testimony clearly states that utilizing depreciation lives less than physical retirements (also known as mortality), is an ACC violation, yet he too recommends depreciation lives less than implied by historical retirement rates.

Q. WHY SHOULDN'T ACTUAL PHYSICAL RETIREMENT EXPERIENCE (HISTORICAL MORTALITY DATA) BE USED TO SET DEPRECIATION LIVES?

A. The historical mortality rate is an element to consider, but in rapidly changing environments, other factors such as technological obsolescence, changes in the art and technology, changes in consumer demand, etc. must be given more weight. That is precisely what the Commission ordered in May 2000.

---

[2] Rebuttal Testimony of Kerry Dennis Wu - Qwest, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, December 20, 2004, p. 1.

Q. WHAT DOES MR. DUNKEL'S SURREBUTTAL TESTIMONY NOW SAY ABOUT STAFF'S INTERPRETATION OF WHAT "SERVICE LIFE" MEANS?

A. Mr. Dunkel states,

> No. I never testified "that service life must be estimated based solely on historical mortality data." This grossly misrepresents my testimony and the position of Staff. Other than Mr. Wu, no witness or party to this case has stated "that service life must be estimated based solely on historical mortality data.[3]
>
> I had actually said that **"Failure to depreciate over the "service life"** violates these requirements. Mr. Wu misstates my testimony by falsely claiming that I testified that **"utilizing depreciation lives less than implied by historical retirement rates"** violates these requirements.[4]

Q. ARE MR. DUNKEL'S DIRECT TESTIMONY STATEMENTS ABOUT QWEST'S ALLEGED AAC AND USOA VIOLATION CONSISTENT WITH THE POSITION HE NOW ADVOCATES?

A. No. In his direct testimony, Mr. Dunkel states Qwest is in violation of the AAC for utilizing depreciation lives less than service lives. He then states service lives mean from the time assets are placed into service until the time they are retired (retirement experience). In his surrebuttal Mr. Dunkel states,

> I said that depreciation should be over the service life, but I did not saying [sic] the expected service lives cannot be "less than implied by historical retirement rates."[5]

---

[3]Surrebuttal Testimony William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, January 2005, p. 2.
[4] Ibid. p. 6.
[5] Ibid. p. 7.

Q. GIVEN MR. DUNKEL'S ABOVE SURREBUTTAL STATEMENT, WHAT DO YOU THINK HE MEANS BY "SERVICE LIFE"?

A. It appears Mr. Dunkel's surrebuttal position is that "service life" means the expected depreciation life the Commission determines as most appropriate.

Q. HOW IS QWEST'S PROPOSAL IN VIOLATION OF THE AAC?

A. It's difficult to see how Qwest's proposal, using depreciation lives and parameters the Commission determined as most appropriate, subsequently affirmed by the Arizona Court of Appeals, is in violation of the AAC.

V. STRAIGHT-LINE METHOD OF DEPRECIATION

Q. ON PAGE 10 OF HIS SURREBUTTAL, MR. DUNKEL STATES "ON PAGE 4 AND 5 OF HIS REBUTTAL MR. WU DISAGREES WITH THE 'STRAIGHT-LINE METHOD' OF DEPRECIATION." DO YOU DISAGREE WITH THE "STRAIGHT-LINE METHOD" OF DEPRECIATION?

A. The purpose of the rebuttal pages referenced by Mr. Dunkel is to show his selective deletion of the modifier "may" from the FCC's Part 32 language. Mr. Dunkel's modified Part 32 language was then subsequently used to bolster his AAC and USOA violation allegation. My testimony does not say I disagree with the "straight-line method" of depreciation. A careful reading of pages 4 and 5 in the context if my rebuttal testimony shows that I do not take issue with the "straight-line method" of depreciation. Quite the contrary, all parties including Mr. Dunkel were provided workpapers

that clearly show Qwest's depreciation proposal utilizes equal life group **straight-line** depreciation.

VI. FCC DEPRECIATION LIFE RANGES

Q. ON PAGE 10 OF HIS SURREBUTTAL, MR. DUNKEL STATES, "MR. WU'S CLAIM THAT I USED THE 1995 FCC LIFE RANGES MISREPRESENTS THE SOURCE OF THE FCC LIFE RANGES THAT I USED FOR THE MAJOR ACCOUNTS. FOR MOST MAJOR ACCOUNTS, THE FCC LIFE RANGES I USED WERE FROM THE FCC'S DECEMBER 1999 ORDER." PLEASE COMMENT?

A. In 1994 and 1995, the FCC issued life ranges for approximately 30 plant categories. In 1999, the FCC modified a single category – digital switch. The rest were unchanged. When Mr. Dunkel advocates depreciation lives from the FCC's 1999 order, with the exception of digital switch, he recommends life ranges initially suggested by the FCC in 1994/1995.

Q. WHEN YOU STATE THE FCC'S 1999 ORDER MODIFIED A SINGLE CATEGORY'S LIFE RANGE, WHAT WAS THAT CHANGE?

A. The FCC's original digital switch category life range was 15 to 18 years. In 1999, the FCC simply extended the lower end of that range to 12 years, so that digital switch's modified life range was now 12 to 18 years.

Q. WHEN THE FCC MODIFIED THE DIGITAL SWITCH LIFE RANGE, WHAT DID THE FCC SAY ABOUT THE REMAINING EQUIPMENT CATEGORY LIFE RANGES?

A. The FCC's 1999 order stated,

> ... We agree with MCI-Worldcom, that, except for digital switching equipment, recent carrier accounting data and trends do not support reductions in prescribed projection life ranges. ... .[6]

Q. WHAT IS SIGNIFICANT ABOUT THIS ORDER?

A. At the time the 1999 order was issued, the FCC's Local Competition Report[7] shows that nationally 4% of end-user switched access lines were served by CLECs. At the end of 2003, the national average percentage increased to 16%. For the same end of year 2003 period, Arizona-only percentage is shown at 22%. The testimonies of Qwest witnesses Philip E. Grate and David L. Teitzel show that Arizona competitors' market share have continued to increase. The point is that the telecommunications landscape is much different today than when either the FCC's 1995 or 1999 order was issued.

Q. WHAT DID MR. DUNKEL SAY ABOUT INDIANA'S AND ILLINOIS' RECOGNITION THAT THE FCC'S LIFE RANGES ARE NO LONGER APPROPRIATE?

A. Mr. Dunkel stated that these Commission decisions were in the context of interconnection dockets and therefore were not relevant to his testimony. The issues raised and their effects on Arizona equipment lives apply to telecommunications investment, regardless of use. For example, regarding use of the FCC's depreciation life ranges, the Indiana Commission 2004 order stated,

> ... we reject any claim that we are somehow bound to adopt regulatory lives, or even that they must be used as a starting point.

---

[6] FCC 99-137, Report and Order in Docket No. 98-137, Memorandum Opinion and Order in ASD 98-91, Released December 30, 1999, para. 14.

[7] Local Telephone Competition: Status as of December 31, 2003, Industry Analysis and Technology Division, Wireline Competition Bureau, June 2004.

> Whatever the merit of such an argument may have been in 1996, it carries no weight in 2003.
>
> Despite the frequent use of regulatory lives by other states in the first round of TELRIC proceedings, this Commission led the way toward a more progressive view of depreciation, tied more closely to the ongoing development of new technology and the growth of competition. ... .
>
> We believe that our decision was correct in 1998 and is even more appropriate today. Technological advancement continues at a rapid pace, leading to faster obsolescence of all types of telecommunications equipment. If anything, the pace of technological advancements should only increase as unbundling and pricing determinations are brought more in line with the goals of the 1996 Act in the wake of the 1999 Biennial Order, the Triennial Review Order, and the TELRIC NPRM, and as the incentive for facilities-based investment and innovation increases.
>
> We want to encourage SBC Indiana to take advantage of and deploy technological advancements, and one way to do that is to allow it to use reasonable depreciation lives based on criteria SBC employs for financial reporting purposes. We also note the increase in competition faced by SBC Indiana, both intermodal and intramodal, compels use of shorter depreciation lives. (Triennial Review Order, ¶ 685) SBC Indiana also has now "fully and irreversibly opened" the local market to competition, as evidenced by the FCC's grant of Section 271 long-distance authority, and such approvals often accelerate the pace and level of competition for the ILEC. For all of these reasons, we adopt SBC Indiana's proposal to use financial reporting lives in computing depreciation expense.[8]

The FCC's depreciation life ranges are simply not appropriate in today's telecommunications environment. It is naïve to believe environmental changes described above in Indiana's order are uniquely isolated to just interconnection equipment.

---

[8] Investigation and Generic Proceeding of Rates and Unbundled Network Elements and Collocation for Indiana Bell Telephone Company, Incorporated D/B/A SBC Indiana Pursuant to the Telecommunications Act of 1996 and Related Indiana Statutes, Cause No. 42393, Section B. Commission Findings and Conclusions, January 5, 2004.

VII. QWEST'S COMPETITORS' LIVES ARE RELEVENT TO QWEST

Q. MR. DUNKEL STATES THAT QWEST'S COMPETITORS' "'FINANCIAL REPORTING' LIVES CANNOT BE USED AS QWEST'S REGULATED UTILITY LIVES." PLEASE COMMENT.

A. Mr. Dunkel proffers a few technical reasons why he objects to using Qwest's competitor's lives as Qwest's regulated utility lives, but does not address the larger strategic issues. Is new technology shortening the depreciation lives of Qwest's assets? Is competition and loss of market share reducing the expected lives of Qwest's investments?

Q. WHAT DID THE COMMISSION SAY ABOUT THIS ISSUE?

A. The Commission stated in May 2000,

> Advancements in technology, coupled with the desire to create robust competition in Arizona's telecommunications industry, warrants setting U S WEST's depreciation lives within the range of its competitors.[9]

Q. WHAT DID THE ARIZONA COURT OF APPEALS SAY WITH RESPECT TO USE AND RELEVANCE OF COMPETITOR'S LIVES IN DETERMINING QWEST'S DEPRECIATION LIVES?

A. As stated in my rebuttal testimony,

> The Commission's regulations governing the establishment of depreciation rates authorize a public service corporation to "propose any reasonable method for estimating service lives." A.A.C. R14-2-102(C) (2). We do not find it unreasonable for the

[9] Arizona Docket No T-01051B-97-0689 Decision No. 62507, Conclusions of Law, May 4, 2000, Para 3, p. 14.

> Commission to conclude that in a competitive environment, the lives of U.S. WEST's property should be set comparably to those of companies with which U.S. WEST would be competing. Given that premise, we are not persuaded that use of the SEC data was arbitrary or unreasonable.[10]

Q. WHAT WERE SOME OF THE REASONS MR. DUNKEL STATES THAT QWEST'S COMPETITORS' "'FINANCIAL REPORTING' LIVES CANNOT BE USED AS QWEST'S REGULATED UTILITY LIVES?"

A. Mr. Dunkel states,

> ... As discussed on pages 46 – 54 of my Direct Testimony, there were several reasons the CLEC/IXC "financial reporting" lives cannot be used as Qwest's regulated utility lives. These reasons are: (1) CLEC/IXC's depreciation rates are not calculated consistent with the USOA/ACC requirements; ... (4) and there would be a mismatch of the way utility regulated depreciation rates are applied if depreciation rates are calculated on a different standard.[11]

I agree CLEC/IXCs calculate rates differently, but their depreciation lives represent the time periods over which CLECs plan to fully recover their invested capital.

VIII. RUCO DEPRECIATION RECOMMENDATION

Q. ON PAGE 12 OF HIS SURREBUTTAL, MR. DUNKEL QUOTES RUCO'S DATA RESPONSES IN WHICH RUCO STATES THAT DOES NOT TAKE A POSITION ON QWEST'S DEPRECIATION PARAMETERS.

---

[10] Residential Utility Consumer Office v. The Arizona Corporation Commission and Qwest Corporation, Court of Appeals, July 24, 2001, Π20, pp. 11-12.

[11] Surrebuttal Testimony William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, January 2005, pp. 13 - 14.

MR. DUNKEL THEN APPARENTLY CONCLUDES RUCO DOES NOT CONCUR WITH QWEST'S CURRENT DEPRECIATION PARAMETERS. PLEASE COMMENT.

A. RUCO states in its direct testimony,

> I have recalculated Qwest's test year depreciation expense utilizing the Company's proposed depreciation rates and test year-end plant balances. **There is no difference between the annual accruals calculated by the Company and those calculated by RUCO.** [Emphasis added] Accordingly, I have made no adjustments to proforma depreciation expense. [12]

Annual depreciation accruals result from depreciation rates times investment balances. Depreciation rates, in turn, are developed from depreciation lives and parameters. If RUCO states there is no difference between Qwest's annual depreciation accruals and RUCO's calculations, then RUCO concurs with Qwest's depreciation proposal. By definition, if one agrees with the results of a calculation, then one must agree with the factors producing those same results.

IX. ARIZONA CONCLUSIONS

Q. TO SUMMARIZE, WHAT IS THE SINGLE MOST IMPORTANT ISSUE INVOLVING DEPRECIATION?

A. Depreciation lives. All other depreciation issues are relatively small in comparison. The difference between Staff and Qwest positions is about how Qwest's investment will be affected by the future forces of obsolescence, competition, changes in consumer demand, changes in the

[12] Direct Testimony Marylee Diaz Cortez on Behalf of Residential Utility Consumer Office, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, November 2004, p. 23.

state of the art and technology and regulatory requirements. For the major plant accounts, Mr. Dunkel wants to "roll back the clock" and, with the exception of a single plant category, advocates lives initially established in the 1994/1995 time frame. Qwest did not propose any change to the appropriate depreciation lives already ordered by this Commission.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**

STATE OF WASHINGTON)
) **ss** **AFFIDAVIT OF KERRY DENNIS WU**
COUNTY OF KING)

Kerry Dennis Wu, of lawful age being first duly sworn, deposes and states:

1. My name is Kerry Dennis Wu. I am Staff Director – Capital Recovery for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Kerry Dennis Wu

Kerry Dennis Wu

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

LORI L. WHITE
COMMISSION EXPIRES
NOTARY
PUBLIC
STATE OF WASHINGTON

Lori L. White

Notary Public

My Commission Expires: 7/10/07

ORIGINAL

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-30 Admitted

04P

BEFORE THE ARIZONA CORPORATION COMMISSION

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

Arizona Corporation Commission
DOCKETED
OCT 19 2004
DOCKETED BY

AZ CORP COMMISSION
DOCUMENT CONTROL

2004 OCT 19 P 3:43

RECEIVED

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

CERTIFICATION OF PUBLICATION AND NOTICE

Pursuant to the Procedural Order dated August 5,2004 in the above-referenced matter, Qwest Corporation hereby files this Certification of Publication and Notice. Attached hereto as Exhibit "A" is an Affidavit of Sally Reede-Morris of The Arizona Republic, who indicates that publication of Qwest's application and hearing date was made on August 7th, 2004 and August 14th, 2004. A copy of that advertisement accompanies the Affidavit.

Attached as Exhibit "B" is an Affidavit of Judith Rone Choi, Manager for Traverse Communications, concerning the printing and distribution of the Arizona Price Regulation Plan bill insert and newspaper advertisement during the month of August, 2004. A copy of that advertisement accompanies the Affidavit.

RESPECTFULLY SUBMITTED this 19th day of October, 2004.

By: _____

Norman G. Curtright, Corporate Counsel
QWEST SERVICES CORPORATION
4041 N. Central Ave., Suite 1100
Phoenix, Arizona 85012
Telephone: (602) 630-2187
Fax: (602) 235-3107

- and -

Timothy Berg, Esq.
FENNEMORE CRAIG P.C.
3003 N. Central Ave., Suite 2600
Phoenix, AZ 85012
Telephone: (602) 916-5421

ORIGINAL and 15 copies hand-delivered
for filing October 19th, 2004, to:

Docket Control
WZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

COPIES hand-delivered October 19th, 2004 to:

ane Rodda, Administrative Law Judge
WZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Maureen Scott, Counsel
WZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

Ernest Johnson
Director, Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

COPY of the foregoing mailed
this 19th day of October, 2004 to:

Joan S. Burke
Osborne Maledon
2929 N. Central Ave., 21st Fl.
Phoenix, AZ 85067

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

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

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

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

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

Richard S. Wolters
Mary Tribby
AT&T
1875 Lawrence Street, Room 1575
Denver, CO 80202-1847

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

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

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

Eric S. Heath
Sprint Legal Division
100 Spear Street, Suite 930
San Francisco, CA 94105

Accipiter Communications, Inc.
2238 W. Lone Cactus Dr., Ste.lOO
Phoenix, AZ 85027

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

Archtel, Inc.
1800 West Park Drive, Ste. 250
Westborough, MA 01581

Brooks Fiber Communications of Tucson, Inc.
201 Spear Street, 9th Floor
San Francisco, CA 94105

Centruytel
PO Box 4065
Monroe, LA 71211-4065

Zitizens Utilities Rural Co. Inc.
Zitizens Communications Co. of Arizona
4 Trial Center, Suite 200
Salt Lake City, UT 84180

Citizens Telecommunications Co. of the White Mountains, Inc.
4 Triad Center, Ste. 200
Salt Lake City, UT 84180

Comm South Companies, Inc.
2909 N. Buckner Blvd., Ste. 200
Dallas, TX 75228

Copper Valley Telephone, Inc.
PO Box 970
Willcox, AZ 85644

Electric Lightwave, Inc.
4 Triad Center, Ste. 200
Salt Lake City, UT 84180

Eschelon Telecom of Arizona, Inc.
730 Second Avenue South, Ste.1200
Minneapolis, MN 55402

Ernest Communications, Inc.
5275 Triangle Pkwy, Ste. 150
Norcross, GA 30092-6511

Intermedia Communications, Inc.
3608 Queen Palm Drive
Tampa, FL 33619-1311

Level 3 Communications, LLC
1025 Eldorado Blvd.
Broomfield, CO 80021

Max-Tel Communications, Inc.
105 N. Wickham
PO Box 280
Alvord, TX 76225

MCI WorldCom Communications
201 Spear Street, 9th Floor
San Francisco, CA 94105

MCIMetro
201 Spear Street, 9th Floor
San Francisco, CA 94105

Metropolitan Fiber Systems of Arizona, Inc.
201 Spear Street, 9th Floor
San Francisco, CA 94105

Midvale Telephone Exchange
PO Box 7
Midvale, ID 83645

Navajo Communications Co., Inc.
4 Triad Center, Suite 200
Salt Lake City, UT 84180

Nextlink Long Distance Svcs.
3930 E. Watkins, Ste. 200
Phoenix, AZ 85034

North County Communications Corporation
3802 Rosencrans, Ste. 485
San Diego, CA 92110

One Point Communications
Two Conway Park
150 Field Drive,Ste. 300
Lake Forest, IL 60045

Opex Communications, Inc.
500 E. Higgins Rd., Ste. 200
Elk Grove Village, IL 60007

Pac-West Telecomm, Inc.
1776 W. March Lane, #250
Stockton, CA 95207

The Phone Company/Network Services of New Hope
6805 Route 202
New Hope, PA 18938

Rio Virgin Telephone Co.
Rio Virgin Telephone and Cablevision
PO Box 189
Estacada, OR 97023-000

South Central Utah Telephone Association, Inc.
PO Box 226
Escalante, UT 84726-000

Southwestern Telephone Co., Inc.
PO Box 5158
Madison, WI 53705-0158

Special Accounts Billing Group
1523 Withorn Lane
Inverness, IL 60067

Sprint Communications Company, L.P.
6860 W. 115th ,MS:KSOPKD0105
Overland Park, KS 66211

Touch America
130N. Main Street
Butte, MT 59701

Table Top Telephone Co, Inc.
600 N. Second Avenue
Ajo, AZ 85321-0000

TCG Phoenix
1875 Lawrence Street, Room 1575
Denver, CO 80202

Valley Telephone Cooperative, Inc.
752 E. Malley Street
PO Box 970
Willcox, AZ 85644

Verizon Select Services Inc.
5665 MacArthur Blvd, HQK02D84
Irving, TX 75039

VYVX, LLC
One Williams Center, MD 29-1
Tulsa, OK 74172

Western CLEC Corporation
3650 131st Avenue SE, Ste. 400
Bellevue, WA 98006

Williams Local Network, Inc.
h e Williams Center, MD 29-1
Tulsa, OK 74172

XO Arizona Inc.
3930 Watkins, Ste. 200
Phoenix, AZ 85034

EXHIBIT "A"

PUBLIC NOTICE OF HEARING ON QWEST CORPORATION'S APPLICATION FOR RENEWED PRICE REGULATION PLAN, DEREGULATION OF SERVICES, REQUEST FOR ARIZONA UNIVERSAL SERVICE FUNDING AND ON THE INVESTIGATION OF TELECOMMUNICATIONS ACCESS CHARGES. DOCKET NO. T-01051B-03-0454, ET AL

On May 20, 2004, Qwest Corporation ("Qwest" or "Company") filed an application with the Arizona Corporation commission ("Commission") for a renewed price regulation plan, deregulation of services and request for Arizona universal service funding. This matter has been consolidated with the investigation of telecommunications access charges. Qwest has requested changes in rates for specific services, the introduction of a "competitive zone" test for competitive services, the elimination of the revenue cap on competitive services and greater flexibility in pricing competitive services. The actual rate changes for individual customers will vary depending upon the type and quantity of service provided. Copies of the Company's application and proposed tariffs are available at its office and the commission's offices for public inspection during regular business hours.

The commission will hold a hearing on this matter beginning January 12, 2005, at 10:00 a.m., at the Commission's offices, 1200 West Washington, Phoenix, Arizona. Public comments will be taken on the first day of the hearing.

The law provides for an open public hearing at which, under appropriate circumstances interested parties may intdrvene. intervention shall be permitted to any person entitled by law to intervene and having a direct and substantial interest in the matter. Persons desiring to intervene must file a written motion to intervene with the commission, which motion should be sent to the Company or its counsel and to all parties of record and which, at the minimum, shall contain the following:

1. The name, address and telephone number of the Proposed intervenor and of any party upon whom service of documents is to be made if different than the intervenor.
2. A short statement of the proposed intervenors interest in the proceeding (e.g., a customer of the company, a stockholder of the company, etc.).
3. A statement certifying that a copy of the motion to intervene has been mailed to the Company or its counsel and to all parties of record in the case.

The granting of motions to intervene shall be governed by A.A.C. R14-3-105, except that all motions to intervene must be filed on or before October 9, 2004. The granting of intervention, among other things, entitles a party to present sworn evidence at hearing and to cross-examine other witnesses. However, failure to intervene will not preclude any customer from appearing at the hearing and making a statement on such customer's own behalf. All correspondence should contain the Docket No. T-01051B-03-0454, et al.

If you wish to make written comments objecting to, or supporting this application, mail them to: Arizona Corporation Commission
Attention Docket Control
Re: Qwest Corporation
T-01051B-03-0454 & T-00000D-00-0672
1200 W. Washington Street
Phoenix, Arizona 85007

If you have any questions about this application, or want further information on intervention, you may contact the Consumer Services Section of the Commission at 1200 W. Washington Street, Phoenix, Arizona 85007 or call 1-800-222-7000.

The Commission does not discriminate on the basis of disability in admission to its public meetings. Persons with a disability may request a reasonable accommodation such as a sign language interpreter, as well as request this document in an alternative format, by contacting Yvonne McFarlin, ADA Coordinator, voice phone number 602/542-3931. E-mail ymcfarlin@cc.state.az.us. Requests should be made as early as possible to allow time to arrange the accommodation.

04385-August 7, 14, 2004

AFFIDAVIT OF PUBLICATION

THE ARIZONA REPUBLIC

STATE OF ARIZONA
COUNTY OF MARICOPA } SS.

Sally Reede-Morris, being first duly sworn, upon oath deposes and says: That she is a legal advertising representative of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published at Phoenix, Arizona, by Phoenix Newspapers Inc., which also publishes The Arizona Republic, and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates as indicated.

The Arizona Republic

August 7, 14, 2004

Sworn to before me this
5TH day of
October A.D. 2004

OFFICIAL SEAL
MARILYN GREENWOOD
NOTARY PUBLIC-ARIZONA
MARICOPA COUNTY
My Comm. Expires May 23, 2007

Notary Public

EXHIBIT "B"

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF APPLICATION FOR RENEWED PRICE REGULATION PLAN, DEREGULATION OF SERVICES, REQUEST FOR ARIZONA UNIVERSAL SERIVE FUNDING, AND ON THE INVESTIGATION OF TELECOMMUNICATIONS ACCESS CHARGES	)	DOCKET NO. T-01051B-0304541 AFFAIDVAIT OF Judith Rone Choi

Judith Rone Choi, of being lawful age being first duly sworn, depose and states:

1. My name is Judith Rone Choi. I am a Project Manager for Traverse Communications, Seattle, Washington and coordinated the printing and distribution of the Arizona Price Regulation Plan bill insert, and newspaper ad.

2. I hereby swear and affirm that the copy hereto attached is a true copy of the insert that was included in the bills of all Qwest Corporation customers in the state of Arizona during the month of August 2004.

Further affiant sayeth not.

Judith Rone Choi

Judith Rone Choi

SUBSCRIBED AND SWORN to before me on 9/20/04 (date)

Notary Public

My Commission Expires: _____

WASHINGTON SHORT-FORM INDIVIDUAL ACKNOWLEDGMENT (RCW 42.44.100)

State of Washington
County of King } ss.

I certify that I know or have satisfactory evidence that Judith Rone-Choi
Name of Signer
is the person who appeared before me, and said person acknowledged that ~~he~~/she signed this instrument and acknowledged it to be ~~his~~/her free and voluntary act for the uses and purposes mentioned in the instrument.

Dated: 09/20/04
Month/Day/Year

Notary Public
State of Washington
SIHEM DI CRISTO
My Appointment Expires May 7, 2007

Notary Public
State of Washington
SIHEM DI CRISTO
My Appointment Expires May 7, 2007

Di Cristo
Signature of Notarizing Officer

Notary Public
Title (Such as "Notary Public")

My appointment expires

05/07/07
Month/Day/Year of Appointment Expiration

Place Notary Seal Above

OPTIONAL

Although the information in this section is not required by law, it may prove valuable to persons relying on the document and could prevent fraudulent removal and reattachment of this form to another document.

Right Thumbprint of Signer
Top of thumb here

Description of Attached Document

Title or Type of Document: Affidavit

Document Date: 09/20/04 Number of Pages: 1

Signer(s) Other Than Named Above: N/A.

© 1999 National Notary Association • 9350 De Soto Ave., P.O. Box 2402 • Chatsworth, CA 91313-2402 • www.nationalnotary.org
Item No. 5906 • Reorder: Call Toll-Free 1-800-876-6827

PUBUC NOTICE OF HEARING ON QWEST CORPORATION'S APPLICATION FOR RENEWED PRICE REGULATION PLAN, DEREGULATION OF SERVICES, REQUEST FOR ARIZONA UNIVERSAL SERVICE FUNDING AND ON THE INVESTIGATION OF TELECOMMUNICATIONS ACCESS CHARGES.
DOCKET NO. T-010518-03-0454, ET AL.

On May 20, 2004, Qwest Corporation ("Qwest" or "Company") filed an application with the Arizona Corporation Commission ("Commission") for a renewed price regulation plan, deregulation of services, and request for Arizona universal service funding. This matter has been consolidated with the investigation of telecommunications access charges. Qwest® has requested changes in rates for specific services, the introduction of a "competitive zone" test for competitive services, the elimination of the revenue cap on competitive services and greater flexibility in pricing competitive services. The actual rate changes for individual customers will vary depending upon the type and quantity of service provided. Copies of the Company's application and proposed tariffs are available at its office and the Commission's offices for public inspection during regular business hours.

The Commission will hold a hearing on this matter beginning January 13,2005, at 10:00 a.m., at the Commission's offices, 1200 West Washington, Phoenix, Arizona. Public comments will be taken on the first day of the hearing.

The law provides for an open public hearing at which, under appropriate circumstances, interested parties may intervene. Intervention shall be permitted to any person entitled by law to intervene and having a direct and substantial interest in the matter. Persons desiring to intervene must file a written motion to intervene with the Commission, which motion should be sent to the Company or its counsel and to all parties of record, and which, at the minimum, shall contain the following:

1. The name, address, and telephone number of the proposed intervenor and, of any party upon whom service of documents is to be made if different than the intervenor.

2. A short statement of the proposed intervenor's interest in the proceeding (e.g., a customer of the Company, a stockholder of the Company, etc.).

continued on back

3. A statement certifying that a copy of the motion to intervene has been mailed to the Company or its counsel and to all parties of record in the case.

The granting of motions to intervene shall be governed by A.A.C. R14-3-105, except that all motions to intervene must be filed on or before **October 9**, 2004. The granting of intervention, among other things, entitles a party to present sworn evidence at hearing and to cross-examine other witnesses. However, failure to intervene will not preclude any Customer from appearing at the hearing and making a statement on such customer's own behalf. All correspondence should contain the Docket No. T-010518-03-0454, et al.

If you wish to make written comments objecting to, or supporting this application, mail them to:

Arizona Corporation Commission
Attention Docket Control
Re: Qwest Corporation
T-01051B-03-0454 & T-00000D-00-0672
1200 W. Washington Street
Phoenix, Arizona 85007

If you have any questions about this application, or want further information on intervention, you may contact the Consumer Services Section of the Commission at 1200 W. Washington Street, Phoenix, Arizona 85007 or call 1-800-222-7000.

The Commission does not discriminate on the basis of disability in admission to its public meetings. Persons with a disability may request a reasonable accommodation such as a sign language interpreter, as well as request this document in an alternative format, by contacting Yvonne McFarlin, ADA Coordinator, voice phone number 602/542-3931, E-mail ymcfarlin@cc.state.az.us. Requests should be made as early as possible to allow time to arrange the accommodation.

Qwest

Spirit of Service™

Qwest Services Corporation
4041 N Central Ave. - 11th Floor
Phoenix, Arizona 85012
Office 602-630-8221
Fax 602-235-3107

Reed Peterson
Staff Advocate - Public Policy

Qwest.

Spirit of Service

RECEIVED

2005 SEP 30 P 4: 00

AZ CORP COMMISSION
DOCUMENT CONTROL

September 30,2005

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

Notice of Filing Certification of Publication

Re: Docket No. T-0 1051 B-03-0454

Dear Sir or Madam:

Pursuant to the Commission's August 26,2005 Procedural Order, Qwest Corporation (QC) hereby tiles the attached affidavit which certifies that the notice requirement contained in the Procedural Order has been met through publication in the Arizona Republic on August 21,2005.

Please let me know if you have any questions concerning this matter.

Sincerely,

Reed Peterson

Attachment

Qwest Services Corporation
4041 N. Central Ave. - 11th Floor
Phoenix, Arizona 85012
Office 602-630-8221
Fax 602-235-3107

Reed Peterson
Staff Advocate – Public Policy

ORIGINAL

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-31 Admitted

Spirit of Service

October 3,2005

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

CORRECTION - Notice of Filing Certification of Publication

Re: Docket No. T-01051B-03-0454

Dear Sir or Madam:

On September 30,2005, Qwest Corporation filed a Notice of Filing Certification of Publication in the above referenced docket (copy attached). The notice incorrectly stated that publication had been made in the Arizona Republic on August 21,2005. It should have stated that publication had been done on September 21,2005. Qwest apologizes for any confusion or inconvenience this may have caused.

Please let me know if you have any questions concerning this matter.

Sincerely,

Attachment

RECEIVED
2005 OCT -3 P 2: 17
AZ CORP COMMISSION
DOCUMENT CONTROL

AFFIDAVIT OF PUBLICATION

PUBLIC NOTICE OF HEARING ON PROPOSED SETTLEMENT AGREEMENT ON QWEST CORPORATION'S APPLICATION FOR RENEWED PRICE REGULATION PLAN, DEREGULATION OF SERVICES, REQUEST FOR ARIZONA UNIVERSAL SERVICE FUNDING AND ON THE INVESTIGATION OF TELECOMMUNICATIONS ACCESS CHARGES DOCKET NO. T-01051B-03-0454, ET.AL.

On May 21, 2004, Qwest Corporation ("Qwest" or "Company") filed an application with the Arizona Corporation Commission ("Commission") for a renewed price regulation plan, deregulation of services, and request for Arizona universal service funding. This matter has been consolidated with the investigation of telecommunications access charges. On August 24,2005, Qwest, Commission Utilities Division Staff and a number of intervening parties filed a proposed Settlement Agreement which, if approved, would resolve all of the issues raised in these matters.

The proposed Settlement Agreement provides for Qwest's revenues to increase through price adjustments by an annual amount of up to $19.8 million in the first year following approval of the agrement and by an annual amount of up to an additional $12.0 million in the second year or thereafter. These potential increases will be achieved by granting Qwest, to the extent that it elects to do so, the ability to increase the rates of a defined list of services, as specified in the Settlement Agreement, The proposed Settlement Agreement also provides for the following specific race changes:

Switched Access Charges would be reduced by $12.0 million annually by eliminating the originating and terminating Carrier Common Charge: as well as the Interconnection Charge. Prices for other competitive services may be increased by Qwest to offset this reduction.

Zone Charges would be reduced by $2.0 million annually through a reduction in the monthly Zone 1 and Zone 2 rates of 5.50 and $1.50, respectively.

Residence Non-Published and Non-Listed Service would be reduced by $2.5 million through a reduction in the monthly rate of $.50 each.

The Line Extension Credit available to offset rural construction charges would be increased from 53.000 to $5,000 per location.

Copies of the proposed Settlement Agreement are available at Qwest's offic? at 4041 N. Central Ave, Phoenix, Arizona and at the Commission's Docket Control at 1200 West Washington, Phoenix, Arizona and at its Tucson office, 400 West Congress, Suite 218, for public inspection during regular business hours.

The Commission will hold a hearing on the proposed Settlement Agreement beginning November 1, 2005, at 10:00 a.m., at the Commission's offices, 1200 West Washington, Phoenix, Arizona. Written public comments may be submitted via e-mail (visit http://www.cc.state.az.us/utility/cons/index.htm for instructions), or by mailing a letter referencing Docket Number T-010519-03-0454 to: Arizona Corporation Commission, Consumer Services Section., 1200 West Washington, Phoenix, AZ 85007.

The law provides for an open public hearing. The Commission does not discriminate on the basis of disability in admission to it public meeting. Persons with a disability may request a reasonable accommodation such as a sign language interpreter, as well as request this document in an alternative format, by contacting Linda Hogan, ADA Coordinator, voice phone number (602) 542-3931, e-mail LHogan@cc.state.az.us. Requests should be made as early as possible to allow time to arrange the accommodation. The Commission does not discriminate on the basis of disability in admission to its public meetings.

05598-Seotember2.., 2005

THE ARIZONA REPUBLIC

STATE OF ARIZONA
COUNTY OF MARICOPA } SS

Diana Chavez, being first duly sworn, upon oath deposes and says: That she is a legal advertising representative of the Arizona Business "Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published at Phoenix, Arizona, by Phoenix Newspapers Inc., which also publishes The Arizona Republic. and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates as indicated.

The Arizona Republic

September 21, 2005

Sworn to before me this
21ST day of
September A.D. 2005

Notary Public

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-32 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	**DOCKET NO. T-00000D-00-0672**

DAVID L. ZIEGLER

DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

SEPTEMBER 6, 2005

TESTIMONY INDEX

		Page
EXECUTIVE SUMMARY		i
I.	IDENTIFICATION OF WITNESS	1
II.	PURPOSE OF TESTIMONY	2
III.	CONSUMER BENEFITS	4
IV.	TARIFFS AND CUSTOMER NOTICE	8
V.	REPORTS	9
VI.	TERM OF THE PLAN	10
VII.	CONCLUSION AND RECOMMENDATION	10

EXECUTIVE SUMMARY

My testimony describes the consumer benefits of the Settlement Agreement (the "Agreement"); the term of the Agreement; notice to consumers; filing of tariffs and price lists; elimination of certain reporting requirements; and why the Agreement is in the public interest.

The Agreement has quantifiable consumer benefits that total $5.5M and additional benefits that cannot be quantified in monetary terms because the benefit is either non-monetary or the number of impacted customers is unknown. Quantifiable benefits include the reduction in zone charges, a reduction in residential non-published and residential non-listed telephone listings and increased funding for the Telephone Assistance Plan for the Medically Needy. Consumer benefits that are not quantified in monetary terms are changes to the service quality tariff, increased line extension credits, a rate cap on directory assistance and the hard cap on Basket 1 services.

The proposed Agreement is in the public interest because it provides numerous consumer benefits as described in my testimony while allowing Qwest to be regulated similarly to its competitors in an increasingly competitive Arizona market.

It is my recommendation that the Commission find that the Agreement is in the public interest and approve the Agreement as filed.

I. IDENTIFICATION OF WITNESS

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

A. My name is David Ziegler. I am employed by Qwest Services Corporation as Assistant Vice President – Arizona Public Policy. My business address is 4041 North Central Avenue, Phoenix, Arizona 85012. I am providing this testimony on behalf of Qwest Corporation ("Qwest"), the public service corporation providing telecommunications service in Arizona.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

A. I am responsible for regulatory, legislative and community affairs in Arizona.

Q. PLEASE REVIEW YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.

A. I received a Bachelor of Science degree in Business Administration from Columbia College in 1988. I have also attended numerous industry seminars on economics, management, marketing and technical courses. I began my career with Qwest (Mountain Bell) in 1978 in the business office. In 1980, I accepted the position of Manager - Residence Operations, where I was responsible for developing methods and procedures for billing and collections. In 1986, I moved to Strategy Development, where I was responsible for cost of service studies and economic regulatory issues. In 1994, I accepted the position of Manager-Regulatory Affairs in Colorado Regulatory where I was responsible for

managing regulatory issues before the Colorado Public Utilities Commission. In 1997, I accepted the position of Director - Regulatory Affairs in Colorado Regulatory. In 2001, I accepted the position of Regional Director – Out of Region, where I was responsible for regulatory and legislative activities in a 14-state area. In 2002, I accepted my current position.

Q. HAVE YOU PREVIOUSLY APPEARED BEFORE THE ARIZONA CORPORATION COMMISSION OR OTHER PUBLIC UTILITY COMMISSIONS AS A WITNESS IN REGULATORY PROCEEDINGS?

A. I have testified before the Arizona Corporation Commission (the "Commission") in the hearing on the proposed settlement in Docket No. RT-00000F-02-271, Docket No. T-00000A-97-0238, and Docket No. T-00151B-02-0871 (consolidated). I have also testified before the Colorado Public Utilities Commission and the Illinois Commerce Commission.

Q. ARE YOU THE SAME DAVID ZIEGLER THAT PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes. I pre-filed Direct Testimony in this proceeding on May 20, 2004.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to provide testimony in support of the Settlement Agreement (the "Agreement") as filed by the Arizona Corporation Commission

Staff in this Docket on August 23, 2005 among Qwest Corporation, the Arizona Corporation Commission Staff, the Department of Defense and All Other Federal Executive Agencies, the regulated subsidiaries of MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Utility Investors Association, Cox Arizona Telecom, LLC and XO Communications Services, Inc. regarding the consumer benefits of the Agreement (Sections 13, 14, 15 and 16); the term of the Agreement (Section 17); notice to consumers (Section 24); filing of tariffs and price lists (Section 25); elimination of certain reporting requirements (Section 27); and why the Settlement Agreement is in the public interest.

Q. IS THE PROPOSED AGREEMENT IN THE PUBLIC INTEREST?

A. Yes. The proposed Agreement is in the public interest because it provides numerous consumer benefits while allowing Qwest to be regulated similarly to its competitors. In his direct testimony in support of settlement, Qwest witness Mr. Jerrold Thompson discusses additional reasons why this Agreement is in the public interest. The Agreement is the result of many months and meetings between the parties to develop a Renewed Price Cap Plan ("Plan") that balances the needs of the Company, its competitors and consumers in an increasingly competitive Arizona market.

III. CONSUMER BENEFITS

Q. WOULD YOU PLEASE DESCRIBE THE CONSUMER BENEFITS IN THE AGREEMENT?

A. The consumer benefits were designed to be statewide in scope, be meaningful, and affect as many customers as possible. Several of the consumer benefits affect all Qwest customers statewide. Those that benefit all customers are the hard cap on basket 1 services as described in the testimony of Mr. Thompson, a rate cap on directory assistance, and changes to the service quality tariff. Other consumer benefits are more targeted benefits but are statewide nonetheless. Those benefits consist of the reduction in zone charges, a reduction in residential non-published and residential non-listed telephone listings, increased funding for the Telephone Assistance Plan for the Medically Needy and increased line extension credits. Although the benefit of certain provisions within the Agreement cannot be quantified, the benefits that can be quantified total $5.5 million.

Q. PLEASE DESCRIBE THE DIRECTORY ASSISTANCE CONSUMER BENEFIT.

A. The directory assistance consumer benefit (Section 14) is a continuation of the directory assistance benefit in the previous price cap plan in that it caps the existing rate of $1.15 per call rather than pricing directory assistance at the higher market rate. It also includes one call allowance per month without charge,

two inquiries per usage and call completion. This benefit affects all Qwest customers statewide.

Q. PLEASE DESCRIBE HOW SERVICE QUALITY ISSUES AND THEIR ASSOCIATED CONSUMER BENEFIT HAVE BEEN ADDRESSED IN THE SETTLEMENT AGREEMENT.

A. Section 15 of the proposed Settlement Agreement addresses service quality issues in several ways. First, it contains incentives for Qwest to continue to maintain the high service quality levels that it achieved during the term of the initial price cap plan. Section 5 of the prior price cap plan contained a provision for business and residence customers to receive a $2.00 one-time credit during any year in which Qwest became subject to penalties under two or more of the five categories defined in Section 2.6 of the Service Quality Plan Tariff. Qwest's performance under the prior plan resulted in no customer credits being issued. The Renewed Price Cap Plan would carry over these provisions from the prior plan and provide additional incentive for Qwest to maintain high levels of service quality in addition to the competitive market incentives which exist in Arizona.

The second way in which the Agreement addresses service quality is by adopting the recommendation from Staff Witness Del Smith's Direct Testimony to adjust the penalty and offset ranges for Residence Office, Business Office, and Repair Office Access. This provision will provide Qwest with a strong incentive to perform satisfactorily because it will have the effect of increasing the ranges for

which penalties are assessed and decreasing the ranges for which penalty offsets are received.

The third way in which the Agreement addresses service quality is by establishing an additional objective for trouble reports. Pursuant to Section 2.5.6A of Qwest's Service Quality Tariff, the Company must not exceed 8 trouble reports per 100 access lines per month, averaged over a 3 month period. Under the terms of the Settlement Agreement, Qwest would modify its Service Quality Tariff to further require that the Company not exceed 3 trouble reports per 100 access lines in any month, averaged over all of its Arizona Wire Centers. This provides an additional incentive to minimize trouble reports that benefits customers.

Q. DOES THE AGREEMENT CONTAIN ANY OTHER SERVICE QUALITY PROVISIONS?

A. Yes. The Agreement also permits modifications to the Service Quality Tariff that would clarify Qwest's obligations during conditions outside of its control. These conditions, which are termed "Force Majeure", do not significantly change Qwest's obligations, but provide greater clarity and include examples of events for which Qwest would not be held responsible under the terms of the Tariff.

Q. PLEASE DESCRIBE THE REDUCTION IN ZONE CHARGES.

A. Zone charges reflect the fact that the farther a customer service location is from the central office, the higher the cost of providing service to those customers. In

many exchanges statewide, there are two zones around the base rate area of the exchange, Zone 1 and Zone 2. The Agreement (Section 13(a)) reduces the zone charges by 50% for each zone. The current Zone 1 charge of $1.00 will be reduced to $0.50 and the current Zone 2 charge of $3.00 will be reduced to $1.50. Based on test year volumes, these reductions amount to $2M annually.

Q. PLEASE DISCUSS THE CONSUMER BENEFIT OF THE REDUCTION IN NON-PUBLISHED AND NON-LISTED TELEPHONE NUMBER RATES FOR RESIDENTIAL CUSTOMERS.

A. The Agreement provides that Qwest shall reduce rates for residential Non-Published and residential Non-Listed Telephone numbers (Section 13(b)) by $0.50. The current rates of $1.65 for residential Non-Published numbers and $1.30 for residential Non-Listed numbers will be reduced to $1.15 and $.80, respectively. Based on test year volumes, these reductions amount to $2.5M annually.

Q, WOULD YOU PLEASE DESCRIBE THE CONSUMER BENEFIT OF THE TELEPHONE ASSISTANCE PLAN FOR THE MEDICALLY NEEDY?

A. The Agreement provides for an increase in funding for the Telephone Assistance Plan ("TAP") for the Medically Needy of $1.0 Million per year. Qwest is currently providing $1.0 million of annual funding for this plan and under the Agreement that amount would increase to $2.0 million per year. In combination with the Federal Lifeline Program, the additional funding will pay the entire cost for basic

telephone service for up to approximately 7,200 new customers each year. Under the Agreement, Qwest and DES will work together to develop a public awareness program to increase participation in the TAP program.

Q. PLEASE DESCRIBE THE LINE EXTENSION CREDIT BENEFIT.

A. Qwest currently provides a one time credit of $3,000 towards the cost of establishing telephone service and constructing facilities to locations in rural areas outside of the Base Rate Area of an exchange. The intent of this credit is to offset some of the high construction costs that rural customers incur which are the result of longer loop lengths and lower customer densities. The Settlement Agreement increases the amount of the Line Extension credit to $5,000 per location. The higher Line Extension Credit amount will benefit customers living in rural areas who according to Staff Witness Elijah Abinah's Direct Testimony, may otherwise be unable to afford telephone service.

IV. TARIFFS AND CUSTOMER NOTICE

Q. PLEASE DESCRIBE THE NOTICE TO CONSUMERS AND THE FILING OF REVISED TARIFFS AND PRICE LISTS.

A. Section 24 of the Settlement Agreement includes several provisions relating to customer notices. First, Qwest has agreed to provide customers with two separate bill inserts, the first to be sent beginning 60 days following entry of an order approving the settlement, and the second to be sent 60 days after the first bill insert. The notice is to inform customers of the following information:

- Services for which rates and charges may change without Commission approval.

- That essential basic services which are part of any packages or offering remain available and can be obtained by the customer as a separate offering.

- That the Arizona Corporation Commission remains the regulatory agency responsible for overseeing the terms, conditions, rates, and quality of intrastate telecommunications service provided by Qwest.

- Complaints regarding any of Qwest's regulated services should be directed to the Commission's Consumer Services Section.

Second, Qwest will provide training for its customer service representatives concerning the implementation of the Renewed Price Cap Plan.

Third, within 60 days from the effective date of the Renewed Price Cap Plan, Qwest will send a memorandum to organizations that assist persons with physical limitations which describes the exemption from Directory Assistance charges which is available to qualified persons with physical limitations that prevent them from using printed telephone directories. Qwest will also continue to provide this information in the red "Phone Service Pages" through its contractual arrangements with DEX.

V. REPORTS

Q. PLEASE DESCRIBE THE TWO REPORTS THAT ARE BEING ELIMINATED.

A. Section 27 of the Agreement provides for elimination of two reports that Qwest has been providing to the Commission. The first report is the deposit calculation

1 report, which was the result of a customer deposit complaint in 1992 and is no
2 longer an issue. The second report is the Public Access Line ("PAL") report.
3 This report was in place because at one time Qwest provided both payphone
4 service and PAL service. Qwest has since exited the payphone business,
5 thereby making the PAL report unnecessary.

6 **VI. TERM OF THE PLAN**

7 **Q. WOULD YOU PLEASE ADDRESS THE TERM OF THE PLAN?**
8 A. The term of the Plan is three years from the effective date specified by the
9 Commission in its order approving this Settlement Agreement and Renewed
10 Price Cap Plan. It will continue in its entirety until the Commission either
11 approves a renewed plan or terminates the Plan.

12 **VII. CONCLUSION AND RECOMMENDATION**

13 **Q. WHAT IS YOUR RECOMMENDATION REGARDING THE SETTLEMENT**
14 **AGREEMENT AND THE RENEWED PRICE CAP PLAN?**
15 A. My recommendation is that the Commission find that the Settlement Agreement
16 and Renewed Price Cap Plan are in the public interest and approve the
17 Settlement Agreement and Renewed Price Cap Plan as filed by the parties.

18 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**
19 A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**
STATE OF ARIZONA COUNTY OF MARICOPA	) :	**AFFIDAVIT OF DAVID L. ZIEGLER** **SS**

David L. Ziegler, of lawful age being first duly sworn, deposes and states:

1. My name is David L. Ziegler. I am Assistant Vice President – Arizona Public Policy for Qwest Services Corporation in Phoenix, Arizona. I have caused to be filed written testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

David L. Ziegler

SUBSCRIBED AND SWORN to before me this 6th day of September, 2005.

Notary Public

My Commission Expires: March 15, 2008

DEBORAH L. STATT
Notary Public – Arizona
Maricopa County
Expires 03/15/08

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-33
Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

JERROLD L. THOMPSON

DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

SEPTEMBER 6, 2005

TESTIMONY INDEX

Page

EXECUTIVE SUMMARY i

I. IDENTIFICATION OF WITNESS 1

II. PURPOSE OF TESTIMONY 2

III. SETTLEMENT AGREEMENT 3

IV. COMPETITIVE ZONES AND UNIVERSAL SERVICE FUNDS 4

V. OPERATION OF BASKETS 5

A. BASKET 1 5
B. BASKET 2 6
C. BASKET 3 7
D. BASKET 4 7

VI. PRICING 8

A. APRIL 1, 2005 PRODUCTIVITY ADJUSTMENT 8
B. SWITCHED ACCESS 9
C. SPECIAL ACCESS 10
D. OPPORTUNITY FOR PRICE CHANGES 10
E. ALLOCATION OF OPPORTUNITY 11
F. OTHER PRICING PROVISIONS 1

VII. DEREGULATION OF VOICE MESSAGING AND BILLING & COLLECTION 1

VIII. CONCLUSION AND RECOMMENDATION 1

EXECUTIVE SUMMARY

My testimony provides a description of the pricing flexibility afforded Qwest by the terms and conditions of the Settlement Agreement and Price Plan negotiated by the parties. Under the terms of the Agreement, Qwest has agreed to price constraints, price reductions, and overall revenue constraints from rate increases in exchange for the opportunity to raise or adjust prices for its competitive services.

Telecommunications is a very complex and competitive business in many parts of Arizona. This Settlement Agreement and Price Plan are the product of thorough consideration and careful balancing of the complex issues raised by the parties to the Agreement which include the Commission Staff, Qwest, local competitors (Cox, MCI, Time Warner, and XO), customers (Department of Defense and All Other Federal Executive Agencies), and investors (AUIA). I recommend that the Commission approve the Settlement Agreement and the Price Plan as submitted by the Parties.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jerrold L. Thompson. My business address is Room 4740, 1801 California Street, Denver, CO.

Q. WHAT IS YOUR POSITION WITH QWEST AND WHAT ARE YOUR RESPONSIBILITIES?

A. My title is Executive Director of Retail Issues in Qwest Service Corporation's Public Policy organization. In that position I direct and coordinate the company advocacy in matters relating to the manner in which Qwest Corporation ("Qwest") is regulated for retail services. These matters include regulatory reform in dockets before commissions and changes to laws with state legislatures.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE?

A. I have a Bachelor of Arts Degree in English and a Master of Business Administration Degree with a concentration in Accounting, both from the University of New Mexico. I have a Master of Taxation Degree from the College of Business and the School of Law of the University of Denver. I hold an inactive certificate as a Certified Public Accountant from the states of New Mexico and Colorado. I began working for Mountain Bell (now Qwest) in 1979 and have held numerous positions in industry relations, finance and accounting, costing and pricing, and public policy.

1 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN ARIZONA?**

2 A. Yes. Although I have not filed testimony in this docket prior to this testimony, I
3 have provided testimony before the Arizona Corporation Commission
4 ("Commission") on several occasions in the past including the rate case in 1994
5 (E-1051-93-183) and the rate case in 2000 (T-0105B-99-0105).

6 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

7 A. My testimony is organized into four topics, Competitive Zones and Universal
8 Service, Operation of Baskets, Pricing and Deregulation of Voice Messaging and
9 Billing and Collection services.

10 **II. PURPOSE OF TESTIMONY**

11 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

12 A. My testimony addresses the agreement among Qwest Corporation ("Qwest"), the
13 Arizona Corporation Commission Utilities Division Staff ("Staff"), the Department
14 of Defense and All Other Federal Executive Agencies ("DOD"), the regulated
15 subsidiaries of MCI, Inc. ("MCI"), Time Warner Telecom of Arizona, LLC ("TW"),
16 the Arizona Utility Investors Association ("AUIA"), Cox Arizona Telcom, LLC
17 ("Cox"), and XO Communications Services, Inc. ("XO"), (collectively "the
18 Parties") to a settlement of the pending Qwest application for renewal of its Price
19 Cap Plan with modifications. Specifically, my testimony explains various aspects
20 of the proposed Settlement Agreement ("Agreement") and alternative form of
21 regulation plan ("the Plan") that is supported by the Parties as filed by Maureen

Scott, Staff attorney on August 23, 2005. My testimony discusses several aspects of the Plan in detail. My testimony, along with the testimonies of Qwest witnesses Mr. David Ziegler and Mr. Philip Grate, detail the reasons why the Commission should approve the Agreement and Plan as proposed by the Parties.

III. SETTLEMENT AGREEMENT

Q HOW DO YOU VIEW THE SETTLEMENT AGREEMENT?

A. In my view, the Agreement proposes a thoroughly considered and thoughtfully balanced plan of alternative regulation that includes targeted benefits for consumers, recognition of the increasingly competitive market for telecommunications services in Arizona, incentives for Qwest to offer new and different competitive consumer choices, resolution of complex accounting issues, elimination of certain legal disputes, reductions in rates for Qwest's services purchased by its customers and its competitors, and movement toward cost-saving reductions in regulatory requirements. In sum, the Plan is in the public interest and should be approved by the Commission.

Q. WHICH AREAS OF THE AGREEMENT AND PLAN DOES YOUR TESTIMONY ADDRESS?

A. My testimony discusses the areas of Pricing, Operation of the Service Baskets, and the mechanics of the Agreement and Plan. Mr. Ziegler addresses the consumer benefits that have been incorporated into the Agreement and Plan and

Mr. Grate's testimony discusses the financial and accounting aspects of the Agreement and Plan.

IV. COMPETITIVE ZONES AND UNIVERSAL SERVICE FUNDS

Q. IN ITS DIRECT TESTIMONY QWEST PROPOSED THE USE OF COMPETITIVE ZONES AND REQUESTED FUNDS FROM THE STATE UNIVERSAL SERVICE FUND. HOW ARE THOSE TWO ISSUES ADDRESSED IN THE SETTLEMENT AGREEMENT?

A. In the process of negotiation, Qwest agreed to withdraw its request for competitive zones and not renew its request during the term of the Plan (Agreement, Section 26). Qwest also agreed to withdraw its request for Arizona Universal Service funds and to decrease its allowable revenue limits by a pro-rata share of any amounts of federal or state universal service funds received during the term of the Plan (Agreement, Section 19).

Competitive zones were a controversial topic in the direct testimony in this proceeding with very disparate points of view. The elimination of this issue removes this controversy. Qwest will continue to price its services to consumers in sparsely-populated areas in the state in similar ways to consumers in the highly competitive areas of Phoenix and Tucson. In other words, whatever consumer friendly action Qwest takes to compete in Phoenix and Tucson will be enjoyed by its customers in all other parts of Arizona whether those areas have the same level of competition or not.

During the course of the negotiations, the Commission solicited comments from interested parties concerning rule changes proposed by the Arizona Local Exchange Carriers Association in Docket No. RT-00000H-97-0137, *In the Matter of Review and Possible Revision of the Arizona Universal Service Fund Rules*. In the spirit of compromise, and in recognition of the fact that the rules for the operation of the fund could change as a result of the above docket, Qwest agreed to withdraw its request for $64 million of funding in this proceeding. Qwest is participating in Docket No. RT-00000H-97-0137 and could potentially qualify for universal service funding during the first three years of the Plan in that rulemaking. Qwest has agreed however, that any additional funding for universal service during the first three years of the Plan, whether from the state or federal jurisdictions, would result in a pro-rata decrease to the revenue opportunity established in the Plan (Agreement, Section 19).

V. OPERATION OF BASKETS

A. BASKET 1

Q. PLEASE EXPLAIN HOW THE PLAN SEPARATES SERVICES INTO DIFFERENT CATEGORIES AND HOW BASKET 1 IS TREATED IN THE PLAN.

A. The Plan creates four categories, or "baskets", of services provided by Qwest. All tariffed and price listed services are categorized in one of the Baskets. Basket 1 contains those services that are termed "Hard capped", Basket 2 contains those services allowed Limited Price Flexibility and Basket 3 consists of

Flexibly Priced Competitive Services. Basket 4 includes tariffed wholesale services.

Basket 1 consists of basic services whose prices will not be allowed to increase over the three year term of the Plan. These services include primary line flat-rate service to residence and business customers, low use option service, toll restriction, exchange zone increment charges, residence non-published and non-listed service, telephone assistance programs, and other miscellaneous services (Agreement, Section 12 and Appendix A-1). Prices for these Basket 1 services may be reduced but they may not be increased during the three year term of the Plan.

B. BASKET 2

Q. HOW DOES THE PLAN REGULATE BASKET 2 SERVICES?

A. The Plan acknowledges that competition has increased in Arizona since the prior plan and that the Plan should recognize degrees of relaxation of regulation. As such, a number of services were reviewed and agreed upon as services for which a limited amount of price flexibility should be allowed. These services include discretionary services such as central office vertical features and some complex business services (Agreement Section 12, and Appendix A-2). Prices for these services may be increased, but no more than 25% per year, and no more than the established aggregate limits (see Opportunity for Price Change below).

C. BASKET 3

Q. HOW DOES THE PLAN REGULATE BASKET 3 SERVICES?

A. Basket 3, Flexibly-Priced Competitive Services, consists of services that have been accorded pricing flexibility or have been determined by the Commission to be competitive under Commission Rule R14-2-1108 (Agreement Section 12, and Appendix A-3). Basket 3 also includes new services and packages of services offered by Qwest.[1] Individual price increases for these services are not limited but the combined revenue increase opportunity for all services in this Basket is subject to the established limit (see Opportunity for Price Change below).

D. BASKET 4

Q. HOW DOES THE PLAN REGULATE BASKET 4 SERVICES?

A. Basket 4, Wholesale Services, contains services provided to other providers of service in Arizona. Local access services to long distance companies, interconnection services, services to pay phone providers, and other miscellaneous services are included in this category (Agreement Section 12, and Appendix A-4). The Plan requires that these services be capped at the tariffed or contract price levels for the three year term of the Plan, or until contracts are re-negotiated, or the FCC, the Commission or the courts determine that other prices are appropriate.

---

[1] As part of the Agreement, Qwest agrees to make individual elements of its packages available on an a la carte basis and that the price of a package shall be no higher than the sum of the highest price of its a la carte prices of the services available for the package.

The Plan does provide for a decrease in intrastate switched access prices. This provision is discussed in greater detail in the next section of my testimony.

VI. PRICING

A. APRIL 1, 2005 PRODUCTIVITY ADJUSTMENT

Q. WHAT WAS THE COMMISSION DECISION REGARDING THE APRIL 1, 2005 PRODUCTIVITY ADJUSTMENT FROM THE PRIOR PLAN?

A. In its Decision No. 67734, the Commission made the following statement:

> "We agree with RUCO that based on the terms of the current Price Cap Plan, and our holdings in Decision Nos. 66772 and 67047 that unless we approve a new Plan or terminate the current Plan, Qwest is required under the Continuation Clause of the Plan to make the April 1, 2005 productivity adjustment."

Further the Commission stated:

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

Q. HOW DOES THE AGREEMENT ADDRESS THESE COMMISSION DECISIONS?

A. The Parties agree that Qwest's obligation under Decision No. 67734 is satisfied by a $12 million reduction to the allowable revenue from price changes for the first year of the Plan (Agreement, Section 7). Without this provision, Qwest would otherwise have the opportunity to raise rates by an additional $12 million

the first year of the Plan. By reducing Qwest's opportunity to raise its rates, Qwest is being denied the opportunity to earn its fair rate of return for one year. $12 million is the one-year value of the productivity adjustment and therefore represents the "full value" of that adjustment as provided in the prior plan.

B. SWITCHED ACCESS

Q. WHAT IS THE SWITCHED ACCESS COMPONENT OF THE SETTLEMENT AGREEMENT?

A. The Commission determined that Phase I of the docket *In the Matter of the Investigation of the Cost of Telecommunications Access*, should be considered in conjunction with the renewed Plan. Thus, Docket No. T-00000D-00-0672 was consolidated with Docket No. T-01051B-03-0454. Under the Agreement, Qwest will make a $12 million (annualized) reduction to its switched access prices. Specifically, under the terms of this Agreement Qwest will reduce its Carrier Common Line rate for originating traffic from $0.006244 to $0.00, its Carrier Common Line rate for terminating traffic from $0.014153 to $0.00, and its Interconnection charge from $0.00245 to $0.00. The reduction in switched access revenue of $12 million is accompanied by price increases in other services for an equivalent amount of revenue as discussed in the Opportunity for Price Change section of my testimony. The Parties agree that the reduction in switched access prices satisfies the issue of Qwest's access rates for the three year term of the Plan (Agreement, Section 8).

C. SPECIAL ACCESS

Q. WHAT IS THE SPECIAL ACCESS COMPONENT OF THE SETTLEMENT AGREEMENT?

A. During the negotiations, Qwest agreed to provide, under the conditions of its Competitive Private Line Transport Services Tariff, a custom offer of intrastate DS-1 service that meets the specific needs of Parties to this Agreement. The offer is found as Attachment D to the Agreement. This offer, subject to the approval of the Agreement and Plan by the Commission, allows these and other similarly situated carriers a three-year volume-commitment arrangement at discounted prices (Agreement, Section 9).

D. OPPORTUNITY FOR PRICE CHANGES

Q. PLEASE EXPLAIN THE OPPORTUNITY FOR PRICE CHANGES THAT IS PART OF THE AGREEMENT AND PLAN.

A. Part of the Agreement, as described by Qwest witness Mr. Philip Grate, is the recognition that Qwest has an Arizona revenue deficiency of $31.8 million. The Parties to the Agreement have agreed that Qwest should be granted the opportunity to adjust certain of its rates during the term of the Plan to correct this deficiency. Because of the $12 million April 1, 2005 adjustment condition in the Plan, Qwest will not be allowed to increase its rates for services listed in Baskets 2 or 3 more than $31.8 in the first year of the Plan ($31.8 million less $12 million for the April 1, 2005 issue, plus $12 million to offset the switched access price

reduction). In the years following the first year of the Plan, the maximum amount allowed to Qwest would be a cumulative total of $43.8 million ($31.8 million revenue deficiency plus the $12 million to offset the switched access price reduction). It is the position of the Parties that this pricing flexibility results in just and reasonable rates for Qwest's intrastate operations (Agreement, Section 10).

E. ALLOCATION OF OPPORTUNITY

Q. THERE IS ALSO A PROVISION IN THE AGREEMENT THAT THE OPPORTUNITY FOR PRICE CHANGES IS FURTHER LIMITED BY AN ALLOCATION BETWEEN BASKET 2 AND BASKET 3 SERVICES. PLEASE ELABORATE.

A. The $31.8 million increased revenue opportunity during the first year of the Plan is allocated between Basket 2 and Basket 3 services such that no more than $1.8 million is allowed from Basket 2 services. For years 2 and 3, no more than a cumulative $13.8 million is allowed from Basket 2 services. The portion of the revenue opportunity not used for Basket 2 is allocated to Basket 3, Flexibly-Priced Competitive Services.

F. OTHER PRICING PROVISIONS

Q. WHAT OTHER PRICING PROVISIONS ARE INCLUDED IN THE PLAN?

A. Other provisions include agreement by the Parties that the Commission's rules on imputation do not need to be changed at this time and that Qwest be allowed to introduce promotional offerings upon one day notice to the Commission.

VII. DEREGULATION OF VOICE MESSAGING AND BILLING & COLLECTION

Q. WHAT RECOMMENDATION DOES THE PLAN HAVE FOR VOICE MESSAGING SERVICE AND BILLING AND COLLECTION SERVICES?

A. The Parties agree on deregulation of both Voice Mail Service and Billing and Collection Services. The Parties recommend that the Commission approve the deregulation of these services.

VIII. CONCLUSION AND RECOMMENDATION

Q. COULD YOU PLEASE PROVIDE YOUR CONCLUSION AND RECOMMENDATION TO THE COMMISSION?

A. The Agreement and Plan presented to the Commission contain many benefits. Several consumer benefits are described by the testimony of Mr. Ziegler. The benefits my testimony covers range from price stability for basic residence and business consumers, sharing competitive incentives with both urban and rural customers, foregoing revenue increases for the first year of the Plan (for the April

2005 adjustment), reducing switched access rates for long distance carriers, offering term and volume discounts for competitive special access services, limiting price increases for all three years of the Plan, and getting promotional discounts to customers quicker. The Plan is very comprehensive in its design and is supported by all of the signing Parties. I recommend that the Commission approve the Plan as presented.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**
STATE OF COLORADO COUNTY OF DENVER	) :	**AFFIDAVIT OF JERROLD L. THOMPSON** **SS**

Jerrold L. Thompson, of lawful age being first duly sworn, deposes and states:

1. My name is Jerrold L. Thompson. I am Executive Director of Retail Issues for Qwest Services Corporation in Denver, Colorado. I have caused to be filed written testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Jerrold L. Thompson

Jerrold L. Thompson

SUBSCRIBED AND SWORN to before me this 31st day of August, 2005.

Catherine I. Hansen

Notary Public

My Commission Expires: _____

CATHERINE I. HANSEN NOTARY PUBLIC STATE OF COLORADO

My Commission Expires July 25, 2008

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-34 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	))))	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)))))	**DOCKET NO. T-00000D-00-0672**

PHILIP E. GRATE

DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

SEPTEMBER 6, 2005

PUBLIC VERSION

TESTIMONY INDEX

Page

EXECUTIVE SUMMARY I

I. IDENTIFICATION OF WITNESS 1

II. PURPOSE OF TESTIMONY 1

III. STIPULATED COST-OF-SERVICE ISSUES 2

IV. STIPULATED JURISDICTIONAL ACCOUNTING ISSUES 6

A. Stipulation on Accounting for Internal-Use Software 6
B. Stipulation on Accounting for OPEBs 7
C. Stipulation on Accounting for Depreciation 9

V. STIPULATED RATE OF RETURN ON ORIGINAL COST RATE BASE 11

VI. UNSTIPULATED RATEMAKING ADJUSTMENTS 11

VII. EXPANDED REPORTING OBLIGATIONS 12

VIII. EXPANDED RENEWAL OBLIGATIONS 13

EXECUTIVE SUMMARY

In reaching an Agreement, the parties stipulated to the amount of the fair value rate base, the rate of return on fair value rate base, the incremental revenue requirement (revenue deficiency) and the regulatory accounting Qwest is to use in future Arizona ratemaking to account for depreciation, other post-employment benefits and internal use software. The depreciation lives and methods that the Agreement prescribes reduce Qwest's test year depreciation expense 57% and will continue to be used in the future. Agreement on these key ratemaking and regulatory accounting issues allowed the parties to settle and avoid possibly protracted litigation. The revenue deficiency amounts that the parties advocated and that the Agreement stipulates are as follows:

Qwest	RUCO	Staff	Agreement
$355.4 million	$159.5 million	$3.5 million	$31.8 million

Qwest has agreed to expanded reporting obligations whereby it will provide Staff separated results of operations annually. Qwest also agreed to file a rate case if its application for extension, renewal or termination of the Renewed Price Cap Plan contemplates increasing Arizona intrastate revenues more than a de minimis amount above the increased revenues that the parties agreed upon as part of this Agreement and that are permitted by the Renewed Price Cap Plan.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

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

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT?

A. This testimony addresses the agreement among Qwest Corporation ("Qwest"), the Arizona Corporation Commission Utilities Division Staff ("Staff"), the Department of Defense and All Other Federal Executive Agencies, the regulated subsidiaries of MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Utility Investors Association, Cox Arizona Telcom, LLC, and XO Communications Services, Inc., (collectively "the Parties") to a Settlement Agreement ("Agreement") of the pending Qwest application for renewal of its current Price Cap Plan with modifications. Specifically I describe and explain the portions of the Agreement that pertain to cost-

of-service ratemaking issues, Arizona jurisdictional accounting and reporting issues, and filing for renewal.

III. STIPULATED COST-OF-SERVICE ISSUES

Q. DID THE PARTIES STIPULATE TO COST-OF-SERVICE ISSUES IN THE AGREEMENT?

A. Yes. The parties stipulated to the following cost-of-service issues:

- Fair Value Rate Base
- Rate of Return on Fair Value Rate Base
- Revenue Deficiency
- Jurisdictional accounting for Software, OPEBs, and Depreciation.

Q. WHY DOES THE AGREEMENT PROVIDE FOR SPECIFIC RESOLUTION OF THESE ISSUES AND NOT OTHERS?

A. In testimony, Staff argued that Qwest should agree to disagree on any number of ratemaking issues that do not impact the overall level of rate relief sought by Qwest and that Qwest should narrow the scope of the case to address only those issues that actually require a Commission finding to successfully conclude the proceeding.[1] The Agreement accomplishes this objective. It stipulates to those issues of ratemaking—rate base, rate of return and incremental revenue requirement (revenue deficiency)—upon which the Commission ordinarily makes findings of fact in rate cases, by agreeing on values but expressly not agreeing on treatment of a

[1] Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 4.

number of ratemaking issues. However, the Agreement does stipulate to the treatment of three accounting issues that require a Commission decision so as to make clear the Arizona jurisdictional accounting to be followed in the conduct of any future Qwest rate cases and to be used in expanded annual Arizona financial reporting that the Company has agreed to provide.

Q. WHAT DOES THE AGREEMENT PROVIDE WITH REGARD TO RATE BASE, RATE OF RETURN AND REVENUE DEFICIENCY?

A. In pertinent part, section 1 of the Agreement provides:

> "For ratemaking purposes, and in accordance with the terms of this Agreement, the Parties agree that the "fair value" of Qwest's Arizona rate base for the test year ending December 31, 2003 (the "Test Year") is $1,507,745,000. For ratemaking purposes and for purposes of this Agreement, the Parties agree that a reasonable return on the fair value of that rate base is 9.5%."

Section 2 of the Agreement provides:

> "For ratemaking purposes and in accordance with the terms of this Agreement, the Parties agree that Qwest's jurisdictional revenue deficiency is $ 31.8 Million." [footnote omitted]

Q. HOW DO THE AMOUNTS FOR RATE BASE, RATE OF RETURN AND REVENUE DEFICIENCY SET FORTH IN THE AGREEMENT COMPARE WITH THE POSITIONS OF THE PARTIES IN TESTIMONY?

A. The following table compares the amounts specified in the Agreement with the positions of those Parties that filed testimony concerning rate base, rate of return and revenue deficiency.

	Qwest	RUCO	Staff	Agreement
Original Cost:				
Rate Base	$1,717 M	$1,489 M	$1,560 M	NA
Rate of Return	11.18%	8.73%	9.50%	NA
Revenue Deficiency	$275.0 M	$159.5 M	$3.5 M	NA
Fair Value:				
Rate Base	$2,141 M	$2,285 M	$2,229 M	$1,508 M
Rate of Return	11.18%	5.69%	6.65%	9.50%
Revenue Deficiency	$355.4 M	$159.5 M	$3.5 M	$31.8 M

Q. HOW DID THE PARTIES ARRIVE AT THE AMOUNTS FOR FAIR VALUE RATE BASE, RATE OF RETURN AND REVENUE DEFICIENCY REFLECTED IN THE AGREEMENT?

A. The amounts in the Agreement reflect the Parties' compromise of the many contested issues in this case. The compromise was negotiated as an indivisible part of the overall agreement to settle. The parties did not stipulate any agreement on a

number of contested ratemaking issues in the case. I call these issues "unstipulated ratemaking issues" in recognition of the fact that the Parties have not resolved how such issues should be treated for ratemaking purposes—they have only compromised on aggregate settlement values.

Q. PLEASE EXPLAIN HOW THE REVENUE DEFICIENCY IDENTIFIED IN THE AGREEMENT DIFFERS FROM QWEST'S CALCULATION OF THE REVENUE DEFICIENCY.

A. The difference between the $355.4 million revenue deficiency that Qwest advocated in testimony and the $31.8 million revenue deficiency stipulated in the Agreement is $323.6 million. The following schedule quantifies the elements of the $323.6 million difference:

Stipulated jurisdictional accounting issues	$ (170.0) million
Stipulated rate of return on original cost rate base	$ (49.8) million
Unstipulated ratemaking issues	$ (103.8) million
Total revenue deficiency difference	$ (323.6) million

IV. STIPULATED JURISDICTIONAL ACCOUNTING ISSUES

A. Stipulation on Accounting for Internal-Use Software

Q. WHAT ISSUE REGARDING ACCOUNTING FOR INTERNAL-USE- SOFTWARE WAS CONTESTED IN THIS CASE?

A. The issue that Staff, Qwest and RUCO contested is whether accrual accounting for internal-use computer software in accordance with the American Institute of Certified Public Accountants' Statement of Position 98-1 (SOP 98-1) was incorporated into Arizona regulatory accounting and Qwest ratemaking in 1999 when the FCC incorporated SOP 98-1 into the Uniform System of Accounts (USOA). Qwest and RUCO testified that it was.[2] Staff's testimony argues that it was not and treats SOP 98-1 as adopted in the 2003 test year.[3]

Q. WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING FOR INTERNAL-USE- SOFTWARE?

A. The Agreement reflects a compromise of the parties' positions and assumes that SOP 98-1 was adopted at the beginning of the year 2001, the year in which Qwest's current Price Cap Plan became effective pursuant to Commission Decision No. 63487. Specifically, Section 3 of the Agreement provides:

---

[2] Docket No. T-01051B-03-0454: Direct Testimony of Marylee Diaz Cortez, page 6, line 20 to page 7, line 11; Rebuttal Testimony of Philip E. Grate, pages 23 through 32; Surrebuttal Testimony of Marylee Diaz Cortez, page 3, line 4 to line 16.

[3] Docket No. T-01051B-03-0454, Direct Testimony of Steven C. Carver; page 45, line 8 to page 56 line 2.

"[W]ith respect to calculating Qwest's rate base and revenue requirement, Qwest shall be treated as having adopted on January 1, 2001 the American Institute of Certified Public Accountants' Statement of Position 98-1 ("SOP 98-1") to account for the costs of internal use computer software, effective January 1, 2001."

Applying the assumptions employed in the Agreement instead of the assumptions Qwest and RUCO made with regard to this jurisdictional accounting issue reduces Qwest's calculated revenue requirement $30.6 million.[4] A schedule showing this revenue requirement effect is set forth in Qwest Corporation—Exhibit PEG-S01.

B. Stipulation on Accounting for OPEBs

Q. WHAT IS OPEBS?

A. OPEBs is an acronym for other post-employment benefits.

Q. WHAT ISSUE REGARDING ACCOUNTING FOR OPEBS WAS CONTESTED IN THIS CASE?

A. The issue that Staff, Qwest and RUCO contested is whether Qwest's use of accrual accounting for OPEBs under Statement of Financial Accounting No. 106 (SFAS 106) began for Arizona ratemaking purposes in 1999. Staff argues that it did.[5] Qwest and RUCO believe that it did not and that Qwest continues to operate under the

[4] The assumptions used to compute this amount include the 9.5% rate of return to which the parties agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.
[5] Docket No. T-01051B-03-0454, Direct Testimony of Steven C. Carver; page 56 line 4 to page 71, line 13.

cash (or "pay-as-you-go") method of accounting[6] that the Commission ordered Qwest to continue using in Qwest's last fully litigated rate case.[7]

Q. WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING FOR OPEBS?

A. The Agreement reflects a compromise of the parties' positions and assumes that SFAS 106 was adopted when Qwest's current Price Cap Plan became effective *concurrent with the effective date of Commission Decision No. 63487*, which was April 1, 2001. Specifically, Section 3 of the Agreement provides:

> "For settlement purposes, the Parties agree that with respect to calculating Qwest's revenue requirement, Qwest shall be treated as having adopted on April 1, 2001, Statement of Financial Accounting Standards ("SFAS") 106 to account for Other Post Employment Benefits ("OPEBs"), with a ten year amortization of Qwest's December 31, 2000 Accumulated Post-Retirement Benefit Obligation ("APBO") starting April 1, 2001."

Applying the assumptions employed in the Agreement instead of the assumptions Qwest and RUCO made with regard to this issue reduces Qwest's calculated revenue requirement $19.8 million.[8] The calculation of this revenue requirement effect is set forth in Qwest Corporation—Exhibit PEG-S01.

---

[6] Docket No. T-01051B-03-0454: Direct Testimony of Philip E. Grate, page 54, line 7 through page 56; Rebuttal Testimony of Philip E. Grate, pages 15 through 23; Surrebuttal Testimony of Marylee Diaz Cortez, page 8, line 1 to line 11.
[7] A.C.C. Decision No. 58927, page 7, lines 9 through 19 and page 40, line 20 through page 45, line 5.
[8] The assumptions used to compute this amount include the 9.5% rate of return to which the parties agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.

C. Stipulation on Accounting for Depreciation

Q. WHAT ISSUE REGARDING ACCOUNTING FOR DEPRECIATION WAS CONTESTED IN THIS CASE?

A. The issue that Staff, Qwest and RUCO contested is whether Qwest's depreciation rates should be based on the lives and survivor curves the Commission prescribed in Decision No. 62507 on May 4, 2000 in Qwest's last depreciation case[9] or on newly prescribed lives and survivor curves. Qwest[10] and RUCO[11] testified that the depreciation rates should reflect a technical update of the lives the Commission prescribed in Decision No. 62507 while Staff proposed the use of longer lives.[12]

Q. WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING FOR DEPRECIATION?

A. In pertinent part, Section 4 of the Agreement provides:

> "The Parties agree that Qwest will use the depreciation rates and amortizations shown on Attachment B. This results in approximately a $255 Million reduction in the annual intrastate depreciation expense for each year of the first five years, and approximately a $225 million annual reduction below the test year level in the intrastate depreciation expense thereafter."

The rates and amortizations shown on Attachment B reflect substantially longer projection lives than those the Commission prescribed in Qwest's last depreciation

[9] Docket No T-01051B-97-0689.
[10] Docket No. T-01051B-03-0454, Direct Testimony of Dennis Wu, page 2, lines 1 through 9.
[11] Docket No. T-01051B-03-0454, Direct Testimony of Marylee Diaz Cortez, page 23, lines 12 through 16.
[12] Docket No. T-01051B-03-0454, Direct Testimony of William A. Dunkel, page 27, line 18 to page 38, line 6.

case. The result of these longer lives and other changes to which Qwest agreed decrease Qwest's unadjusted 2003 test year Arizona intrastate depreciation expense by 57%. Qwest's use of the longer lives will be ongoing.

Q. HOW DOES THE DEPRECIATION EXPENSE REDUCTION PRESCRIBED BY THE AGREEMENT COMPARE WITH THE DEPRECIATION EXPENSE REDUCTION THAT STAFF PROPOSED IN TESTIMONY?

A. The following table sets forth the amount of Arizona intrastate depreciation expense change proposed by Qwest and Staff, and the amount prescribed by the Agreement.

Proposed Test Year Depreciation Expense Adjustment

Qwest	Staff	Agreement
($155) million	($253) million	($257) million

As the table shows, the Agreement calls for a $4 million greater reduction in depreciation expense than Staff proposed. The reduction in test year depreciation expense prescribed in the Agreement reduces Qwest's calculated revenue requirement $119.6 million.[13] A schedule showing this revenue requirement effect is set forth in Qwest Corporation—Exhibit PEG-S01.

[13] The assumptions used to compute this amount include the 9.5% rate of return to which the parties agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.

V. STIPULATED RATE OF RETURN ON ORIGINAL COST RATE BASE

Q. PLEASE EXPLAIN THE STIPULATED RATE OF RETURN ON ORIGINAL COST RATE BASE.

A. Arizona Administrative Code (A.A.C.) R14-2-4-103 calls for the filing of two different calculations of rate base, one on the original cost basis and one on a fair value basis. Using an 11.18% rate of return on its calculation of original cost rate base, Qwest calculated a revenue deficiency of $275.0 million. Substituting the 9.5% rate of return stipulated in the Agreement for the 11.18% that Qwest used reduces Qwest's calculated revenue deficiency by $49.8 million. A schedule showing this revenue requirement effect can be found in Qwest Corporation—Exhibit PEG-S01.

The 9.5% rate of return is the same as the rate of return Staff applied to its calculation of original cost rate base.

VI. UNSTIPULATED RATEMAKING ADJUSTMENTS

Q. PLEASE EXPLAIN THE UNSTIPULATED RATEMAKING ADJUSTMENTS.

A. Staff and Qwest contested a variety of ratemaking issues upon which they reached no stipulation or agreement. The parties reserve their right to contest these unstipulated ratemaking issues in any future Arizona ratemaking proceedings. Specifically, footnote 1 of the Agreement provides:

"The agreements set forth in Sections 1 and 2 regarding the quantification of fair value rate base, a reasonable rate of return and the amount of the revenue deficiency are made for purposes of settlement only. The Parties stipulate that the agreements regarding quantification of fair value rate base, a reasonable rate of return, revenue requirement, and revenue deficiency should not be construed as admissions against interest or waivers of litigation positions or claims by any Party relating to the calculation of these amounts. The Parties also stipulate that except as specifically set forth in Sections 3 and 4 of the Agreement, each Party reserves the right to pursue its advocacy in regard to any such controversy in other proceedings."

Sections 3 and 4 of the Agreement address the stipulated jurisdictional accounting issues, which the parties have agreed not to contest in future ratemaking proceedings. The difference between the Agreement's calculation of revenue requirement and Qwest's calculation of revenue requirement attributable to unstipulated ratemaking issues is $103.8 million. A schedule setting forth this revenue requirement effect can be found in Qwest Corporation—Exhibit PEG-S01.

VII. EXPANDED REPORTING OBLIGATIONS

Q. DOES THE SETTLMENT AGREEMENT EXPAND QWEST'S FINANCIAL REPORTING OBLIGATIONS?

A. Yes. In pertinent part, Section 3 of the Agreement provides:

"The Parties agree that Qwest will provide Staff with a confidential copy of its year-to-date December 1990s report for Arizona, prepared in the normal course of business, or any substantively identical replacement. Qwest will provide this report at the same time it files its annual report with the Commission. Staff will treat the 1990s report as confidential, the same treatment required under Commission rules for its annual report."

Qwest Corporation—Confidential Exhibit PEG-S02 provides examples (showing calendar years 2001 through 2004) of the annual reporting that Qwest will provide in accordance with Section 3 of the Agreement.

Q. WHY IS THE PROVISION OF THE 1990S REPORT FOR ARIZONA AN EXPANSION OF QWEST'S REPORTING OBLIGATIONS?

A. The 1990's report provides separated results of operations. The Commission's rules do not call for the regular periodic filing of separated results of operations. Qwest does not routinely provide this information except as part of a rate case filing under A.A.C. R14-2-103.

VIII. EXPANDED RENEWAL OBLIGATIONS

Q. DOES THE SETTLMENT AGREEMENT EXPAND QWEST'S OBLIGATIONS WITH REGARD TO THE FILING OF AN APPLICATION FOR EXTENSION, REVISION OR TERMINATION OF THE PLAN?

A. Yes. At Section 18, the Agreement contains essentially all of the filing requirements for extension, revision or termination of the Renewed Price Cap Plan that are found in Qwest's current Price Cap Plan. However, the Agreement also adds a new obligation to file a rate case under certain circumstances. In pertinent part, Section 18 of the Agreement provides:

> "Qwest shall initiate extension, revision or termination of the Renewed Price Cap Plan by submitting an application to the Commission for review by the

1 Commission, Staff, RUCO, and any other interested parties at least 9 months
2 prior to the expiration of the Renewed Price Cap Plan. Qwest shall serve its
3 application upon all Parties to this Settlement Agreement.

4 If Qwest's application is for an extension, revision or termination that would
5 increase Arizona regulated revenues in aggregate by more than a de minimis
6 amount, then Qwest shall file a rate case under A.A.C. R-14-2-103, at least 9
7 months prior to the expiration of the Renewed Price Cap Plan. The timeframes
8 established herein for filing shall not alter Commission rules (A.A.C. R14-2-103)
9 with respect to processing times. The procedural rules and timeframes
10 established under A.A.C. R14-2-103 §§ 7 through 11 thereof shall apply."

11 The current Price Cap Plan includes no requirement to file a rate case. The Revised
12 Price Cap Plan does in cases where Qwest's application for an extension, revision
13 or termination would increase Arizona regulated revenues in aggregate by more
14 than a de minimis amount above the increased revenues that the parties agreed
15 upon as part of this Agreement and that are permitted by the Renewed Price Cap
16 Plan.

17 **Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?**

18 A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

PHILIP E. GRATE

EXHIBITS OF

DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

SEPTEMBER 6, 2005

INDEX OF EXHIBITS

DESCRIPTION	EXHIBIT
Schedule showing the elements of revenue requirement representing the difference between Qwest's position in testimony and the Agreement.	PEG-S01
Confidential copy of Qwest's year-to-date December 1990s report for Arizona for the years 2001, 2002, 2003 and 2004 modified to reflect ratemaking adjustments for accounting for OPEBs and internal-use software as stipulated in the Agreement and further modified to include ratemaking adjustments for a $72 million directory revenue imputation and for state and local taxes.	PEG-S02

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Exhibit PEG-S01

Calculation of the elements of revenue requirement representing the difference between Qwest's position in testimony and the Settlement Agreement.

1) Detail of Differences:
($ 000's)

Ln	Adjustment #	Adjustment Description	Qwest Revised Revenue Requirement Per Settlement	Qwest (1) Revenue Requirement Per Testimony	Difference Between Qwest Position in Testimony vs the Settlement Agreement	Running Total RevReq
			A	B	C=A-B	D=D1 + Sum C
1	Total	Total Revenue Requirement (Rejoinder Testimony of Philip E. Grate pg 21)				355,449
2						
3	Per Books	Per Books Revenue Requirement at Qwest 11.18% ROR	417,448	417,448	-	355,449
4	All	Effect of Stipulated ROR of 9.50% on Original Cost Rate Base	(49,757)		(49,757)	305,692
5	PFA-02	PFA-02 Post Employment Benefits Other Than Pensions	23,397	43,239	(19,842)	285,849
6	PFA-03	PFA-03 REVISED SOP98 Adoption	(13,010)	17,608	(30,618)	255,231
7	PFA-01 & PFN-11	PFA-01 Depreciation and PFN-11 Depreciation Synchronization	(262,780)	(143,180)	(119,600)	135,632
8						
9	All Other	Net of all issues not stipulated in Settlement Agreement	(83,497)	20,335	(103,832)	31,800
10	Sum Lns 3 thru 9	**Revenue Requirement Proposal**	31,800	355,449	(323,649)	**31,800**

(1) Qwest Revenue Requirements for PFA-01, PFA-02, PFA-03 and PFN-11 are sourced from Exhibit PEG-RJ05 in Rejoinder Testimony of Philip E. Grate, but revised to reflect Staff factors for ROR and Revenue Multiplier. This avoids a double count of differences due to Staff factors already included in Ln 6

2) Summary of Differences (Summary of Column C in Table 1):
($ Millions)

	Difference Between Qwest Position in Testimony vs the Settlement Agreement
Stipulated Jurisdictional Accounting Issues	(170.0)
Stipulated Rate of Return on Original Cost Rate Base	(49.8)
Unstipulated Ratemaking Issues	(103.8)
Total Revenue Deficiency Difference	(323.6)

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2001

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1201
VERSION 504

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	YTD BILLING & COLLECTION	MR YTD INTERSTATE OPERATIONS (E)	MR YTD INTRASTATE OPERATIONS (F=A-D-E)	JR YTD INTRASTATE OPERATIONS (G=F+B)
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 SELL,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 OPRS BEFORE TAXES (L5-L22)									
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									

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2001

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1201
VERSION 504

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	YTD BILLING & COLLECTION	MR YTD INTERSTATE OPERATIONS (E)	MR YTD INTRASTATE OPERATIONS (F=A-D-E)	JR YTD INTRASTATE OPERATIONS (G=F+B)
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 CONSTUCTION									
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)									
OTHER INVESTMENT DETAIL									
54 CUSTOMER DEPOSITS									
55 AVG LAND DEVEL AGREE DEPOSITS									
56 AVG OTHER SPC CONSTR DEPOSITS									

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2001

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1201
VERSION 504

ACCOUNT DESCRIPTION	JR YTD PERCENT INTRASTATE (H=G/C)	Ratemaking Adjustment: Reverse Offbook SOP 98-1 (I)	Ratemaking Adjustment: Remove Pre-2001 SOP 98-1 (J)	Ratemaking Adjustment: Directory Imputation (K)	Ratemaking Adjustment: OPEB (L)	Ratemaking Adjustment: [blank] (M)	Adjusted JR YTD Intrastate Operations (N)=G+I+J+K+L+L
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 SELL,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 OPRS BEFORE TAXES (L5-L22)							
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							

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2001

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1201
VERSION 504

ACCOUNT DESCRIPTION	JR YTD PERCENT INTRASTATE (H=G/C)	Ratemaking Adjustment: Reverse Offbook SOP 98-1 (I)	Ratemaking Adjustment: Remove Pre-2001 SOP 98-1 (J)	Ratemaking Adjustment: Directory Imputation (K)	Ratemaking Adjustment: OPEB (L)	Ratemaking Adjustment: [blank] (M)	Adjusted JR YTD Intrastate Operations (N)=G+I+J+K+L
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 CONSTUCTION							
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)							
OTHER INVESTMENT DETAIL							
54 CUSTOMER DEPOSITS							
55 AVG LAND DEVEL AGREE DEPOSITS							
56 AVG OTHER SPC CONSTR DEPOSITS							

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2002

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1202
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	YTD BILLING & COLLECTION	MR YTD INTERSTATE OPERATIONS (E)	MR YTD INTRASTATE OPERATIONS (F=A-D-E)	JR YTD INTRASTATE OPERATIONS (G=F+B)
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 SELL,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 OPRS BEFORE TAXES (L5-L22)									
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									

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2002

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1202
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	YTD BILLING & COLLECTION	MR YTD INTERSTATE OPERATIONS (E)	MR YTD INTRASTATE OPERATIONS (F=A-D-E)	JR YTD INTRASTATE OPERATIONS (G=F+B)
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 CONSTUCTION									
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)									
OTHER INVESTMENT DETAIL									
54 CUSTOMER DEPOSITS									
55 AVG LAND DEVEL AGREE DEPOSITS									
56 AVG OTHER SPC CONSTR DEPOSITS									

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2002

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1202
VERSION 505

ACCOUNT DESCRIPTION	JR YTD PERCENT INTRASTATE (H=G/C)	Ratemaking Adjustment: Reverse Offbook SOP 98-1 (I)	Ratemaking Adjustment: Remove Pre-2001 SOP 98-1 (J)	Ratemaking Adjustment: Directory Imputation (K)	Ratemaking Adjustment: OPEB (L)	Ratemaking Adjustment: [blank] (M)	Adjusted JR YTD Intrastate Operations (N)=G+I+J+K+L+L
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 SELL,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 OPRS BEFORE TAXES (L5-L22)							
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							

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2002

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1202
VERSION 505

ACCOUNT DESCRIPTION	JR YTD PERCENT INTRASTATE (H=G/C)	Ratemaking Adjustment: Reverse Offbook SOP 98-1 (I)	Ratemaking Adjustment: Remove Pre-2001 SOP 98-1 (J)	Ratemaking Adjustment: Directory Imputation (K)	Ratemaking Adjustment: OPEB (L)	Ratemaking Adjustment: [blank] (M)	Adjusted JR YTD Intrastate Operations (N)=G+I+J+K+L+L
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 CONSTUCTION							
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)							
OTHER INVESTMENT DETAIL							
54 CUSTOMER DEPOSITS							
55 AVG LAND DEVEL AGREE DEPOSITS							
56 AVG OTHER SPC CONSTR DEPOSITS							

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2003

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1203
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	YTD BILLING & COLLECTION	MR YTD INTERSTATE OPERATIONS (E)	MR YTD INTRASTATE OPERATIONS (F=A-D-E)	JR YTD INTRASTATE OPERATIONS (G=F+B)
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 SELL,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 OPRS BEFORE TAXES (L5-L22)									
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									

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2003

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1203
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	YTD BILLING & COLLECTION	MR YTD INTERSTATE OPERATIONS (E)	MR YTD INTRASTATE OPERATIONS (F=A-D-E)	JR YTD INTRASTATE OPERATIONS (G=F+B)
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 CONSTUCTION									
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)									
OTHER INVESTMENT DETAIL									
54 CUSTOMER DEPOSITS									
55 AVG LAND DEVEL AGREE DEPOSITS									
56 AVG OTHER SPC CONSTR DEPOSITS									

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2003

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1203
VERSION 505

0

ACCOUNT DESCRIPTION	JR YTD PERCENT INTRASTATE (H=G/C)	Ratemaking Adjustment: Reverse Offbook SOP 98-1 (I)	Ratemaking Adjustment: Remove Pre-2001 SOP 98-1 (J)	Ratemaking Adjustment: Directory Imputation (K)	Ratemaking Adjustment: OPEB (L)	Ratemaking Adjustment: [blank] (M)	Adjusted JR YTD Intrastate Operations (N)=G+I+J+K+L+L
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 SELL,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 OPRS BEFORE TAXES (L5-L22)							
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							

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2003

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1203
VERSION 505

ACCOUNT DESCRIPTION	JR YTD PERCENT INTRASTATE (H=G/C)	Ratemaking Adjustment: Reverse Offbook SOP 98-1 (I)	Ratemaking Adjustment: Remove Pre-2001 SOP 98-1 (J)	Ratemaking Adjustment: Directory Imputation (K)	Ratemaking Adjustment: OPEB (L)	Ratemaking Adjustment: [blank] (M)	0 Adjusted JR YTD Intrastate Operations (N)=G+I+J+K+L+L
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 CONSTUCTION							
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)							
OTHER INVESTMENT DETAIL							
54 CUSTOMER DEPOSITS							
55 AVG LAND DEVEL AGREE DEPOSITS							
56 AVG OTHER SPC CONSTR DEPOSITS							

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2004

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

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	YTD BILLING & COLLECTION	MR YTD INTERSTATE OPERATIONS (E)	MR YTD INTRASTATE OPERATIONS (F=A-D-E)	JR YTD INTRASTATE OPERATIONS (G=F+B)
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 SELL,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 OPRS BEFORE TAXES (L5-L22)									
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									

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2004

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

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	YTD BILLING & COLLECTION	MR YTD INTERSTATE OPERATIONS (E)	MR YTD INTRASTATE OPERATIONS (F=A-D-E)	JR YTD INTRASTATE OPERATIONS (G=F+B)
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 CONSTUCTION									
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)									
OTHER INVESTMENT DETAIL									
54 CUSTOMER DEPOSITS									
55 AVG LAND DEVEL AGREE DEPOSITS									
56 AVG OTHER SPC CONSTR DEPOSITS									

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2004

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

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

Yr 2004

ACCOUNT DESCRIPTION	JR YTD PERCENT INTRASTATE (H=G/C)	Ratemaking Adjustment: Reverse Offbook SOP 98-1 (I)	Ratemaking Adjustment: Remove Pre-2001 SOP 98-1 (J)	Ratemaking Adjustment: Directory Imputation (K)	Ratemaking Adjustment: OPEB (L)	Ratemaking Adjustment: FCC Dereg (Part X) Tax Allocation (M)	Adjusted JR YTD Intrastate Operations (N)=G+I+J+K+L+L
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 SELL,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 OPRS BEFORE TAXES (L5-L22)							
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							

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2004

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

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

Yr 2004

ACCOUNT DESCRIPTION	JR YTD PERCENT INTRASTATE (H=G/C)	Ratemaking Adjustment: Reverse Offbook SOP 98-1 (I)	Ratemaking Adjustment: Remove Pre-2001 SOP 98-1 (J)	Ratemaking Adjustment: Directory Imputation (K)	Ratemaking Adjustment: OPEB (L)	Ratemaking Adjustment: FCC Dereg (Part X) Tax Allocation (M)	Adjusted JR YTD Intrastate Operations (N)=G+I+J+K+L+L
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 CONSTUCTION							
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)							
OTHER INVESTMENT DETAIL							
54 CUSTOMER DEPOSITS							
55 AVG LAND DEVEL AGREE DEPOSITS							
56 AVG OTHER SPC CONSTR DEPOSITS							

REDACTED

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-35 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

JERROLD L. THOMPSON

REBUTTAL TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

OCTOBER 28, 2005

TESTIMONY INDEX

Page

EXECUTIVE SUMMARY i

I. IDENTIFICATION OF WITNESS 1

II. PURPOSE OF TESTIMONY 1

III. SUMMARY 1

IV. OMISSIONS 2

V. ERRORS 9

VI. COMPETITIVE RECLASSIFICATION 17

VII. "CERTAIN PROBLEMS" 19

VIII. CONCLUSION AND RECOMMENDATION 21

EXECUTIVE SUMMARY

My testimony explains why the responsive testimony of Dr. Johnson is counter-factual and misleading. My testimony details why Dr. Johnson's testimony does not reflect a thorough understanding of the specifics of the settlement and the proposed Price Plan. I explain how he bases his conclusions on misunderstandings and assumptions that are not accurate. I list his omissions of critical aspects of the settlement and the proposed Price Plan which further his view that the proposed Price Plan does not provide increased levels of regulation over Qwest. I respond to Dr. Johnson's inaccurate critique that the Price Plan does not include broad policy issues such as universal service funding and geographic issues. I conclude that Dr. Johnson's responsive testimony offers very little to the Commission due to its inaccuracy and erroneous conclusions and should be disregarded.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jerrold L. Thompson. My business address is Room 4740, 1801 California Street, Denver, CO.

Q. ARE YOU THE SAME JERROLD L. THOMPSON THAT PROVIDED DIRECT TESTIMONY ON SEPTEMBER 6, 2005?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My testimony responds to the testimony of RUCO witness Ben Johnson, Ph.D. filed October 14, 2005.

III. SUMMARY

Q. CAN YOU PROVIDE A SUMMARY OF YOUR RESPONSE TO DR. JOHNSON'S TESTIMONY?

A. Yes. Dr. Johnson's testimony has numerous omissions and errors that provide the foundation for his conclusion and recommendation to the Commission. He stresses several industry policy matters that cannot be reasonably resolved in the context of a Qwest-only rate proceeding such as this one. Nevertheless, the majority of these

issues have been considered in the details of the proposed Price Plan and are not the obstacles that Dr. Johnson alleges they are. As a result of these serious deficiencies, his conclusions and recommendations are not based in fact and should be disregarded by the Commission. My rebuttal testimony identifies and discusses these omissions, errors and mischaracterizations and recommends that the Commission approve the settlement and Price Plan as presented.

IV. OMISSIONS

Q. WHAT IS THE MOST OBVIOUS OMISSION FROM DR. JOHNSON'S DISCUSSION OF THE SETTLEMENT PROPOSAL?

A. The most obvious omission is his disregard for the revenue requirement aspect of this case. A significant number of the controversial issues in this case involved different views on the level of Qwest's revenue deficiency and the rate changes corresponding to that deficiency to allow the required finding by the Commission of a fair value rate base and a reasonable rate of return.[1] Approximately 25% of the settlement agreement resolves the revenue deficiency issues between Staff and Qwest.

[1] In its earlier Order in this proceeding, the Arizona Corporation Commission (Decision No. 66772) found that: "The Commission cannot order termination of the Plan, or adopt a modified Plan without making a finding of fair value and a determination that the rates adopted therein are just and reasonable. Whether the Commission and Qwest ultimately continue under some sort of Price Cap Plan, or whether we return to traditional rate of return regulation, the commission must make a finding of fair value and Qwest must provide whatever information is necessary to make such a determination."

Integral to the issue of revenue deficiency is the determination of just and reasonable rates. Since the settlement has an agreed upon revenue deficiency, the issue of which rates need to be increased to correct the deficiency must be addressed in some fashion. The settlement solution to this requirement is a proposal for a limited and monitored revenue opportunity for Qwest to be allowed price changes of its non-hard capped services, should it choose to do so over the next few years. It is the parties' view that the proposed opportunity for Qwest to recover the revenue deficiency "results in just and reasonable rates".[2]

The omission by Dr. Johnson of this important aspect of the case results in his erroneous conclusion that Qwest focused its "negotiating efforts on trying to obtain policy changes that will result in increased rates...".[3] To the contrary, based on the Commission's position, the requirement to identify the revenue deficiency (if any), the constitutional requirement for a finding of fair value in Qwest's rate base, and the finding of just and reasonable rates all require the inclusion of these issues and the determination of price levels during the Price Plan.

Q. DR. JOHNSON TAKES ISSUE WITH THE RE-CLASSIFICATION OF CERTAIN SERVICES PREVIOUSLY IN BASKET 1. DID HE NEGLECT TO DISCUSS THE MOVEMENT OF SERVICES INTO THE PRICE CAP CATEGORY?

---

[2] Settlement Agreement Section 1.

[3] Ben Johnson, Ph. D, Supplemental Testimony in Opposition to Qwest's Settlement Agreement, October 14, 2005, p.22, lines 5-6.

A. Yes, those services were not discussed by Dr. Johnson. Under Qwest's current Price Plan, certain services are subject to a hard price cap. Those services are: flat rated residential and business service; multi-party service; residence and business exchange zone-increment charges; low use option service; service-station service; telephone assistance programs; individual PBX trunks including features; caller identification blocking service; long distance blocking service; 900 blocking service; and the basic listing service.[4] There are other services contained in Basket 1 in the current Price Plan, but those services are not hard capped. Prices for those services are limited to annual increases of no more than 25%.[5] (I have prepared exhibit JLT-1 that details the services in the hard price cap category on page 1 and the 25% Price Flex category on page 2 of that exhibit.) In the analysis of changes in classification of service from the current Price Plan, two services can be excluded. Those are multiple party service which no longer is offered and 900 blocking which has no recurring price (i.e., a free service). With the exception of PBX trunks and additional lines, all of the remaining services **continue to be hard capped** in the proposed Price Plan. What Dr. Johnson failed to note is that six services have been moved from the current Price Plan 25% Price Flex category to the hard capped category in the proposed Price Plan. Those services are E911, Emergency Transport Backup service, Disaster Recovery service, 10xxx blocking service, non-published listing service, and non-listed service. The addition of price caps for these

[4] Attachment A, 2(c)(i).
[5] Attachment A, 2(c)(iii).

1 services is considered an additional consumer benefit included in the Price Plan. Dr.
2 Johnson's omission of this fact unfairly characterizes the value of the Price Plan to
3 Arizona consumers.

4 **Q. DOES DR. JOHNSON GENERALLY DISREGARD THE CONSUMER BENEFITS**
5 **THAT ARE INCLUDED IN THE SETTLEMENT?**

6 A. Dr. Johnson takes no recognition of the numerous consumer benefits that are
7 included in the settlement and proposed Price Plan. In fact, he makes the statement
8 that "...the proposed Price Plan includes very few, if any, changes which would
9 benefit residential and other mass market customers."[6] In addition to the hard
10 capped services discussed above, there are multiple additional consumer benefits
11 included in the proposed Price Plan.

12 The proposed Price Plan includes ***targeted*** consumer benefits of approximately $5.5
13 million each year of the three year Price Plan (or a total of **$16.5 million**).
14 Residential and small business customers outside urban areas that currently pay
15 zone-increment charges will receive a **50% reduction** in those rates upon
16 implementation of the proposed Price Plan which then are capped at those reduced
17 rates for the Price Plan period.[7] This will result in an annual benefit to consumers
18 and a reduction in revenue to Qwest of $2 million. Residential customers that
19 subscribe to non-published and non-listed telephone number services will receive a

[6] Johnson, p.2, lines 20-21.

[7] Dr. Johnson's testimony (at p.10, line 22 and p.13, line 11) is incorrect that the zone-increment rates for additional lines are not price capped. All zone-increment services are found in Basket 1 of the proposed Price Plan.

1 **30% and 38% discount** (respectively) for a total annual benefit of $2.5 million.
2 Qualified medically needy residential customers will receive **an additional $1**
3 **million in assistance** toward payment of their telephone bills each year of the
4 proposed Price Plan. Improving consumer benefits of the current Price Plan, rural
5 residential customers receive a **67% increase in the amount they are credited** for
6 construction of new services to their homes (from $3000 to $5000). Likewise, the
7 current Price Plan benefit for Directory Assistance consumers is carried over to the
8 proposed Price Plan where users of this competitive service receive **one free call**
9 **per month, two inquiries, and optional call completion at a below-market**
10 **capped rate of $1.15 per month**. In addition, in contrast to the many non-
11 telephony consumer prices that are increasing and likely to increase over the next
12 three years, prices for what the settlement considers as Qwest's most consumer
13 sensitive services are not allowed to increase during the term of the proposed Price
14 Plan. Not only does this provide price stability for consumers but places the risk of
15 inflation[8] upon Qwest because it has also agreed to forego its right to file a rate case
16 for the next three years.

17 The total amount of revenue that Qwest may seek through price increases is limited
18 to the revenue deficiency that existed in the historical test year. To the extent that
19 revenue declines further due to competition, or that price increases cause declines
20 in demand, Qwest will be unable to recover further revenue deficiencies during the

[8] In contrast to Dr. Johnson (p.21, line 17) many of Qwest's costs continue to increase: the cost of its labor will increase

1 period of the proposed Price Plan because of the agreed upon rate case
2 moratorium.

3 In addition to the targeted price-related consumer benefits, Qwest is subject to
4 service quality standards and **potential consumer bill credits** should Qwest fail to
5 meet the standards in the settlement agreement.

6 **Q. ARE THERE OTHER CONSUMER BENEFITS THAT HAVE BEEN OMITTED BY**
7 **DR. JOHNSON?**

8 A. Yes. The settlement agreement contains resolutions to two issues that will
9 encourage more competition in Arizona. First, Qwest has offered an individual case
10 basis agreement that has been tailored to competitive local exchange carrier's
11 special business needs that will **facilitate increased competition** in the Phoenix
12 and Tucson markets. XO Communications Services, Inc.'s witness Rex Knowles
13 believes the settlement "strikes a reasonable balance between the interests of
14 Qwest, the need for competitive product rate stability, and consumer needs".[9]

15 Second, although Dr. Johnson acknowledges that this docket includes an
16 investigation of the price of Qwest's switched access rates,[10] his current background
17 summary does not acknowledge the Commission's concern about the competitive
18 effect of higher prices of intrastate switched access compared to similar interstate

---

7.5% over the next three years; health care benefits continue to increase; fuel costs are expected to increase; interest rates are expected to increase; etc.

[9] Direct Testimony of Rex Knowles, September 6, 2005, p.3, lines 21-23.

1 services. And although he admits that it is "feasible" to implement changes to
2 Qwest's switched access rates, Dr. Johnson turns the Commission's concern on its
3 head by expressing his view that reductions in Qwest's intrastate switched access
4 make "it less profitable for competitive local exchange carriers to serve high cost
5 rural areas, without making any improvements to the structure of the existing USF
6 mechanism".[11] As the leading proponent for increasing competition through
7 switched access price changes in this proceeding (and its predecessor's), MCI
8 witness Don Price testifies that the switched access reduction included in the
9 settlement "is an appropriate compromise that results in **meaningful intrastate**
10 **switched access reductions**", and that MCI considers the settlement overall "is in
11 the public interest from its perspective".[12]

12 **Q. ARE THERE OTHER GENERAL BENEFITS OF THE PRICE PLAN THAT ARE**
13 **OMITTED BY DR. JOHNSON?**

14 A. There are two benefits that were not discussed by Dr. Johnson, although they are
15 mentioned by several of the witnesses. The first is that the settlement allows for
16 streamlining of regulatory processes for Qwest to allow movement toward the same
17 regulation that is applied to its competitors. In spite of Dr. Johnson's admission that
18 "Qwest has been experiencing substantial market share losses in Phoenix and
19 Tucson" and "competitors have been quite successful in winning customers" in some

---

[10] Although Dr. Johnson takes administrative recognition of the docket consolidation, p.4-5, he disagrees with switched access reductions without "improvements" in universal service funding, p.23.
[11] Dr. Johnson, p.20, lines 9-11.
[12] Supplemental Direct Testimony, Don Price September 6, 2005, p.5.

markets,[13] he does not give credit to the provisions in the settlement and Price Plan that move regulation of Qwest more toward that of its competitors. The provision whereby Qwest is allowed to shorten its notice time for promotions of its products will encourage more competitive offers sooner. The Commission has previously recognized this type of change as beneficial.[14] The second is that the parties, the Commission and the state government in Arizona will benefit from the avoidance of lengthy litigation and the dismissal of the pending Consolidated Appeals. Should the Commission adopt Dr. Johnson's recommendation for rejection of the settlement, these benefits would not be realized.[15]

V. ERRORS

Q. IS DR. JOHNSON CORRECT THAT THE CLASSIFICATION OF ZONE INCREMENTS HAS BEEN CHANGED FROM HARD CAPPED TO NON-HARD CAPPED IN THE PROPOSED PRICE PLAN?

A. No. Zone increment services for both residential and business services will have prices reduced and be included in Basket 1 in the proposed Price Plan.

Q. IS DR. JOHNSON CORRECT THAT BASKET 2 REVENUES CAN INCREASE BY $43.8 MILLION BY INCREASING THE PRICE OF ADDITIONAL LINES IN THE PROPOSED PRICE PLAN?

---

[13] Dr. Johnson at p.17, lines 7-10.
[14] For example, see Decision No. 63487, p. 15, lines 2-3.
[15] See Dr. Johnson, p.23, lines21-23.

A. No. Dr. Johnson states that:

> "...In fact, under the proposed settlement, revenues from Basket 2 services can increase up to $43.8 million, so the additional line rates could immediately be increased by 25%, and Qwest could thereafter increase these prices by as much as 25% per year, until they reach monopoly profit-maximizing levels ("whatever the traffic will bear")."[16]

Dr. Johnson is incorrect. Additional line services are included in Basket 2, however, there are conditions on Basket 2 services in the proposed Price Plan that would not allow increases of $43.8 million.

In the current Price Plan, since the formula for Basket 1 does not allow overall revenue increases in the Basket, prices (rate elements) for some services can be increased as much as 25%, provided other rates would be decreased by an equal revenue amount.[17] In the proposed Price Plan, prices for services in Basket 2 may be increased as much as 25%[18], but only to the dollar limits imposed on services in that Basket. For the first year of the proposed Price Plan, **no more than $1.8 million** can be requested from Basket 2 services. For years 2 and 3, no more than $13.8 million can be requested from Basket 2 services.

In addition, Qwest must comply with A.A.C. R14-2-1109 for services in Basket 2. This means that Qwest, like its competitors, is required to request and obtain

---

[16] See Dr. Johnson, p.13, lines 7-10.

[17] In contrast to this current testimony, Dr. Johnson's Testimony filed November, 2004 provides a broader description of this condition, p.23-24.

[18] Dr. Johnson's November, 2004 testimony makes a distinction between prices for "services" and prices for "rate elements". His example distinguishes Custom Calling Services (what he calls a "service") and Call Waiting (what he calls a "rate element"). In Qwest's terminology what Dr. Johnson calls a "service" in his example is termed a tariff category and

1 Commission approval for minimum and maximum rates for services in Basket 2. If a
2 maximum price for additional lines is found to be acceptable by the Commission,
3 then any price change below the maximum price (and above the minimum price) is
4 allowed after notice. Qwest is also subject to provisions of A.A.C. R14-2-1110 which
5 requires Qwest, like its competitors, to submit an application to the Commission for
6 subsequent changes to the maximum rate.

7 The parties to the settlement, representing consumers, investors and competitors,
8 agree that the time is right to move regulation of Qwest toward the form of regulation
9 that the Commission uses for Qwest's competitors.

10 **Q. ARE THERE COMPETITIVE REASONS WHY THE AGREEMENT PROVIDES**
11 **LIMITED PRICING FLEXIBILITY FOR ADDITIONAL LINES?**

12 A. Yes. As discussed in more detail in Mr. David Teitzel's testimony, competition for
13 additional lines is strong and growing in Arizona. As indicated by the information
14 supplied by Mr. Teitzel, the number of Qwest's residential additional lines have
15 decreased more than 40% in the last few years. Consumers are dropping this
16 traditional service and using alternatives such as cell phones. As a further indication
17 of the level of competition for additional lines, Qwest has significantly reduced its
18 rates for additional lines.[19] In a high growth state such as Arizona, decreases in

---

what he calls a "rate element" is termed a service. To the extent the proposed Plan uses the term "services" it is meant to include all individual services offered under each tariff category identified in Attachments A-1, A-2, A-3 and A-4.

[19] For example, Qwest has reduced its residential additional line rate twice in the last few years for a total of nearly 25% through April 2004.

access lines and decreases in price are clear indications that numerous competitive choices for consumers exist.

Q. IS DR. JOHNSON CORRECT THAT THE PRICE CAP STATUS OF CALLER ID BLOCKING SERVICE IS CHANGED IN THE PROPOSED PRICE PLAN?

A. No. Dr. Johnson also is mistaken when he states that Caller ID Block is a service that was moved from a hard capped classification to a non-hard capped classification in Basket 2. In the current Price Plan, Caller ID Block is a hard capped Basket 1 service as shown in Appendix A-1, Basket 1 Non-Recurring Charges of the settlement agreement. Qwest offers two types of Caller ID Blocking service: per call and per line. Caller ID Block per call is a free service from Qwest and as such, the price cap designation is superfluous. Caller ID Block per line is a service that does not have a recurring charge, but rather has a non-recurring charge.[20] The non-recurring charge is a hard capped service in **both** the current Price Plan and the proposed Price Plan.

Q. IS DR. JOHNSON CORRECT THAT PBX TRUNKS ARE PROPOSED TO BE MOVED FROM THE CURRENT PRICE CAP CLASSIFICATION TO BASKET 2?

A. Yes. In the proposed Price Plan, PBX trunks are proposed to be moved from the current price cap designation to Basket 2, Limited Pricing Flexibility Retail Services. Analog PBX trunk services have been and continue to be a competitive business

[20] Per line blocking is provided free of charge to law enforcement and domestic violence agencies and individual victims of domestic violence upon request.

service which warrants decreased regulation.[21] The testimony of Mr. Teitzel discusses the robust competitiveness of PBX trunks including the number of competitors that provide the service in Arizona.

Q. DR. JOHNSON TAKES ISSUE WITH THE CLASSIFICATION OF PACKAGES OF LOCAL SERVICE IN THE PROPOSED PRICE PLAN. ARE HIS COMMENTS ACCURATE?

A. No. Dr. Johnson inaccurately depicts Qwest's ability to change prices for packages of local service. He states:

> "The limited degree of competition which currently exists for local exchange service is not sufficient to justify giving Qwest complete freedom to increase prices for these local exchange service packages."[22]

Dr. Johnson is incorrect. Qwest does not have complete freedom to increase prices for packages under the proposed Price Plan. There are several limitations and conditions on the pricing of packages. First, for new services Section 4 (a) says:

> "Any new services and new service packages offered by Qwest shall be subject to the prior review and approval of the Commission...".

This provision is unchanged from the current Price Plan and provides protection through expressed Commission approval.

---

[21] Qwest's PBX trunk services have declined nearly 50% over the last five years. See Teitzel p. 12.

[22] Dr. Johnson p. 14, lines 17-19.

Second, Section 4 (d) states that:

> "Qwest may include packaged offerings in Basket 3 under the Renewed Price Cap Price Plan subject to the conditions that each of the individual elements of packages must be available on an a la carte basis in Basket 1, 2 or 3 of the Renewed Price Cap Price Plan. The price of a package shall be no higher than the sum of the highest prices of its a la carte prices of the services available for the package."

The condition that Qwest offer the services available in the package at individual prices "a la carte" means that consumers can choose any or all of the package services at the individual service prices. While those prices may be increased under the Basket 2 conditions, those opportunities are limited as I have discussed. Further, the condition that the package price be no higher than the sum of the highest individual prices available in the package, provides additional price control on package pricing. Additionally, Section 4 (h) states:

> "All services and packages in Basket 3 shall continue to be offered statewide at price list rates, unless or until the Commission orders retail geographic rate deaveraging, or unless Qwest demonstrates a cost difference for a new service on which to base the price difference."

The effect of this condition in the proposed Price Plan is to limit Qwest's ability to geographically differentiate its Basket 3 services between areas in Arizona. This means that the price of a package, or any other Basket 3 service, in Phoenix is the same price as is offered at any other customer location in Arizona, until such time as the Commission allows retail deaveraging. This condition disproves Dr. Johnson's inaccurate assertion that "Qwest would be granted an excessive degree of pricing

flexibility in some of the markets where it faces relatively little competitive pressure...",[23] Qwest's package pricing would be the same in all Arizona markets via statewide pricing. Because of the requirement for statewide average pricing, even Dr. Johnson's view that "Qwest has been experiencing substantial market share losses in Phoenix and Tucson"[24] should provide the Commission assurance that through the statewide average pricing, all other communities in Arizona will benefit from the competitive pressures that exist in Phoenix and Tucson.

Q. HOW DOES THE PROPOSED PLAN DIFFER FROM DR. JOHNSON'S RECOMMENDATION WITH REGARD TO BASKETS AND PRICE FLEXIBILITY?

A. Dr. Johnson recommends three baskets: Moderate Pricing Flexibility, High Pricing Flexibility, and Total Pricing Flexibility. In spite of the terms used by Dr. Johnson the pricing flexibility in the Moderate and High Flexibility baskets doesn't exist. The Moderate basket appears to be similar to the current Price Plan Basket 1 with a price increase opportunity where the Gross Domestic Product Price Index (GDP-PI) exceeds 4.2%, and is limited to 25% per year by rate element. The High Pricing Flexibility basket is a new middle basket that allows price flexibility for revenue increases up to two times the GDP-PI but is limited to 25% per year by rate element. The Total Pricing Flexibility basket has no cap or productivity factor offset, but uses the Commission's rules A.A.C. R14-2-1109 and 1110. Since GDP-PI has not exceeded 4.2% in recent times and is not expected to be at those levels in the next

[23] Dr. Johnson p.12, lines 15-16.

three years, the effect of Dr. Johnson's proposal is continued rate decreases for the majority of Qwest's services[25] without a real opportunity for Qwest to improve its financial position.

Q. WHY WOULD RUCO'S PRICE PLAN NOT GIVE QWEST A REAL OPPORTUNITY TO IMPROVE ITS FINANCIAL POSITION?

A. Dr. Johnson recommends continuation of the 4.2% productivity factor for the majority of Qwest's services. The percent decreases that resulted from the current Price Plan range from 1.9 to 3.4. Continued forced reductions in Qwest's prices cannot be sustained and do not allow a finding of a legitimate opportunity for Qwest to realize the necessary funds to keep its infrastructure and business healthy. Further, Dr. Johnson recommends that services be placed in his recommended baskets by a very complex and lengthy process of examination of competition in Arizona. He recommends a broad examination of market conditions followed by an examination of the competitiveness of services by Qwest wire center be completed before any service be classified by basket type. I know of no commission that has attempted such an undertaking and would guess that such an undertaking would be extraordinarily difficult if not impossible. More important from a consumer perspective, such a process of classification does not allow Qwest to respond to market conditions in a timely and practical manner.

---

[24] Dr. Johnson p. 17, lines 7-8.

[25] Based on Dr. Johnson's analysis of residence and business services and his recommendation of placement of services by geography, it is apparent that the majority of Qwest's revenues will be classified as Moderate using his methods.

Q. IN CURRENT REGULATORY REVIEWS FOR PRICE PLANS IS A PRODUCTIVITY FACTOR A COMMON ELEMENT OF SUCH PLANS?

A. No. Productivity factors that require reduced rates such as the 4.2% that is recommended by Dr. Johnson are non-existent in current Price Plans. In fact, there are only three states in the country that still have that type of element in regulation. According to the State Retail Regulation of Local Exchange Providers, *A Communications Daily White Paper*, Vol. 25, October 4, 2005,[26] only Illinois, Kansas and Delaware have a productivity factor such as that proposed by Dr. Johnson. Those factors are considerably less than the one proposed by Dr. Johnson: 3% in Illinois (GDP-PI less 3%), 3.15% in Kansas (GDP-PI less 3.15%), and 3% in Delaware (GNP-PI less 3%). Those plans also predate the current Price Plan in Arizona: Illinois 1995, Kansas 1998, and Delaware 1994. No other state in the country uses such antiquated regulatory devices. Where those mechanisms were once used, they have been replaced with Price Plans that closely resemble the proposed Price Plan of the parties in this proceeding.

VI. COMPETITIVE RECLASSIFICATION

Q. DR. JOHNSON DISAGREES WITH THE RECLASSIFICATION OF SERVICES PROPOSED IN THE PRICE PLAN. IN ADDITION TO ADDITIONAL LINES AND PBX TRUNKS THAT HAVE BEEN RECLASSIFIED INTO BASKET 2 IN THE

[26] The white paper is attached as exhibit JLT-2.

PROPOSED PRICE PLAN, WHAT OTHER SERVICES DOES THE AGREEMENT RECLASSIFY?

A. Exhibit JLT-1 lists the tariff category by Basket under the current Price Plan compared to the same tariff category under the proposed Price Plan. As there are six services that Qwest agreed to move into price cap Basket 1, there are also six services that the parties agreed to be moved into Basket 3. Those services are: Stand By Line, Home Business Line, Packages, Uniform Call Distribution, Code Billing, and Uniform Access Solutions. With the exception of residential packages, these are business services. Mr. Teitzel's testimony explains the nature of these business services and extent of competition for them in Arizona. There is also considerable competition for residential local service packages in Arizona, as explained in Mr. Teitzel's testimony.

Overall, the services that the parties agreed to be moved into Basket 3 are notable by the significant level of demand loss as explained in Mr. Teitzel's testimony. Demand by Qwest's customers for some of these services has declined over 90% since the time the classification of those services was established in the current Price Plan.

VII. "CERTAIN PROBLEMS"

Q. DR. JOHNSON'S RESPONSIVE TESTIMONY DISCUSSES ISSUES THAT THE PROPOSED PRICE PLAN DOES NOT ADDRESS IN HIS OPINION. IS HE CORRECT?

A. No. Dr. Johnson lists three conceptually related issues that he feels are important and should have been covered more completely in the Price Plan. Those three issues are geographic cost differences, geographic competitive differences, and an improved universal service fund. I disagree with Dr. Johnson on all three issues. The settlement and the proposed Price Plan **does** address these issues to the extent that they are appropriate in a single carrier Price Plan such as the one in this proceeding.

Q. IN WHAT WAY DOES THE PROPOSED PRICE PLAN ADDRESS THESE ISSUES?

A. As I explained in my September 6, 2005 testimony, as part of the settlement Qwest agreed to withdraw its USF request in this proceeding. I explained that subsequent to Qwest's filing in May 2004, the Commission solicited comments from interested parties in an industry-wide rule making for possible changes to the state universal service fund. In Docket No. RT-00000H-97-0137 there is the clear ability for the Commission to change its rules and make any improvements suggested by Dr. Johnson should RUCO be interested in participating and advancing his ideas in that docket. Qwest's proposed Price Plan includes provisions to incorporate changes the

1 Commission may implement in the Arizona universal service fund, as those
2 provisions affect Qwest. In the agreement Qwest is allowed to reflect USF
3 assessments in its charges and should it receive funding, its retail revenues may be
4 adjusted. This is the only practical manner to currently address future and currently
5 unknown universal service fund changes since the proposed Price Plan is a Qwest-
6 only form of regulation.

7 Issues concerning geographic cost and competition are largely overstated by Dr.
8 Johnson. As indicated in Mr. Teitzel's testimony, most carriers in Arizona utilize
9 statewide average pricing. This is true, not only for Arizona, but all 14 states where
10 Qwest Communications operates. This is not surprising since it is very difficult and
11 very expensive for telecommunications carriers to manage geographically de-
12 averaged prices. What is somewhat puzzling is why Dr. Johnson complains about
13 the significant impediments to competition for competitive carriers, when the major
14 competitive carriers in Arizona support the settlement as in the public interest.

15 I agree with Dr. Johnson that there are differences in the cost of providing service in
16 different areas of Qwest's service territory in Arizona. There are differences in the
17 cost of providing almost any service in rural sparsely populated areas. Certainly, as
18 competition continues to increase, continued retail price averaging will become more
19 difficult due to Qwest's continued likely loss of low cost high margin customers.
20 However, contrary to what Dr. Johnson would lead the Commission to believe, the

proposed Price Plan specifically allows for these changes to the extent the Commission decides to make changes to statewide average pricing for Qwest.

VIII. CONCLUSION AND RECOMMENDATION

Q. COULD YOU PLEASE PROVIDE YOUR CONCLUSION AND RECOMMENDATION TO THE COMMISSION?

A. Dr. Johnson's testimony is rife with misleading omissions and errors. Because of these inaccuracies, his recommendations are not based on the proper facts of the settlement and proposed Price Plan. The provisions the parties have agreed upon for the Commission-directed fair value determination in this case have been distorted by Dr. Johnson. Qwest filed the revenue requirement part of the case at the direction of the Commission. As such, revenue requirement, revenue deficiencies, just and reasonable rates, and price changes became issues in the case. Since the primary form of regulation that the Commission applies to competitive carriers and their services is price regulation, it should be no surprise that movement toward parity of regulation for like services is of interest to Qwest.

Contrary to Dr. Johnson's view, there are multiple benefits for consumers. The changes from the current Price Plan and the proposed Price Plan are logical and well supported with competitive data. The agreed upon changes are an improvement for consumers over the current Price Plan were that to be the only basis of consideration by the Commission. But that should not be the Commission's

only consideration. Like the current Price Plan that, in the Commission's words, "takes a step along the road to competition"[27], the proposed Price Plan takes additional steps along that road. Given that competition has grown significantly in Arizona since the current Price Plan was decided in 2001, the changes proposed in the proposed Price Plan are very conservative and certainly not "extreme".

Under the proposed Price Plan Qwest's pricing and revenues are limited and monitored by the Staff. There are different standards that have been applied to services that are subject to competition in three different levels: hard capped prices, limited pricing freedom, and higher pricing freedom. Qwest will not be able to extract "monopoly profits" as exaggerated by Dr. Johnson because its ability to price is limited by the proposed Plan and by the competitive market.

The Commission should disregard Dr. Johnson's supplemental testimony and approve the settlement and proposed Price Plan as submitted by the parties.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

[27] Arizona Corporation Decision No. 63487, p.22 line 9.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL EXHIBITS

OF

JERROLD L. THOMPSON

ON BEHALF OF

QWEST CORPORATION

OCTOBER 28, 2005

Current Plan Basket 1 25% Price Flex Categories	Proposed Plan Basket 2 25% Price Flex Categories
Secretarial Answering	*Obsolete*
Stand By Line	***Basket 3***
Home Business Line	***Basket 3***
Direct Inward Dialing	Direct Inward Dialing
Custom Calling Service	Custom Calling Service
Market Expansion Line	Market Expansion Line
Basic Exchange Enhancement	Basic Exchange Enhancement
Open Switch Interval Protection	Open Switch Interval Protection
Caller ID Bulk Service	Caller ID Bulk Service
Custom Ring	Custom Ring
Hunting	Hunting
Singlenumber	*Obsolete*
Findme	*Obsolete*
Joint User	*Obsolete*
Non Publish Listings	***Basket 1***
Non Listed Service	***Basket 1***
Premium Listings	Premium Listings
Custom Number	Custom Number
Packages	***Basket 3***
Resale	Resale
E911	***Basket 1***
Emergency Transport Service	***Basket 1***
Uniform Call Distribution	***Basket 3***
Central Office Make Busy	Central Office Make Busy
Customnet	Customnet
Billed Number Screening	*Obsolete*
Code Billing	***Basket 3***
Message Delivery Service	Message Delivery Service
Message Waiting Indication	Message Waiting Indication
Disaster Recovery	***Basket 1***
Scoopline Restriction	*Free service*
10xxx Blocking	***Basket 1***
Digital Switched Service	Digital Switched Service
Uniform Access Solutions	***Basket 3***
Custom Services	Custom Services

Current Plan Basket 1 Price Capped Categories	Proposed Plan Basket 1 Price Capped Categories
Flat Rate Residence	Flat Rate Residence
Flat Rate Business	Flat Rate Business
Residence Additional Lines	***Basket 2***
Business Additional Lines	***Basket 2***
Multi-Party Service	*Obsolete*
Res. Exchange Zone Increments	Res. Exchange Zone Increments
Bus. Exchange Zone Increments	Bus. Exchange Zone Increments
Low Use Option	Low Use Option
Service Station	Service Station
Telephone Assistance Plan	Telephone Assistance Plan
PBX Trunks	***Basket 2***
Caller ID Block	Caller ID Block
Toll Restriction	Toll Restriction
9xx Block (free service)	9xx Block (free service)
Basic Listings	Basic Listings
-	E911
-	Emergency Transport Backup
-	Disaster Recovery
-	10xxx Restriction
-	Non Publish Listings
-	Non List

State Retail Regulatio Local Exchange Providers

A Communications Daily White Paper

TUESDAY, OCTOBER 4, 2005 **VOL. 25, WHITE PAPER**

State	Company	Method Now In Use	Notes
Ala.	All Incumbents	Price Caps (1996)	Basic Exchange and access rates under nonindexed caps. Other services can rise up to 10% year, in aggregate, with rate design subject to PSC review. Earnings not regulated. No expiration date. 2004 state law lets incumbents, starting in 2005, opt into more-flexible capping system that bases rate regulation on population density. Plan deregulates retail rates other than residential basic exchange in dense urban areas. In less dense suburbs, rate hikes limited to 15% yearly through 2006, 20% in 2007 and 25% afterward. In rural areas, increases limited to 5% through 2007, gradually rising to 15% by 2010. A 2005 state law gave incumbents option of regime that will deregulate bundled and contract services statewide in summer 2006 and, starting 2008, let incumbents facing at least 2 local competitors opt out of state retail rate regulation. PSC has opened proceeding to reevaluate its entire regulatory scheme, hoping to entice at least some incumbents to remain under state rate regulation.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. Must file tariffs and give notice of rate changes. CLEC tariff changes get regulatory staff review but normally aren't questioned.
Alaska	All Incumbents	Rate of Return	All large incumbents and most small ones are under rate of return regulation. Rate boosts up to 6% and rate drops can be decided in as few as 45 days under rate of return principles in annual filings. Other changes require full rate case. In markets designated competitive, incumbents can cut rates on 30 days' notice without prior state approval. Returns to previous levels may trigger state review. Incumbents can set limited-duration promotional rates to match competition without prior state approval. But revenues from services in competitive markets still count in rate-of-return calculations. Anchorage, Fairbanks and Juneau are designated competitive markets. Regulators in Sept. adopted new rules designating competitive any market where a facilities-based wireline carrier is providing local service in competition with the incumbent. Small incumbents -- under $500,000 annual revenue -- can opt out of state rate and earnings regulation with ratepayers' approval. Rates and earnings of incumbents under $50,000 annual revenue are deregulated.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs and give 30 days' notice of changes. CLEC changes get regulatory staff review but normally aren't challenged.
Ariz.	Qwest	Rate of Return with Price Caps (2001)	Carrier under earnings-based regulation pegged to rate of return on "fair value" of its rate base. Regulators in 2001 set up price capping system to give Qwest pricing flexibility. Basic service rates frozen. Noncompetitive services can rise up to 25% a year. Competitive services flexibly priced, but subject to revenue cap for entire basket of competitive services. All service revenue counts in rate-of-return calculations. State constitution requires fair-value ratemaking, so major telecom deregulation would require voter approval of a constitutional amendment. Last such attempt failed in 2000. Staff in August urged extending price cap program through 2007 and allowing Qwest $43.3 million in rate hikes for nonbasic services over 3 years to correct revenue deficiency. In return, Qwest would drop a May 2004 proposal for rate-deregulated competitive zones in state's major cities and end litigation over a $12 million productivity adjustment ordered in April 2005. Decision possible this year.

Copyright© 2005 by Warren Communications News, Inc. Reproduction or retransmission in any form, without written permission, is a violation of Federal Statute (17 USC101 et seq.).

	Other Incumbents	Rate of Return	Other incumbents come under fully tariffed earnings-based rule pegged to rate of return on "fair value" of rate base. They don't have pricing flexibility. State constitution requires fair-value ratemaking, so major telecom deregulation would require voter approval of a constitutional amendment. Last such attempt failed in 2000.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs and give 30 days' notice of changes. Regulatory staff review all changes, and major changes may trigger hearings; minor changes generally aren't questioned. State constitution demands CLEC rates relate to "fair value" of their rate base, but a Nov. 2001 state Supreme Court ruling gave state regulators discretion to decide how CLEC assets' fair value was determined and how it was applied in setting CLEC rates. Fair value issues are decided on case by case as CLECs file tariffs for new services and rate changes.
Ark.	SBC, Alltel	Price Caps (1997)	Basic exchange and switched access under caps indexed to 75% of GDP-PI. Firms can aeek basic exchange rate deregulation in exchanges with effective local competition. Rates for all other services deregulated. SBC in late 2004 and early 2005 received basic exchange rate deregulation in its competitive urban markets. Alltel hasn't sought basic exchange rate deregulation. Earnings not regulated. No expiration date.
	Century	Rate of Return	Rate of return regulation applies to 203,000 access lines Century Tel bought in 2000 from Verizon. Century operates these lines in business unit separate from rest of its Ark. operation. It has option to switch to price caps but hasn't exercised it. Carrier filed rate case in 2003 and in Jan. 2004 got $3.1 million (12%) rate increase, about 1/10 what it sought.
	Other Incumbents	Price Caps (1997)	All other incumbents operate under price caps permitting basic exchange services to rise annually by lesser of 15% or $2 per line monthly. All other service rates deregulated. Earnings not regulated. No expiration date. Century Tel's original 45,000-line Ark. operation is under this cap system.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must obtain state certificate by showing technical, financial and managerial competence. They must file tariffs and give 30 days' notice of changes, but changes normally aren't reviewed. All CLECs must contribute to state universal service fund regardless of whether they are eligible to receive subsidies from fund.
Cal.	SBC, Verizon, Surewest Telecom, Citizens/Frontier	Price Caps (1990)	Rates for noncompetitive services frozen except for cost-justified changes. Competitive services flexibly priced. Plan's original inflation indexing suspended in 1995 by PUC; profit sharing suspended in 1999 for SBC and Verizon. In 1995, Surewest (formerly Roseville Telephone) and Citizens/Frontier joined system. PUC in 2002 opened comprehensive multiphase review of regulatory program for SBC and Verizon. In 2003, PUC concluded no major structural changes needed. PUC review of Verizon and SBC financials found profits understated 1997-99. Verizon understatements produced $12 million 2003 refund to customers. SBC's didn't require repayment. PUC reexamining price cap regulation programs for all 4 incumbents.
	Other Incumbents	Rate of Return	Seventeen other incumbents are under fully tariffed rate-of-return regulation. PUC in 1997 set one-time schedule for rate cases to ensure all small companies' rates received review. All filed rate cases that have been concluded. PUC required earnings-regulated small incumbents wanting to keep receiving state high-cost subsidies to file rate cases within 5 years of their last cases; otherwise, their state high-cost support will be phased out.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs and give 30 days' notice of rate increases, 5 days' notice of cuts and 30 days' notice of changes to terms and conditions. Regulatory staff review changes but normally don't challenge them.
Colo.	Qwest	Price Caps (2005)	New system adopted in June 2005 to replace expired 1999 plan puts basic exchange on first residential line and first 5 business lines under nonindexed caps. Interexchange service rates deregulated statewide. Rates for business services to customers over 5 lines and optional or discretionary services deregulated in state's 5 largest cities and in any other market where sufficient competition can be shown. Earnings not regulated.

	Other Incumbents	Rate of Return	All other incumbents come under fully tariffed rate-of-return regulation. Other incumbents have option to petition for alternative regulation but none have done so.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive, except that residential basic exchange can't exceed $14.74 statewide cap set by state law for all providers. CLECs must get state certificate by attesting to technical, financial and managerial competence; affidavits presumed truthful. At start of service CLECs have option to file tariffs or price lists. Changes require 30 days' notice for rate hikes, 14 days' for cuts. Tariff and price list changes get regulatory staff review but normally aren't challenged. CLECs can opt into program applied to Qwest.
Conn.	SBC	Price Caps (1996-2006)	Noncompetitive services under caps indexed to GDP-PI. Caps don't change -- except by 1/2 any GDP-PI rise above 5% a year. Competitive services flexibly priced. Penalties assessed for failure to meet service quality targets. Earnings not regulated. Program last reviewed in 2001; no changes made. Next review due 2006.
	Other Incumbents	Rate of Return	Other incumbent telcos remain under fully tariffed rate-of-return regulation. No proceedings pending to change that. Regulators granted Verizon pricing flexibility under RoR in 2001. Verizon in 2003 proposed change to price caps, later withdrew filing. Regulators in 2005 reaffirmed contested Dec. 2004 decision to keep Verizon price flexibility through 2007.
	CLECs	Rates Not Reviewed	Rates presumed competitive. CLECs must get state certificate by showing technical managerial and financial competence. Must file tariffs and give 7 days' notice of rate changes, but changes normally aren't reviewed.
Del.	Verizon	Price Caps (1994-2011)	Basic services under caps indexed to GNP-PI minus 3%. Competitive services flexibly priced. Earnings not regulated. In June, PSC finished review of plan by extending it unchanged until Sept. 2011. No special conditions imposed.
	Other Incumbents	None.	
	CLECs	Cost-Based Rate Floor	Rates presumed competitive if they stay above incremental cost. CLECs must get certificate by showing technical, managerial and financial competence, and must post $10,000 performance bond. CLECs must file tariffs or price lists, with 3 days' notice of rate and service changes. Rate changes above cost floor normally get no further review.
D.C.	Verizon	Price Caps (2000-2006)	Basic residential rate frozen. Other basic residential and business services can rise up to 10% a year. Discretionary services can rise up to 15% annually. But percentage revenue increase can't exceed annual inflation rate. Competitive service rates deregulated, except they can't be priced below incremental cost. Earnings not regulated. Plan was to expire in 2004 but was extended through the end of 2006 in settlement giving Verizon a small local rate increase.
	Other Incumbents	None.	
	CLECs	Rates Not Reviewed	Rates presumed competitive. CLECs must get certificate by showing technical, financial and managerial competence. They must file tariffs and give notice of rate changes, but changes aren't reviewed.
Fla.	BellSouth, Verizon, Sprint	Price Caps (1995)	Basic services under caps indexed to GDP-PI minus 1%. Other services can rise 6% yearly in noncompetitive markets and up to 20% elsewhere. Access charges capped at interstate rate. Earnings not regulated. No expiration date. 2003 state law required major rate rebalancing to shift hundreds of millions of dollars from access charges onto local rates and let basic services be regulated like others after 2 years (3 years for Sprint). PSC in Dec. 2003 allowed these 3 telcos a total of $355 million in local rate hikes. Increases stayed pending court appeals but Fla. Supreme Court in June 2005 upheld them. Carriers plan to impose increases effective late Oct.
	Other Incumbents	Price Caps (1995)	Can elect price cap regulation under program similar to 3 large telcos'. Six of 7 eligible incumbents chose caps. One small incumbent remains under rate-of-return regulation.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence, must file tariffs. CLEC rules distinguish between those providing residential and small-business -- under 5 lines -- basic service and other providers. Rate changes by CLECs that provide residential/small business basic service require 30 days' notice and get PSC staff review but normally aren't challenged. Other CLECs aren't rate regulated; their changes take immediate effect.

Ga.	BellSouth	Price Caps (1995)	Basic rates under caps indexed to GDP-PI, access charges capped at interstate rate. All other retail service rates deregulated. Earnings not regulated. No expiration date. In 2000, BellSouth completed original infrastructure investment requirements of cap program. No new investment requirements have been linked to price caps.
	Other Incumbents	Price Caps (1996)	Option to elect price cap plan resembles that for BellSouth, but without infrastructure investment requirements. About 75% of state's 34 other independents picked price caps. The rest remain under fully tariffed rate-of-return regulation.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. Must file tariffs, give 30 days' notice of rate hikes and new services and 7 days' notice of rate cuts. Regulatory staff review changes but normally don't challenge them.
Hawaii	Hawaiian Telcom	Rate of Return	Company, under traditional rate-of-return regulation, hasn't undergone general rate case since 1997. Formerly Verizon Hawaii, company was renamed and reorganized after being sold to N.Y.-based Carlyle Group in transaction that closed May. PUC sale-approval condition required new owners not file general rate case before 2009. State law requires cost-based rates and earnings-based oversight until PUC decides effective local competition exists.
	Other Incumbents	No Other Incumbents	
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. CLECs must file tariffs and give notice of changes. Changes undergo regulatory staff review but normally aren't challenged.
Ida.	Qwest	Service Deregulation (1989)	Rates deregulated for all retail services except basic exchange provided to accounts with fewer than 5 lines. Basic exchange to customers under 5 lines was under rate-of-return regulation until June, when a state law put basic exchange under temporary price caps limiting annual rate hikes to 10%. Caps expire in 2008 unless PUC extends them to 2010. After caps expire, basic exchange will be deregulated. Law doesn't apply to Qwest's 35,000-line Lewiston service area in northern Idaho -- a separate Qwest operation under traditional rate-of-return regulation.
	Other Incumbents	Rate of Return	Other incumbents remain under fully tariffed rate-of-return regulation. Firms may petition for rate deregulation but none have done so.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file price lists and give 10 days' notice of changes, but changes normally aren't reviewed.
Ill.	SBC	Price Caps (1995)	Residential rates and other noncompetitive services under caps indexed to GDP-PI minus 3%. Competitive services flexibly priced. Earnings not regulated. No expiration date. Firm must meet service quality standards. Under 2001 telecom law, price-regulated incumbent telcos must offer 3 grades of flat-rate local service at regulated rates; law also stipulates additional service quality requirements and penalties.
	Other Incumbents	Rate Of Return	Remain under fully tariffed rate-of-return regulation. No proceedings to change that.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. CLECs must file tariffs. Initial tariffs for new entrants or new services receive regulatory staff review. Changes take effect on one day's notice, without regulatory review. CLECs choosing to participate in state universal service fund come under fund's rate benchmarking rules.
Ind.	SBC	Price Caps (2004-2007)	Basic residential and business services to customers below 5 lines under nonindexed caps. Hikes for vertical services limited to 38¢ a feature yearly. All other retail services and all service bundles considered competitive and rate deregulated except for floor set as cost plus 10%. Earnings not regulated. Company must meet service quality standards on pain of penalties up to $30 million annually. By mid-2008, SBC must make DSL available to 77% of customers, with at least 30% of new deployment in rural areas, and spend $850,000 on consumer education.
	Verizon	Price Caps (2004-2007)	Basic local rates under nonindexed caps. Company can impose single 25¢ hike for vertical services in 2006. All other retail services and all service bundles considered competitive and rate deregulated except for floor set at cost plus 10%. Earnings not regulated. Before 2008, company must make DSL available to 75% of customers, with 45% of new infrastructure in rural areas.

	Sprint	Price Caps (2004-2007)	Basic residential and small business services under nonindexed caps. Cumulative annual hikes for vertical services limited to 8.75% of annual revenues for services in this basket, and services must be priced at least 10% above cost. All other retail services and all service bundles considered competitive and rate deregulated except for floor set at cost plus 10%. Earnings not regulated. Company must meet service quality standards or risk losing pricing flexibility. Sprint must make DSL available to 70% of customers before 2009.
	Other Incumbents	Flexible Regulation	Investor-owned incumbents under 30,000 lines have pricing flexibility, but earnings subject to review. Telephone cooperatives deregulated.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must obtain state certificate by showing technical, financial and managerial competence. Must file tariffs, which can take effect on one day's notice. But all rate and service changes subject to regulatory staff review and possible challenge.
Iowa	Qwest, Iowa Telecom Services, Frontier Communications	Price Caps (1995)	A 2005 state law deregulated retail rates except for single-line basic exchange service. Basic exchange remains under caps but can rise $1 a year for residential and $2 a year for business, to a statewide cap of $19 monthly for residential service and $38 for business service. Earnings not regulated. Full rate deregulation allowed in any market where competitive alternatives exist. Nineteen markets designated competitive; others pending.
	Other Incumbents	Rates Not Reviewed	All other incumbents' rates and earnings deregulated since 1983. Companies must keep current tariffs on file and give 30 days' notice of changes. Rate changes aren't reviewed, but changes to other terms and conditions of service receive regulatory staff review and may be questioned.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must obtain state certificate by showing technical, managerial and financial competence. CLECs must file tariffs and give 30 days' notice of rate hikes, 15 days' notice for cuts. Regulatory staff review changes but normally don't challenge them. CLEC local calling areas are supposed to coincide with incumbent's, but CLECs can petition for waiver.
Kan.	SBC, Sprint	Price Caps (1998)	All services under caps indexed to GDP-PI minus 3.15% for basic services and 1.5% for optional and discretionary services. Earnings not regulated. No expiration date. Firms can petition for rate deregulation of competitive services in markets where competitors operate. SBC in June was granted rate deregulation for bundled services in Kansas City and Wichita and for multiline business services in Wichita. Request for Topeka rate deregulation denied.
	Other Incumbents	Rate of Return	Other incumbents remain under fully tariffed rate-of-return regulation. No proceedings pending to change that.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must obtain state certificate by showing technical, financial and managerial competence. They must file tariffs. Regulatory staff review changes to terms and conditions of service but normally don't question them. Rate changes aren't reviewed and take immediate effect.
Ky.	BellSouth	Price Caps (1995-2009)	Basic service rates under caps indexed to GDP-PI. Access capped at interstate levels. Rates for competitive services deregulated. Earnings not regulated. No specific expiration date; plan subject to periodic review. PSC in 2004 let program continue without major change but ordered BellSouth to eliminate rural zone charges by 2006. Next review due 2009.
	Cincinnati Bell	Price Caps (2004)	Basic local rates frozen. Rates for some vertical services and specialty business services frozen through 2006, then can rise to cap set at double initial rate. All other retail rates flexibly priced. Earnings not regulated. In 2001, PSC made Ky. regulation mirror Ohio regulation, including future changes. Telco in Ohio switched from company-specific plan to PUC generic price cap plan for incumbents mid-2004; Ky. adopted Ohio system late 2004.
	Other Incumbents	Rate Of Return	State's 17 other incumbents have option to propose price caps or other alternative regulation. Only Alltel Kentucky has chosen price caps on basic services with pricing flexibility for other services. Others under rate-of-return regulation.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must register with PSC and file tariffs. Must give 15 days' notice of rate and service changes. CLEC changes get regulatory staff review but normally aren't questioned.

La.	BellSouth	Price Caps (1996)	Rates for residential and single-line business basic services under nonindexed caps, except series of rate changes intended to consolidate 8 local rate groups into one by 2006. After 2006, BellSouth may raise basic service rates up to 10% a year in competitive urban markets. Rates for competitive services deregulated. Earnings not regulated. Plan was to expire in April, but in Dec. 2003 PSC extended it indefinitely after splitting service quality, universal service and access service issues into separate dockets. Future reviews at PSC discretion. Telco completed infrastructure investment requirements by making DSL available throughout its service area.
	Other Incumbents	Price Caps (1997)	Basic and access services under nonindexed caps. Other services flexibly priced. Earnings not regulated. No expiration date. State's 11 other incumbent telcos have opted for caps at times since 1997, with regulatory conditions varying by carrier.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. Must file tariffs and give 10-30 days' notice of changes, depending on type. Regulatory staff review CLEC changes but normally don't challenge them.

Maine	Verizon	Price Caps (1995-2006)	Basic residential and business service rates frozen; nonbasic and competitive services flexibly priced except for operator services, capped at May 2002 levels. Verizon in 2003 completed local rate increases and toll rate cuts stipulated in plan. Plan lets Verizon petition for basic service rate increases due to external factors, and to petition for rate deregulation of business services to customers over 10 lines in markets qualifying as competitive. Plan requires Verizon to meet service quality standards on pain of $12.5 million in annual penalties. Plan vacated by state courts early 2003, reinstated late that year by PUC on public interest grounds. Current plan expires July 2006. PUC in March opened docket on successor plan. First phase will set starting revenue requirement and rates for successor plan; 2nd will address specifics of new price regulation plan. Proceeding in discovery phase, with initial briefs this fall.
	Other Incumbents	Rate Of Return	Other incumbents remain under fully tariffed rate-of-return regulation. In 2003, all underwent rate cases to get intrastate access charges down to interstate levels. PUC in June opened inquiry into petitions for price-based regulation by Pine Tree Telephone and Saco River Telephone, both Country Road Communications affiliates. First phase will address whether to consider alternative regulation; 2nd, specific plans. Schedule not set.
	CLECs	Rates Not Reviewed	Rates presumed competitive. CLECs must get state certificate by showng technical, financial and managerial competence. CLECs must file tariffs and give 30 days' notice of rate changes, but changes normally aren't reviewed.

Md.	Verizon	Price Caps (1996)	Noncompetitive services under caps indexed to GDP-PI minus 3-year average of CPI. Competitive service rates deregulated. Earnings not regulated. No expiration date. PSC has open docket to weigh price cap program changes. Verizon proposed to eliminate productivity offset and rate deregulation of toll and local business services. Case was opened to consider indexing 2002 and 2003 adjustments but expanded 2004 into general review of price cap program. Record completed in spring. PSC decision awaited.
	Other Incumbentsr	Rate Of Return	Only other incumbent telco remains under fully tariffed rate-of-return regulation. No pending proceeding to change that.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. Must file tariffs and give 30 days' notice of rate changes. Regulatory staff review CLEC changes but normally don't challenge them.

Mass.	Verizon	Price Caps (2003)	Basic residential local service and analog private lines under nonindexed caps. All other retail services flexibly priced; rates can move anywhere above wholesale floor. Earnings not regulated. No expiration date. Verizon must meet service quality standards on pain of maximum annual penalty of 1% of intrastate retail revenue.
	Other Incumbents	Rate Of Return	Other incumbents under fully tariffed rate-of-return regulation. No proceedings to change that.
	CLECs	Rates Not Reviewed	Rates presumed competitive. CLECs must register with Telecom & Energy Dept. and file tariffs. Must give 30 days' notice of rate changes, but changes normally aren't reviewed.

Mich.	SBC	Price Caps (1995)	Noncompetitive services under caps indexed to Detroit-area CPI minus 1%. Rate cuts presumed competitive, not reviewed. Competitive service rates deregulated. Earnings unregulated. PSC late 2002 approved settlement agreement waiving rate freeze in 2000 law, allowed continued billing of state subscriber line charge at reduced rate in return for SBC dropping litigation on the law. PSC in Aug. approved rate deregulation for retail services of all telecom providers in 30 largest Mich. cities effective late Oct. after customers get notice. Order appealed to state courts. Regulation of SBC may be affected by Mich. Telecom Act sunset in Dec. and legislative efforts to write replacement law.
	Other Incumbents	Rate Freeze (2000)	2000 state law gave incumbents other than Ameritech and Verizon option to switch from indexed price caps to local rate freeze in return for deregulation of their intrastate switched access charges and waiver of law's requirement to expand local calling areas. All chose rate freeze. But since 2002, 22 incumbents allowed to adjust rates to respond to demand for expanded local calling areas. PSC in Aug. approved rate deregulation for retail services of all telecom providers in 30 largest Mich. cities effective late Oct. after customers get notice. Order appealed to state courts. Regulation of other incumbents may be affected by Dec. 2005 Mich. Telecom Act sunset and legislative efforts to write replacement law.
	CLECs	Rates Flexibly Regulated	Initial rates presumed competitive. CLECs must get state license by attesting to technical, managerial and financial competence; statements presumed true. Must begin service within 2 years of getting license. Must give notice of rate changes. Regulatory staff review rate increases but normally don't question them as long as rate remains below incumbent's. Rate reductions and limited-time promotional rates not reviewed, take immediate effect. 2000 state law gave CLECs option of accepting rate freeze in return for deregulation of intrastate access charges and waiver of legal requirements to widen local calling areas. No CLEC did. PSC in Aug. approved rate deregulation for retail services of all tele om providers in 30 largest Mich. cities effective late Oct. after customers get notice. Order appealed to state courts. CLEC regulation may be affected by Mich. Telecom Act sunset in Dec., and legislative response.
Minn.	Qwest	Price Caps (1999-2005)	Local exchange and access services under nonindexed caps. Other basic and emerging competitive services flexibly priced. Rates for fully competitive services deregulated. Firm must meet minimum service quality standards. Earnings unregulated. Plan was to expire at end of 2004 but state law extended it through 2005. Qwest and state are negotiating successor regulatory plan effective in 2006. The 2004 law also deregulated business rates in 3 major metro areas.
	Sprint, Citizens/Frontier	Price Caps (1996)	Basic services under nonindexed caps. Nonbasic and emerging competitive services flexibly priced. Rates deregulated for fully competitive services. Earnings not regulated. Carriers must meet infrastructure investment requirements. No expiration date but plans subject to periodic review. Sprint's plan was to have come up for review this fall but telco has requested extension through 2006 without change.
	Citizens Telecom	Rate of Return	Citizens properties bought in 1999 from former GTE remain under fully tariffed rate-of-return regulation. Company has option to seek alternative regulation but hasn't done so.
	Other Incumbents	Pricing Flexibility	Other incumbents, all under 50,000 lines, can elect flexible pricing system letting them price basic services to market unless greater of 500 or 5% of ratepayers seek PUC review of rate change. Nonbasic and emerging competitive services flexibly priced. Rates deregulated for fully competitive services. Earnings not regulated. No expiration date. Of 83 eligible small incumbents, 67 have opted for flexible pricing.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs and give notice of changes, with notice period varying by type of change. Regulatory staff review but normally don't challenge changes.
Mo.	SBC, Sprint, Century Tel, Spectra/Century	Price Caps (1997)	Basic services under caps indexed to CPI's telecom component. Nonbasic services can rise up to 5% annually. Earnings not regulated. No expiration date. Companies can petition for rate deregulation in markets where competitors operate. SBC in 2001 won rate deregulation for certain large business services in St. Louis and Kansas City, for residential service in 2 St. Louis suburbs and for toll services statewide. SBC in July 2004 filed petition for statewide rate deregulation of all retail services. Bid mooted in 2005, when legislature deregulated rates for bundled services and for stand-alone services in any exchange where 2 or more local competitors operate. After law took effect in Aug., SBC immediately sought competitive status for roughly 2/3 of its 160 exchanges. Sprint filed for 5 exchanges, CenturyTel for 15 and Spectra for 5. All these petitions will be decided before Nov.

	Other Incumbents	Rate of Return	Other investor-owned incumbents are under fully tariffed rate of return regulation. Telcos have option to petition for switch to price cap system used by large incumbents if they face local competition from 2 wireless or landline competitors. Under a 2005 state law, they can seek rate deregulation in any exchange where 2 or more local competitors operate.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive except for access charges, capped at incumbent's rate. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs and give 10 days' notice of hikes, 1 day's notice of reductions. CLEC changes get regulatory staff review but normally aren't challenged.
Miss.	BellSouth	Price Caps (1996-2007)	Basic service rates frozen. All other services can rise up to 20% a year. Access capped at interstate rate. Earnings not regulated. In June, PSC completed review, changing repair and appointment timeliness standards and rules for nonbasic rate increases. Annual rise can consist of smaller rate changes during year.
	Other Incumbents	Rate of Return	Remain under fully-tariffed rate-of-return regulation. No proceedings to change that.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. Must file tariffs and give 30 days' notice of rate changes. Regulatory staff review but normally don't challenge rate changes.
Mont.	Investor-Owned Incumbents	Rate of Return	All investor-owned incumbents under rate-of-return regulation. Rural telephone cooperatives fully deregulated. Investor-owned incumbents under 12,000 lines have full pricing flexibility but earnings count in rate-of-return calculations. Qwest has option to request pricing flexibility to match competitor rates in exchanges where competitors operate, but earnings count in rate-of-return calculations. Qwest can seek full deregulation of services subject to effective local competition. PSC in July 2003 said Qwest earnings reports indicated substantial overearnings and asked Qwest to respond. Qwest appealed action to state courts, claiming PSC exceeded its statutory authority by initiating a rate case forcing burden of proof onto carrier, not agency. In fall 2004 lower court sided with Qwest. PSC appealed. Case is pending.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must register with PSC and attest to their competence to serve; affidavits presumed truthful. CLECs are exempt from tariff filing requirements and their rate changes aren't reviewed.
Neb.	All Incumbents	Rates Not Reviewed	Retail telecom service rates and earnings not regulated since 1986, except that PSC can roll back excessive residential local rate hikes in exchanges without competition upon petition by affected ratepayers. Percentage of ratepayers triggering review 2-5%, varying by telco size. Basic exchange rate rises exceeding 10% get automatic review, unless telco has under 5% of state total access lines, in which case review threshold is 30%. Telcos must give 10 days notice of rate changes. Companies receiving universal service support may be affected by PSC-set monthly benchmark rates of $17.50 residential and $27.50 business and benchmark earnings of 12%. Incumbents free to change rates at will on 10 days' notice, but those setting rates below benchmarks or posting earnings above 12% would see state universal service fund support shrink.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs, give 10 days notice of changes. New services and changes to terms other than price get regulatory staff review but normally aren't challenged. Rate changes aren't reviewed unless a basic exchange hike exceeds 30%. CLECs choosing to participate in state universal service fund come under fund's rate benchmarking rules.
Nev.	Sprint	Price Caps (1996-2007)	Basic services of state's largest incumbent under nonindexed caps. Rate cuts allowed, but not increases. Nonbasic services can rise up to 5% annually to cumulative total 20% increase. Competitive services flexibly priced. Broadband services and business services provided under customer-specific contracts deregulated under 2003 state law. Earnings not regulated. Expires mid-2007. Impending spinoff of Sprint local exchange operations to LTD Holdings under Sprint-Nextel merger not expected to alter regulatory plan essentials. In Aug., Sprint filed spinoff plan. PUC expected to complete its review this year.
	SBC	Price Caps (1997-2008)	Basic services under nonindexed caps, access charges capped at interstate rate. Other services can be priced at any point above cost floor. Earnings not regulated. Expires mid-2008. Broadband services and business services provided under customer-specific contracts deregulated under 2003 state law. Current cap program authorized for this carrier by 1999 state law to replace PUC-authorized cap program dating to 1997.

	Other Incumbents	Rate of Return	Other incumbents operate under fully tariffed rate-of-return regulation. No pending petitions to change that.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must get state certificate by demonstrating technical, financial and managerial competence. They must file lists with terms and conditions of service but not rates. Changes to terms normally aren't reviewed and can take immediate affect. CLEC rates deregulated, don't have to be filed.
N.H.	All Incumbents	Rate of Return	Verizon and others under rate-of-return regulation. General guidelines for alternative regulation adopted 1996. State law effective July 1 gave incumbents other than Verizon option of same regulation as CLECs if they prove to PUC most customers have access to competitive wireline, wireless or IP-based service providers.
	CLECS	Rates Not Reviewed	Rates presumed competitive. CLECs must register with PUC, attest to competence to serve and lack of criminal record. They must file price schedules and give a day's notice of price changes; changes normally not reviewed.
N.J.	Verizon	Price Caps (2005)	Statewide basic residential and business caps restructured in 2005, fixed at $8.95 (residential) and $15.00 (business). Business rates for customers with 2 or more lines deregulated. Other competitive service rates deregulated. Earnings not regulated. No expiration date. Restructured plan continued 2002 cap plan's service quality commitments, with requirement Verizon invest $55 million for advanced services to public schools and libraries, and provide them discounted monthly rates for high-speed Internet access until 2014.
	Other Incumbents	Rate of Return	Other incumbents remain under fully tariffed rate-of-return regulation. No proceedings to change that.
	CLECs	Some Rates Regulated	Rates presumed competitive except for rate regulated services, including basic exchange, vertical services and switched access, rates for which cannot be increased without cost justification. CLECs must get state certificate by showing technical, financial and managerial competence, and must file tariffs. First tariffs presumed reasonable. Subsequent hikes in rates for basic exchange, vertical services and switched access require cost justification. For other services, CLEC rate changes normally not reviewed. CLECs must give a day's notice of rate reductions, 5 days for increases.
N.M.	Qwest, Valor Telecom	Price Caps (2001-2006)	Basic services of state's 2 largest incumbents under nonindexed caps. Qwest's nonbasic services capped at average of rates in Qwest's 14-state home region. Valor can raise nonbasic rates up to 5% annually. Earnings unregulated. Both plans to be reviewed during 2005. A 2004 state law requires that, as of 2006, Valor cap program must include indexing for adjusting caps. Qwest must invest $788 million in network by 2006, and must meet service quality standards. PRC in July 2004 opened docket to judge if Qwest is on schedule to meet its network investment commitment. In early 2005, staff decided Qwest would fall substantially short of investment commitment and suggested sanctions. Matter is pending.
	Other Incumbents	Rates Not Reviewed	Rates for other incumbents, all under 50,000 lines, deregulated by 1999 state law -- except basic residential rate increases, subject to regulatory review if 2.5% of affected ratepayers or PRC staff protest; decision required within 60 days of hearing. Firms must give 60 days notice of residential rate hikes.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs and give 30 days notice of changes. Regulatory staff review but normally don't challenge changes.
N.Y.	Verizon	Tariff Regulation (2004)	Defaulted to basic form of tariff regulation when revenue cap program expired March 2004. Rates for basic services can be changed by tariff -- if Verizon can cost-justify the change. Nonbasic and competitive services flexibly priced. PSC can review earnings on suspicion of excessive profits, but it's not really rate-of-return regulation. No proceedings to change that.
	Other Incumbents	Rate Of Return	Other incumbents remain under fully tariffed rate-of-return regulation. No proceedings to change that. Frontier Telephone of Rochester defaulted to fully tariffed rate-of-return regulation in January, when its price cap program expired.

	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must get state certificate by showing technical, managerial and financial competence. CLECs must file tariffs and give 30 days' notice of rate changes. Regulatory staff review CLEC changes but normally don't challenge them.
N.C.	BellSouth	Price Caps (2005)	Cap plan adopted in April replaced expired 1996 plan. Basic service rates can rise up to 10%, subject to revenue cap for basic basket equal to 1.5 times annual GDP-PI. Vertical and nonbasic services can rise up to 20%, subject to basket revenue cap equal to 2.5 times annual GDP-PI. Competitive services rates deregulated. Effective Dec., all BellSouth business services will be classed as competitive -- except basic exchange and installation, classed competitive in Dec. 2006. Earnings not regulated. No expiration date.
	Sprint, Verizon	Price Caps (2005)	New cap plans adopted in spring. Sprint basic services can rise up to 12%, subject to basic-basket revenue cap equal to annual GDP-PI. Verizon basic services can rise up to 10% subject to basic-basket revenue cap of 1.5 times annual GDP-PI. Rate regulation for vertical, nonbasic and competitive services same as for BellSouth.
	Other Incumbents	Price Caps (1996)	Five midsized incumbents operate under price based system that puts basic services under caps indexed to GDP-PI minus 2% and groups other services in baskets with service-specific caps. Earnings not regulated. No expiration date. Midsized carrier Concord Telephone seeks revised price-based plan resembling programs for BellSouth, Sprint and Verizon. Eight small incumbents remain under fully-tariffed rate-of-return regulation. Randolph Telephone has given notice of intent to seek price-based regulation.
	CLECs	Rates Not Reviewed	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. Needn't file tariffs or price lists. Rate changes normally aren't reviewed.
N.D.	Qwest	Price Caps (2003)	Residential flat-rate basic exchange on primary line and switched access under nonindexed caps. Rate cuts allowed but no rises except when govt. action ups service costs. All other retail services flexibly priced. Earnings unregulated. No expiration date. This system, prescribed by Aug. 2003 state law, replaced a 1993 version. A state law amended system in August 2005 to remove business basic exchange and additional residential lines from nonindexed caps.
	North Dakota Telephone	Rate-Of-Return	State's 2nd largest investor-owned incumbent operates under fully tariffed rate-of-return regulation with no pending proceeding to change that situation.
	Other Incumbents	Rates Not Reviewed	Retail rates for investor-owned incumbents under 8,000 lines and of all telephone cooperatives deregulated since 1993. Telcos have option to put their intrastate carrier access charges under PSC rate regulation. Some have done so.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. Facilities-based CLECs must get state certificate by showing technical, financial and managerial competence. Local resellers need only register with PSC. CLECs and resellers must file tariffs, but changes normally aren't reviewed and take immediate effect.
Ohio	SBC, Sprint, Cincinnati Bell, CenturyTel, Alltel, Western Reserve, Chillicothe	Price Caps (2002)	Telcos opted for generic alternative price regulation framework PUC adopted April 2002. Plan indefinitely freezes basic local rates. Rates for certain vertical services and specialty business services frozen 2 years from effective date of individual telco's plan, and then can rise up to double initial rate. All other retail rates flexibly priced. Earnings unregulated. No expiration date. Telcos must meet company-specific commitments for expanded availability of advanced services and Lifeline.
	Other Incumbents	Rate-of-Return	State's 36 other incumbent telcos remain under traditional or streamlined rate-of-return regulation. They have option to switch to PUC's generic alternative cap system or propose company-specific alternative regulation plan.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs with maximum prices for basic local service, certain vertical services and specialty business services. Rate changes below maximum not reviewed, take immediate effect. Changes to or beyond maximum require 30 days' notice and receive regulatory staff review.

Okla.	SBC	Price Caps (1999-2005)	All services under nonindexed caps. Earnings unregulated. SBC must invest $200 million in network by program's end in 2005, including retiring all analog switches and deploying DSL service in specific geographic areas. Regulators in July approved new regulation plan that would let SBC set retail rates anywhere above cost floor -- except in rural areas, where local rate increases are limited to $2 per year. Order required SBC to expand rural-area DSL availability. Order stayed pending outcome of CLEC appeals to state Supreme Court, where case is pending.
	Other Incumbents	Streamlined Rate of Return	Other incumbents are under streamlined form of rate-of-return. They can raise monthly basic exchange rates by up to $2 yearly but boosts are subject to investigation and roll-back if 15% of customers protest. Competitive services flexibly priced. All revenues count in rate-of-return calculations. Until 2004, system once covered only incumbents under 75,000 lines, but a new law applied it to all incumbents besides SBC.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs and give up to 20 days' notice of changes. Changes receive regulatory staff review but normally aren't challenged.
Ore.	Qwest	Price Caps (2000)	Residential and small-business basic exchange, PBX trunks and payphone access services frozen except for cost-justified rate changes. Other services under nonindexed caps, with cost floors. Plan lets carrier seek right to change rates on short notice in competitive markets, and it has done so for most of its Ore. markets. Earnings unregulated. No expiration date.
	Verizon, Sprint, Century Tel	Rate of Return	These midsized incumbents are under traditional rate-of-return regulation. They can request right to change rates on short notice in competitive markets and have done so for most of their territories, but earnings count in rate-of-return calculations.
	Other Incumbents	Rates Not Reviewed	Retail rates and earnings of other incumbents, all under 50,000 lines, deregulated by state law since 1983. PUC can review rate changes if 10% of affected customers request it.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. Tariffs or price lists not required. CLEC rate, service changes aren't reviewed and can take immediate effect.
Pa.	All Incumbents	Price Caps (2002)	In 2002, state law moved incumbent telcos to price-based oversight, though some already were under company-specific cap plans. Details differ by telco, but plans have same outline: Basic services under indexed caps. Competitive services flexibly priced. Earnings not regulated. No expiration date. Revenue-neutral rate rebalancing permitted. All telcos had to restructure their access charges to recover fixed costs through flat rates. A Dec. 2004 state law ended price cap indexing formulas' productivity offsets to telcos agreeing to shorten an original 2015 broadband deployment deadline to 2008. All but 4 small firms agreed. That law also let incumbents certify that a service is competitive and exempted rural telcos under 50,000 lines from many competition obligations, effectively limiting rural competition to facilities-based providers.
	CLECs	Rates Usually Not Reviewed	Rates presumed competitive so long as they're at or below incumbents' rates. CLECs must get state certificate by showing technical, financial and managerial competence. CLECs must file tariffs and give 30 days' notice of rate hikes and a day's notice of reductions. Rate changes below incumbent's levels normally aren't reviewed but rates above the incumbent may have to be justified. A Dec. 2004 state law capped CLEC access charges at incumbents' level and freed CLECs from Lifeline and residential service obligations unless they are receiving federal universal service subsidies.
R.I.	Verizon	Price Caps (2003-2005)	Basic residential rates under nonindexed caps, except permitted increases of $1 per line in both 2003 and 2004, which Verizon made. PUC must review other proposed residential rate rises. Rates for all other retail services can be set anywhere above cost floors. Earnings unregulated. Plan required Verizon to donate up to $2 million annually in 2003 and 2004 to support Internet access for K-12 schools and public libraries, and meet service quality standards. Plan expires at year-end. PUC opened docket on successor plan; Verizon to file proposal this fall.
	Other Incumbents	No Other Incumbents	
	CLEC	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. CLECs must file tariffs and give 30 days' notice of rate changes. Regulatory staff review CLEC changes but normally don't challenge them.

S.C.	BellSouth	Price Caps (1999)	Basic services under nonindexed caps. Other services flexibly priced. Rate changes for all other services can't up total revenues more than 5% per year. Earnings not regulated. No expiration date. 2005 state law deregulated rates for all retail service bundles offered by price-regulated incumbents, regardless of services comprising bundle.
	Sprint, Verizon	Price Caps (1999)	Basic services under caps indexed to CPI. Other services flexibly priced, but cumulative effect of rate changes for all other services can't raise total revenues more than 5% a year. Earnings unregulated. No expiration date. Sprint came under caps in 1999, Verizon in 2000. In 2005, S.C. deregulated rates for all retail service bundles offered by price-regulated incumbents, regardless of services in bundle.
	Other Incumbents	Price Caps (2004)	2004 state law set up optional system for other incumbents capping basic residential, business services at statewide average rates. Nonbasic services under caps indexed to national CPI. Competitive services flexibly priced, subject to revenue cap for competitive basket equal to 5% annually. Eleven firms have chosen this system. Other incumbents are under rate-of-return regulation. 2005 state law deregulated rates for all retail service bundles offered by price-regulated incumbents, regardless of services in bundle.
	CLECs	Rates Not Reviewed	CLECs must get state certificate by showing technical, financial and managerial competence and must file tariffs. On certification, CLECs wanting minimal regulation must request "presumptively valid" tariffing status. This means their tariffed rates are presumed competitive on 14 days' notice for rises or new services, 5 days' notice for cuts. Regulatory review of changes isn't required. CLECs not seeking presumptively-valid status must give 30 days' notice of tariff changes. All changes undergo formal regulatory review. All CLECs entering S.C. markets have chosen presumptively-valid status.

S.D.	All Incumbents	Rates Not Reviewed (2003)	Retail service rates for all incumbents deregulated. In Oct. 2003 PUC granted Qwest statewide retail rate deregulation on competition grounds. Other incumbents rate-deregulated by state law since 1987. For incumbents other than Qwest, state law allows for reregulation if most customers petitions for it, but that power hasn't been used.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs and notify customers of rate and service changes. CLEC changes normally not reviewed.

Tenn.	BellSouth, Sprint, Citizens Telecom	Price Caps (1996)	All services under caps indexed to lesser of one-half GDP-PI or GDP-PI minus 2%. Rate changes exceeding caps allowed under revenue-neutral rate rebalancing, expansion of local calling areas or rate group changes. A 2005 state law deregulated retail rates for bundled services and customer-specific service contracts of price-regulated incumbents. Earnings not regulated. No expiration date. Cap system set by state law; changes require legislative action.
	Other Incumbents	Rate of Return	Other incumbents remain under fully-tariffed rate-of-return regulation. State law lets them opt into same price cap system as big incumbents or propose alternate regulation. No proposals are pending.
	CLECs	Rates Not Reviewed	Rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. Must file tariffs and give 14 days' notice of rate increases; reductions take immediate effect. CLEC rate changes normally aren't reviewed.

Tex.	All Incumbents	Price Caps (1999-2007)	Residential basic, 911, Lifeline and carrier access under nonindexed caps. All other services flexibly priced, but services can't be priced below cost. Earnings unregulated. A 2005 state law gave incumbents option of new program that will deregulate retail rates of all providers in cities over 100,000 population effective Jan. 1, 2006. Old cap system will continue for telcos electing to stay with it. Law will deregulate rates in communities of 30,000 to 100,000 population Jan. 1 if 2 landline and a wireless carrier are competing against incumbent. Rates in communities under 30,000 will be deregulated Jan. 1, 2007 except where PUC decides meaningful competition is lacking. Intrastate access charges to be cut to interstate levels. Law vests video franchising authority with state, not municipalities. Law is being challenged in state courts; its application may be stayed.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file tariffs, but changes normally aren't reviewed and they take immediate effect.

Utah	Qwest	Price Caps (2005)	A 2005 state law replaced a 1997 price cap regime with a new system capping residential basic exchange at current rates through 2007, while deregulating all other retail service rates. After 2007, PSC must lift residential cap in exchanges where local competitors offer residential basic exchange. Earnings unregulated. Previous laws gave Qwest significant retail rate deregulation in 2004-2005 due to competition in the state's more populous areas, and covering about 85% of total business lines and about 50% of residential lines.
	Other Incumbents	Streamlined Rate of Return	Other incumbents, all with fewer than 30,000 lines, get speedy administrative review of rates and earnings through expedited process. Other incumbents have option to switch to deregulation regime prescribed in 2005 law.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence. They must file price lists and give 5 days' notice of changes. Regulatory staff review price list changes but normally don't question them.
Vt.	Verizon	Price Caps (2000-2008)	All services under nonindexed caps set at Sept. 2005 rates. Rates for services introduced after Sept. 2005 deregulated, except that they must stay above cost floors. Verizon must meet service quality standards on pain of penalties up to $10.5 million annually. Carrier must invest minimum $40 million annually in network infrastructure. Earnings not regulated. Plan requires $8.2 million in rate cuts, but cuts will be waived if Verizon volunteers to invest like amount to extend broadband service to unserved communities. Another $7 million in cuts held in abeyance pending Verizon separation of Yellow Pages operation from its white pages directories. Regulators approved this 3-year program to replace an expiring plan that was adopted in 2000.
	Other Incumbents	Streamlined Rate Of Return (2005-2008)	2005 state law allows state's 9 other incumbents to increase rates 9% total over 3 years without rate case, but basic service rates can't rise first year. Carriers can seek additional increases from regulators to cover external cost increases such as tax hikes or weather disasters. Earnings remain subject to regulatory review. Law sunsets July 2008.
	CLECs	Rates Flexibly Regulated	Rates presumed competitive except operator services, capped at Verizon rate. CLECs must get state certificate by demonstrating technical, financial and managerial competence. CLECs must file tariffs, with 45 days' notice of rate increases and 5 days' notice of reductions. Rate changes receive regulatory staff review but they normally aren't challenged. PSB considering rule changes to further lighten CLEC regulation.
Va.	Verizon Va. & Verizon South	Price Caps (2005)	Basic service rates capped at 1994 levels, adjusted annually for inflation as measured by GDP-PI. Nonbasic rates can rise up to 10% the first year and 1% more each succeeding year the program runs. Revenue-neutral price changes can be sought any time -- if no single rise exceeds the lesser of 25% or the basic-service rate cap, and if at least a year has passed since the last rate increase. Price cuts are subject to cost floor. Earnings not regulated. No expiration date.
	Sprint Telcos	Price Caps (1995)	Basic services under cap indexed to one-half GDP-PI. Discretionary services indexed to GDP-PI. Competitive services flexibly priced. Earnings unregulated. No expiration date. Carrier hasn't filed for changes in response to 2004 ban on below-cost service pricing.
	Other Incumbents	Rate Deregulation (2000)	Rates of telephone cooperatives deregulated. Investor-owned small telcos' rates semideregulated by statute. Telcos free to move rates up or down, if hikes are advertised and Corporation Commission doesn't receive excessive complaints.
	CLECs	Some Rates Regulated	Rates capped at incumbent's rate unless regulatory waiver is obtained. CLECs must get state certificate and file tariffs. CLEC rate drops take effect next day, normally aren't reviewed. Rate rise require 30 days' notice to customers and Corporation Commission.
Wash.	All Incumbents	Rate-of-Return	All incumbents under rate-of-return regulation, with no pending proceedings to change that situation. Firms can petition for rate deregulation of competitive services but revenues continue to be accounted for on the regulated side and in rate-of-return calculations. Rate deregulation granted to large incumbents' toll, directory assistance and business services to large customers in markets where competitors operate. Qwest in late 2003 got statewide rate deregulation for specialty business services, and in 2004 won statewide rate deregulation for all retail business telecom services. Verizon in April 2005 settled a rate case, getting $38.6 million of a $240 million increase it sought. State law lets incumbents seek alternative regulation but no petitions are are pending. Qwest operated under earnings-based alternative regulation until 1994, when it returned to rate of-return regulation.

	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLECs must register with state and attest to their competence to serve; affidavits presumed truthful. CLECs must file price lists and give 10 days' notice of changes. Changes receive regulatory staff review but normally aren't questioned.
W.Va.	Verizon	Incentive Regulation (1994-2005)	Basic rates under nonindexed caps, vertical services allowed to rise by rate of inflation (GDP-PI), competitive service rates deregulated. No rate case during program. Program required Verizon invest a minimum of $75 million per year in network, cut intrastate access charges to interstate levels, contribute $15 million toward cost of state E-911 mapping and addressing project, and contribute $8.5 million to public benefit projects approved by a State Telecommunications Users Council. Verizon in 2004 received approval to add several business digital data services to deregulated list. Plan expires at year-end. PSC staff and Verizon plan to meet this fall to discuss extension or replacement of plan.
	Frontier Communications	Incentive Regulation	Basic rates capped, vertical services allowed to rise by rate of (1994-2012) inflation (GDP-PI), firm can request rate deregulation for competitive services. No rate case during program. In May 2005, plan extended until end of 2012. Under extension order, Frontier must invest $95 minimum per access line a year in infrastructure ($116 million over next 7 years), contribute $132,000 per year to public benefit projects approved by State Telecommunications Users Council and reduce intrastate access charges to interstate levels. Frontier is the business name for Citizens Telecom.
	Other Incumbents	Rate Of Return	Other incumbents remain under fully-tariffed rate-of-return regulation. No proceedings to change that are pending.
	CLECs	Rates Flexibly Regulated	CLEC rates presumed competitive. CLEC must get state certificate by showing technical, financial and managerial competence. CLECs must file tariffs and give 14 days' notice of rate changes. All CLEC changes receive regulatory staff review but normally aren't challenged.
Wis.	SBC	Price Caps (1994)	Noncompetitive services under caps indexed to GDP-PI minus 3%. Competitive services flexibly priced. Earnings unregulated. No expiration date. Reviewed in 1999 and 2002, program continued without major change. Future reviews at discretion of PSC. No plans for full-scale review of cap program. In late 2004, regulators reclassified basic business and toll services as competitive and are reviewing SBC's request to declare residential service competitive in city and suburban market areas.
	Verizon	Price Caps (1995)	Noncompetitive services under caps indexed to GDP-PI minus 2%. Competitive services flexibly priced. Earnings not regulated. No expiration date. Reviewed in 1999 and 2002, plan continued without change. Future reviews at discretion of PSC. No plans to review cap program.
	Other Incumbents	Flexible Regulation	Of 68, 26 under price-based regulation; 42 under streamlined rate-of-return with some pricing flexibility. No earnings reviews unless they seek rates above statewide averages. Two telcos under traditional fully tariffed rate-of-return. State's 12 telephone cooperatives aren't rate regulated.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must register with PSC but needn't make showings or file tariffs or price lists. CLECs must give customers 30 days' notice of rate changes but changes normally aren't reviewed.
Wyo.	All Incumbents	Rates Not Reviewed (2003)	All incumbents free to set rates for retail services at any point above TSLRIC cost floor. An incumbent pricing basic local service above statewide benchmark rate of $23.10 monthly may see its state universal service support reviewed. Earnings not regulated. No expiration date.
	CLECs	Rates Not Reviewed	CLEC rates presumed competitive. CLECs must get state certificate by showing technical, financial and managerial competence and must file tariffs. Changes can take effect on a day's notice, normally aren't reviewed. Fully facilities-based CLECs' rate changes may be subject to regulatory staff review.

Source: State Utility Commissions

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**
STATE OF COLORADO	)	**AFFIDAVIT OF JERROLD L. THOMPSON**
COUNTY OF DENVER	) :	**SS**

Jerrold L. Thompson, of lawful age being first duly sworn, deposes and states:

1. My name is Jerrold L. Thompson. I am Executive Director of Retail Issues for Qwest Services Corporation in Denver, Colorado. I have caused to be filed written rebuttal testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Jerrold L. Thompson

SUBSCRIBED AND SWORN to before me this 24th day of October, 2005.

Catherine I. Hansen
Notary Public

My Commission Expires:

CATHERINE I. HANSEN NOTARY PUBLIC STATE OF COLORADO

My Commission Expires July 25, 2008

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-36 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

DAVID L. TEITZEL

REBUTTAL TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

OCTOBER 28, 2005

TESTIMONY INDEX

Page

EXECUTIVE SUMMARY i

I. IDENTIFICATION OF WITNESS 1

II. PURPOSE OF REBUTTAL TESTIMONY 1

III. DR. BEN JOHNSON ("RUCO") 2

a. The Current Competitive Environment 3
b. PBX Trunks 11
c. Additional Local Exchange Lines. 13
d. Stand By Line Service 15
e. Home Business Lines 16
f. Uniform Call Distribution ("UCD") Service 18
g. Uniform Access Solution Service 21
h. Code Billing 23
i. Service Packages 25
j. Wireless Service Competition 28
k. Voice over Internet Protocol Competition 36

IV. MR. ALBERT STERMAN (ACC) 45

V. CONCLUSION 49

EXECUTIVE SUMMARY

My rebuttal testimony focuses on issues raised in this docket in the testimonies of Dr. Ben Johnson on behalf of the Residential Utility Consumer Office ("RUCO") and Mr. Albert Sterman of the Arizona Consumers Council ("ACC") in regard to the status of competition in the telecommunications market in Arizona and how the level of current competition bears on the proposed settlement in this docket. Both of these witnesses contend the current telecommunications market in Qwest's service territory in Arizona is not sufficiently competitive to warrant Commission approval of the proposed settlement agreement regarding Qwest's Price Plan. While referencing the current state of telecommunications competition in Arizona, both witnesses discount the ever-expanding effects of wireless and Voice over Internet Protocol ("VoIP") competition in Arizona, and both witnesses ignore the fact that, under the terms of the proposed Price Plan which calls for statewide averaged Qwest local exchange rates, customers in rural areas of Qwest's service territory will benefit from competition in the more competitive areas of the state such as Phoenix and Tucson. Neither witness, while referencing the current telecommunications market in Arizona and discounting competition in the market as now being sufficient to warrant Commission support of the proposed Qwest Price Plan, presents current facts to support his opinions.

The current facts presented in my rebuttal testimony with respect to CLEC-based competition as well as "intermodal" wireless and VoIP competition demonstrate that competition for Qwest's services in Arizona is robust and continues to increase in intensity and diversity. Since the filing of my direct testimony in this docket over 17 months ago, in which I provided facts regarding telecommunications competition in Arizona at that time, the market has undergone a sea change. Not only has Qwest lost over 200,000 retail lines beyond the loss of 577,000 lines through December 2003 shown in my direct testimony, a number of events have occurred in the past 17 months that have radically altered the telecommunications market and will continue to drive such changes for the next several years. For example, the SBC/AT&T and Verizon/MCI mergers (which mark the end of the existence of the first and second largest interexchange carriers in the nation as independent market competitors) were announced and are now rapidly making their way through the regulatory approval process. Since each of these entities is now providing services in Arizona, the merged entities will be able to leverage their synergies to become even more powerful providers of telecommunications services in the state. Another example emblematic of the changing telecommunications paradigm is the recent purchase of Skype by eBay which will accelerate the adoption of "free" VoIP telephone services as alternatives to traditional telephone services of providers such as Qwest (it is also noteworthy that the SBC/AT&T and Verizon/MCI pending merger partners are now actively marketing their own versions of VoIP). Additionally, the number of wireless subscribers in Arizona has now grown to 3,299,222 and now exceeds the <u>combined</u> total of 3,159,283 ILEC and CLEC access lines in the state.

These are just three of the many significant market developments that have occurred in the 17 months since Qwest filed its direct testimony in this docket. The Arizona telecommunications market is competitive and competition will clearly continue to evolve and grow in the state. The present level of telecommunications competition in Qwest's Arizona service territory, and its continuing trajectory, fully warrants Commission approval of the proposed stipulation in Qwest's Price Plan.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is David L. Teitzel. I am employed by Qwest Corporation ("Qwest") as Staff Director-Public Policy. My business address is 1600 7th Avenue, Room 3214, Seattle, WA, 98191.

Q. DID YOU PREVIOUSLY SUBMIT WRITTEN TESTIMONY IN THIS PROCEEDING?

A. Yes. I filed direct testimony in this docket on May 20, 2004, rebuttal testimony on December 20, 2004 and rejoinder testimony on January 27, 2005.

II. PURPOSE OF REBUTTAL TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My rebuttal testimony responds to allegations by Dr. Johnson and Mr. Sterman that the current retail telecommunications market in Arizona is insufficiently competitive to warrant the relief identified in the proposed stipulated agreement regarding Qwest's Price Plan in this docket. In my rebuttal testimony, I provide facts regarding the current status of

competition in the Arizona market showing that these allegations are ill-founded.

III. DR. BEN JOHNSON ("RUCO")

Q. AT PAGE 2, DR. JOHNSON STATES "UNDER THE PROPOSED PLAN, QWEST WILL HAVE GREATER FREEDOM TO EXPLOIT ITS REMAINING MONOPOLY POWER, BY INCREASING PRICES FOR SERVICES WHERE IT FACES RELATIVELY LITTLE COMPETITION." WOULD YOU COMMENT?

A. By this statement, Dr. Johnson appears to be attempting to sway the Commission toward his view that, in the current market, Qwest retains "monopoly" control of its retail services, which are the subject of Qwest's revised Price Plan at issue in this proceeding. Webster's New College Dictionary defines the term "monopoly" as "exclusive control by one group of the means of producing or selling a commodity or service." In view of the many alternatives that now exist for Qwest's retail services, Qwest no longer holds a "monopoly" in the retail telecommunications market in Arizona. Further, Dr. Johnson, at page 14, goes on to assert, without supporting facts, that "the limited degree of competition which currently exists for local exchange service is not sufficient to justify giving Qwest complete freedom to increase prices for these local exchange service

packages." (emphasis added). He also contends at page 21 "the existing level of competition in many parts of Qwest's Arizona service territory is not strong enough to prevent Qwest from imposing substantial price increases on residential customers if the settlement is approved." (emphasis added). Since Dr. Johnson's contentions are framed in the present tense, my fact-based responses that follow showing that Qwest no longer holds a "monopoly" and that Qwest is currently facing significant competition are similarly framed.

a. The Current Competitive Environment

Q. IS COMPETITION IN THE TELECOMMUNICATIONS MARKET STATIC?

A. Definitely not. In fact, competition in the telecommunications industry is extraordinarily dynamic. Since Qwest filed its direct testimony in this proceeding in May 2004, a number of significant changes have occurred in the telecommunications industry that directly impact the Arizona market. For example, the SBC/AT&T and Verizon/MCI mergers were announced and are now rapidly making their way through the regulatory approval process. Since each of these entities is now providing services in Arizona, the merged entities will be able to leverage their synergies to become even more powerful telecommunications competitors in the state. In another example, after the FCC, in its Triennial Review Order, found that the Regional Bell Operating Companies ("RBOCs") were no longer

required to offer UNE-P wholesale services, Qwest deployed its Qwest Platform Plus ("QPP") service as a replacement to UNE-P. This service is now available on a non-discriminatory basis to any CLEC wishing to utilize Qwest's network on a bundled basis to serve retail customers anywhere within Qwest's service territory in Arizona. A third example, and one symbolizing the changing telecommunications paradigm, is the recently-announced eBay purchase of Skype which will accelerate the adoption of "free" Voice over Internet Protocol ("VoIP") telephone services as alternatives to traditional telephone services of providers such as Qwest. Various major carriers, such as AT&T, MCI and XO, have launched their proprietary VoIP service offerings and independent VoIP providers, such as Vonage and SunRocket, have experienced significant increases in their customer bases. Finally, the number of wireless subscribers in Arizona has grown to 3,299,222 and now exceeds the combined total of 3,159,283 ILEC and CLEC access lines in the state.[1] Each of these market developments has occurred in the intervening 17 months since Qwest filed its direct testimony in this docket, each is a factor in the current Arizona telecommunications environment referenced by Dr. Johnson and each will drive additional telecommunications choices for Arizonans.

[1] *Local Telephone Competition, Status as of December 31, 2004*, Industry Analysis and Technology Division, Wireline Competition Bureau, July 2005. Tables 6 and 13.

1 **Q. DOES DR. JOHNSON ACKNOWLEDGE THAT RETAIL**
2 **TELECOMMUNICATIONS COMPETITION HAS INCREASED IN**
3 **ARIZONA?**
4 A. Yes. At Page 10 of his supplemental testimony, Dr. Johnson states:
5 "RUCO agrees with Qwest that competitive conditions in the state have
6 intensified since the Commission approved the current Plan." He is
7 correct. However, even though he acknowledges that competition has
8 intensified beyond the levels that existed when the Commission approved
9 the existing Price Plan, which is inconsistent with the notion that a
10 "monopoly" exists, his position apparently is that competition has not yet
11 evolved to a point he believes is sufficient to support the negotiated terms
12 of the Price Plan settlement in this docket.

13 **Q. DO YOU HAVE CURRENT EVIDENCE THAT SHOWS THAT DR.**
14 **JOHNSON'S OBSERVATION THAT "COMPETITIVE CONDITIONS**
15 **HAVE INTENSIFIED" IN ARIZONA IS ACCURATE?**
16 A. Yes. In my direct testimony, filed on May 20, 2004, I filed Confidential
17 Exhibit DLT-17 showing the changes in Qwest retail line and wholesale in-
18 service quantities in the Phoenix and Tucson MSA wire centers between
19 December 2000 and December 2003. In Highly Confidential Exhibit DLT-
20 2 attached to this rebuttal testimony, I update that data to reflect quantities
21 in service as of March 2005 and to show quantities in wire centers outside

the Phoenix and Tucson MSAs (where Dr. Johnson suggests Qwest faces "relatively little competition"). While there is no dispute that competitive levels are not homogenous throughout Qwest's service territory and the CLECs tend to focus their efforts on geographic markets where customers are concentrated (it is noteworthy that over 80% of the population of Arizona is within the Phoenix and Tucson MSAs)[2] and where margin opportunities are greatest, Highly Confidential Exhibit DLT-2 shows that competition for Qwest's retail services is certainly not restricted to the Phoenix and Tucson markets. In fact, the data shows that Qwest has lost an additional 151,000 retail residential and business lines in Phoenix and 35,000 in Tucson in March 2005 as compared to December 2003 (the latest vintage of Qwest retail line data in Confidential Exhibit DLT-17 attached to my direct testimony), and that Qwest has lost 38,000 retail residential and business lines in addition to those lost in the Phoenix and Tucson MSAs from December 2000 to March 2005.

Q. WHY DIDN'T CONFIDENTIAL EXHIBIT DLT-17 ATTACHED TO YOUR DIRECT TESTIMONY INCLUDE DATA FOR QWEST WIRE CENTERS BEYOND THE PHOENIX AND TUCSON MSAs?

A. The data in my original Confidential Exhibit DLT-17 was developed in support of Qwest's proposal in this docket to establish "competitive zones"

[2] U.S. Census Bureau: State and County Quick Facts, Arizona 2004 Population Estimate, http://quickfacts.census.gov/qfd/states/04/04027.html.

in the Phoenix and Tucson MSAs only. In settlement negotiations with parties in this docket, Qwest agreed to withdraw its competitive zones proposal to which that exhibit was related. However, Dr. Johnson's reference to the current competitive environment in Qwest's Arizona service territory in general now creates a need to update the data displayed in Confidential Exhibit DLT-17 for the Phoenix and Tucson wire centers as well as wire centers in the remainder of the state to demonstrate that Qwest is experiencing the effects of competition in virtually every area it serves.

Q. DOES THE DATA IN HIGHLY CONFIDENTIAL EXHIBIT DLT-2 SHOW THAT CLEC-BASED COMPETITION GENERALLY EXISTS THROUGHOUT QWEST'S SERVICE TERRITORY IN ARIZONA?

A. Yes. In fact, in addition to the Qwest retail access line summary in this exhibit, in-service counts of Local Interconnection Service ("LIS") trunks,[3] unbundled loops, UNE-P lines[4] and resold lines are provided. This data shows that CLECs are actively purchasing wholesale services from Qwest

---

[3] LIS trunks are utilized by facilities-based CLECs to exchange traffic between the CLEC switch and Qwest's switches and are an indicator of the presence of CLECs serving the market via CLEC-owned loops or via UNE loops purchased from Qwest.

[4] While the FCC's ruled in its Triennial Review Order that RBOCs are no longer required to provide UNE-P service after a specific phase-out period, Qwest has deployed a replacement wholesale service entitled "Qwest Platform Plus" (QPP). As of March 2005, some UNE-P lines remained in service pending conversion to QPP. Therefore, the March 2005 quantities used for comparative purposes combine QPP lines with UNE-P lines remaining in service at that time.

1 not only in the Phoenix and Tucson areas, but in virtually every Qwest
2 wire center in the state.

3 **Q. YOUR HIGHLY CONFIDENTIAL EXHIBIT DLT-2 SHOWS THAT**
4 **CERTAIN AREAS IN ARIZONA ARE SUBJECT TO INTENSE**
5 **COMPETITION WHILE OTHER AREAS HAVE MODEST**
6 **COMPETITION. DOES THE PROPOSED PRICE PLAN ADDRESS THIS**
7 **ISSUE?**

8 A. Yes. In fact, the proposed settlement in the pending price plan calls for
9 continued statewide average pricing for the term of the plan or until such
10 time as retail deaveraging is ordered by the Commission. Further, Dr.
11 Johnson, at page 18 of his supplemental testimony, acknowledges Qwest
12 Witness Jerrold Thompson's statement that "Qwest will continue to price
13 its services to consumers in sparsely-populated areas of the state in
14 similar ways to consumers in the highly-competitive areas of Phoenix and
15 Tucson" (referencing Thompson Direct, p. 4). In other words, as Qwest
16 adjusts prices during the term of the proposed Price Plan to respond to
17 intense levels of competition in a particular area of the state, all Qwest
18 consumers will realize the benefit of that price adjustment. In fact, such
19 benefits have already been seen in Arizona. In response to Cox's
20 strategy to price second residential access lines at a discount relative to
21 primary residential lines, Qwest implemented a price reduction from the

previous rate of $13.18 to $11.00 in April 2003 and then to $10.00 in April 2004 for Qwest additional access lines.[5] While Cox is presently competing with Qwest only in the Phoenix and Tucson areas, this reduction was implemented throughout Qwest's service territory in the state.

Q. DO YOU HAVE OTHER CURRENT EVIDENCE SHOWING QWEST'S SERVICES IN ARIZONA ARE SUBJECT TO STRONG COMPETITION?

A. Yes. For example, TNS Telecoms, an independent research entity, produces a quarterly market share analysis of telecommunications providers in each state based upon a combination of primary survey research and review of actual customer bills from their telecommunications providers. For its 2nd Quarter 2005 report,[6] TNS surveyed 651 customers and reviewed 181 telephone bills in Arizona. In this report, TNS calculated Qwest's "share of connections," which quantifies Qwest's proportion of the communications market in its service territory in Arizona, considering customers purchasing service from Qwest (including Qwest wireline service and/or Qwest wireless service), CLECs, cable telephony providers, wireless providers and VoIP providers (television service connections are not considered to be "communications connections" in this analysis). TNS found that, for 2nd Quarter 2005,

[5] Qwest Corporation Exchange and Network Services Price Cap Tariff, Section 5, Page 21, Release 3, Effective 4/1/04.

Qwest had a 33% share of communications connections in its service territory, as compared to a 65% connections share in 2nd Quarter 2000. Clearly, this data shows that customers in increasing numbers are finding alternatives to Qwest services to meet their communications needs.

Q. AT PAGES 10 AND 11 OF HIS SUPPLEMENTAL TESTIMONY, DR. JOHNSON COMPLAINS THAT, IN THE PROPOSED PRICE PLAN, ADDITIONAL LINES, PBX TRUNKS, CALLER ID BLOCK, ZONE INCREMENT CHARGES, STAND-BY LINE SERVICE, HOME BUSINESS LINE SERVICE, UNIFORM CALL DISTRIBUTION AND CODE BILLING ARE BEING RECLASSIFIED FROM BASKET 1 TO BASKETS 2 OR THREE. WOULD YOU DESCRIBE THE SERVICES HE IDENTIFIES?

A. Yes. As a preliminary matter, contrary to Dr. Johnson's testimony, Caller ID Block and Zone Increment Charges remain hard capped in Basket 1 under terms of the proposed Price Plan and I therefore don't address those services. With respect to the remaining services identified by Dr. Johnson in his supplemental testimony, I will discuss in the following sections why the competitive environment supports the proposed reclassification of each of these services.

---

[6] *Consumer Market Share Quarterly Summary Report 2Q2005*, TNS Telecoms, September 2005.

1 **b. PBX Trunks**

2 **Q. PLEASE DEFINE PBX TRUNK SERVICE AS OFFERED BY QWEST.**

3 A. Qwest's PBX trunk service is a local exchange business service, provided
4 on either a two wire or a four wire basis, used to connect on-premises
5 PBX equipment[7] to Qwest's local exchange network.[8] This service can be
6 configured on a two way calling, inward only calling or outward only calling
7 basis as demanded by the PBX customer and is available on a month-to-
8 month or on a rate-stabilized basis. Qwest's recurring rate for a standard
9 two way, two-wire PBX trunk is currently $38.51 while the four- wire PBX
10 trunk is priced at $73.51.

11 **Q. ARE OTHER PROVIDERS NOW OFFERING PBX TRUNKS WITHIN**
12 **QWEST'S ARIZONA SERVICE TERRITORY?**

13 A. Yes. In fact, I have reviewed tariffs and websites of a subset of well-
14 known CLECs in Arizona and have summarized in Exhibit DLT-3 the local
15 exchange services now available from a selection of these CLECs to
16 illustrate the types of competitive PBX trunk services available. As shown
17 in this exhibit, AT&T offers statewide flat-rated PBX trunk service at
18 $35.65 per month within Qwest's service territory, Cox offers PBX trunk

[7] A Private Branch Exchange ("PBX") switch is customer-owned equipment located at the customer's premises and is essentially a small-scale version of a telephone company's central office switch, having many of the features and functions of the larger switch. PBX switches have been manufactured and sold by numerous manufacturers, such as Alcatel, AT&T, Ericsson, NEC, Northern Telecom, Siemens, Rolm and others and have been widely available for retail business applications since the 1960s.

service at a statewide rate of $35.00 per month in its Phoenix and Tucson markets, MCI offers analog PBX trunks service in the Phoenix and Tucson rate centers at $38.51 per month, SBC offers its "Access Advantage Plus Trunk" as a contracted service within the Phoenix and Tucson areas at $18.00 to $25.00 depending on length of term, Time Warner offers contracted analog PBX trunk service in the Phoenix and Tucson areas at $46.88 to $51.98 dependent on term and XO offers contracted two way analog PBX trunk service for $35.95 to $37.95 per month dependent on term. While this list is by no means comprehensive, it illustrates that PBX trunk service is now available from a variety of competitors in Arizona.

Q. WHAT CURRENT EVIDENCE DO YOU HAVE SHOWING THE IMPACT OF COMPETITION ON QWEST'S ARIZONA PBX TRUNK SERVICE CUSTOMER BASE?

A. Qwest's PBX in-service base has declined by nearly 50% between December 2000 and March 2005 from Confidential XXX to XXX (confidential figures are shown in Confidential Exhibit DLT-1). Clearly business PBX customers are finding direct alternatives to Qwest's PBX trunk services.

[8] Qwest Arizona Exchange and Network Services Price Cap Tariff, Section 5.3, Page 49.

1 **c. Additional Local Exchange Lines.**

2 **Q. PLEASE DESCRIBE ADDITIONAL LINE LOCAL EXCHANGE SERVICE**
3 **AS PROVIDED BY QWEST.**

4 A. Qwest has established an "additional individual line" service to respond to
5 changes in the competitive market in Arizona.[9] Additional line service is
6 provided for residential and business customers. This service is simply a
7 flat-rated access line in addition to the primary line at the customer's
8 location that may be differentially priced in response to competition. For
9 example, Qwest's residential additional line is priced at $10.00 per month
10 while the primary residential line is priced at $13.18 per month.

11 **Q. HAVE QWEST'S COMPETITORS OFFERED DIFFERENTIAL PRICING**
12 **FOR ADDITIONAL LOCAL EXCHANGE LINES IN ARIZONA?**

13 A. Yes. As shown in Exhibit DLT-3, Cox Communications offers a second
14 line to its residential "Combination Service" customers in the greater
15 Phoenix and Tucson areas (those who subscribe to Cox cable television
16 service as well as Cox telephone service) for $8.50 per month while its
17 primary residential line is priced at $11.75 per month. MCI offers its
18 "Business B1 Multi-Line Service" in the Phoenix and Tucson rate centers
19 at a recurring rate of $24.99 per month, while its "Business B-1" single line
20 service is priced at $44.99 per month. SBC offers a "Multi-Line for

Residence" service in the greater Phoenix and Tucson areas at $16.00 per month while its primary line residential service is a packaged offering (includes 16 features) priced at $30.00 per month. Trinsic (f/k/a Z-Tel) offers an additional line residential package (including features) priced approximately $5.00 lower than its primary line residential package. Many other CLECs offer multi-line services without pricing distinctions between first and additional lines. Qwest's "additional line" pricing structure enables Qwest to react quickly to shifting market strategies with respect to the additional line market.

Q. WHAT CURRENT EVIDENCE DO YOU HAVE SHOWING THE IMPACT OF COMPETITION ON QWEST'S ARIZONA ADDITIONAL LINE SERVICE CUSTOMER BASE?

A. Qwest has experienced dramatic declines in additional line counts for both residence and business services. For example, Qwest's residential additional line in-service quantities declined over 40% between December 2000 to March 2005 from Confidential XXX to XXX and its business additional line in-service counts declined from Confidential XXX to XXX over this same period (confidential figures are shown in Confidential Exhibit DLT-1).

[9] Qwest Exchange and Network Services Price Cap Tariff, Section 5.2.4, Pages 21 and 22.

d. Stand By Line Service

Q. PLEASE DESCRIBE QWEST'S STAND BY LINE SERVICE.

A. Stand By Line Service is an additional line business service which allows business customers to expand access to their business and expand the capacity to make outgoing calls on an as-needed basis. This service is designed for customers that experience periodic peaks and valleys in calling volumes to and from their businesses. The service is priced at $17.00 per month and all inbound and outbound calls are priced at $0.05 per minute.[10]

Q. DO COMPETITIVE ALTERNATIVES EXIST TO QWEST'S STAND BY LINE SERVICE?

A. Yes. Business local exchange services available from CLECs in Arizona are competitive substitutes for Qwest's Stand By Line service. The customer's decision as to purchase of a Stand By Line vs. a CLEC's business access line will be driven by individual customer usage patterns: the customer will weigh the expected level of usage on the line in determining whether Stand By Line service or a CLEC's business line service best meets his or her needs. Additionally, as shown in Exhibit DLT-3, Eschelon provides a service in the greater Phoenix area entitled "Premium Seasonal Line" at $15.13 per month which serves precisely the

same need as Qwest's Stand By Line. This service provides a "stand by" business line that is connected to the Eschelon switch but is not activated until the customer notifies Eschelon that its needs additional calling capacity.

Q. WHAT CURRENT EVIDENCE DO YOU HAVE SHOWING THE IMPACT OF COMPETITION ON QWEST'S ARIZONA STAND BY LINE SERVICE CUSTOMER BASE

A. Qwest's Stand By Line in-service access line base has declined in Arizona by over 50% between December 2000 and March 2005, from Confidential XXX to XXX (confidential figures are shown in Confidential Exhibit DLT-1).

e. Home Business Lines

Q. PLEASE DESCRIBE QWEST'S HOME BUSINESS LINE SERVICE.

A. Home Business Line service is a flat-rated business voice-grade service which includes the functionality of Custom Ringing and both business and residential listings. This service is designed for "work at home" customers who wish to have a business listing and combine residential and business usage on a single telephone line, and the service is priced at $36.03 per month.[11]

---

[10] Qwest Exchange and Network Services Price Cap Tariff, Section 5.2.5, Pages 29, 30.
[11] Qwest Exchange and Network Price Cap Tariff, Section 5.2.8, Pages 42, 43.

1 **Q. DO COMPETITIVE ALTERNATIVES NOW EXIST IN ARIZONA TO**
2 **QWEST'S HOME BUSINESS LINE SERVICE?**
3 A. Yes. Clearly, any CLEC offering business local exchange services in
4 Arizona, including the CLEC subset shown in Exhibit DLT-3, provides
5 services substitutable for Qwest's Home Business Line service. Cox
6 offers a service in its greater Phoenix and Tucson service territories
7 marketed as "Home Office Line" priced at $30.00 per month. Arizona Dial
8 Tone, which states it serves "most areas of Arizona,"[12] offers a Business
9 Flat Rate service priced as low as $18.99 per month as an attractive
10 alternative to Qwest's Home Business Line service. Eschelon offers its
11 business "On Network Premium Measured Line Service" at $23.31 per
12 month which includes a business directory listing and represents another
13 alternative for the work at home business customer. Regal Telephone,
14 which markets its service as being available in Qwest's service territory,
15 offers a local exchange service priced at a flat $39.99 per month for
16 residential and business applications. Trinsic offers its "Trinsic Spectrum
17 Local Plus PPS" business local service in Qwest's Arizona service territory
18 at an attractive rate of $26.00 per month which is yet another alternative to
19 Qwest's Home Business Line.

[12] www.arizonadialtone.com, visited 10/17/05.

Q. WHAT CURRENT EVIDENCE DO YOU HAVE SHOWING THE IMPACT OF COMPETITION ON QWEST'S ARIZONA HOME BUSINESS LINE SERVICE CUSTOMER BASE?

A. Despite the popularity growth of home-based businesses, Qwest's Home Business Line service has seen a significant decrease in market demand, and Qwest's access line base for this service has nearly disappeared with a decline between December 2000 and March 2005 from Confidential XXX to XXX (confidential figures are shown in Confidential Exhibit DLT-1).

f. Uniform Call Distribution ("UCD") Service

Q. PLEASE DESCRIBE QWEST'S UNIFORM CALL DISTRIBUTION SERVICE.

A. Uniform Call Distribution service provides a method of automatically distributing a high volume of incoming calls to lines in a multi-line hunt group equally and is often used by companies' customer service groups to handle incoming calls. This arrangement places calls in queue if all customer service lines are busy and distributes the calls as representatives become available. This service is priced at $2.00 per line in the multi-line hunt group, and additional charges are applied if the subscriber needs specific queuing and delay announcement options.

Q. DO COMPETITIVE ALTERNATIVES EXIST IN ARIZONA TO QWEST'S UCD SERVICE?

A. Yes. Major carriers, such as AT&T and MCI offer call distribution services in the Enterprise market. AT&T's current website discusses its AT&T Resource Manager ("ARM") product which "establishes a next generation of telephony software architecture by applying Automatic Call Distributor-like (ACD) call routing and by consolidating management information at the network level."[13] Similarly, MCI advertises "Intelligent Contact Routing" service, which provides "the benefits of Call Routing plus in-network queuing to reduce call transfers and customer wait times."[14] Additionally, modern PBX equipment typically provides call distribution functionality that is a direct substitute for Qwest's central office-based routing services. As research entity Wikipedia notes:

> PBXs offer many capabilities, with different manufacturers providing different features in an effort to differentiate their products. Here is a short list of common capabilities (note that each manufacturer may have a different name for each capability):
>
> > Call Transfer, Direct Inward Dialing, Speed Dialing, Voice Mail, Follow Me, Call Forwarding, Music on Hold, Automatic Ring Back, Night Service, **Call Distribution (ACD, fixed sequences, etc),** Call Waiting, Call Pick Up, Call Park, Call

[13] http://www.business.att.com/service_fam_overview.jsp?repoid=ProductSub-Category&repoitem=eb_resource_manager&serv_port=eb_contact_centers&serv_fam=eb_resource_manager&segment=ent_biz, visited 10/19/05.

[14] http://global.mci.com/us/enterprise/contactcenter/routing/, visited 10/19/05.

> Conferencing, Custom Greetings, Shared Message Boxes, Automated Directory Services.[15]

Clearly, direct alternatives to Qwest's UCD service are available from multiple providers.

Q. DO YOU HAVE EVIDENCE THAT COMPETITIVE ALTERNATIVES ARE IMPACTING QWEST'S UCD CUSTOMER BASE IN ARIZONA?

A. Yes. Because UCD service has long been competitive, even before 2000, Qwest has a small portion of the market for this service. Customer demand for Qwest's UCD service in 2000 was slight and demand has declined even further since that time. The in-service line counts for Qwest's UCD service declined by over 20% between December 2000 and March 2005 from Confidential XXX to XXX (confidential figures are shown in Confidential Exhibit DLT-1).

[15] http://en.wikipedia.org/wiki/PBX, visited 10/19/05.

1 **g. Uniform Access Solution Service**

2 **Q. PLEASE DESCRIBE QWEST'S UNIFORM ACCESS SOLUTION**
3 **SERVICE.**

4 A. Uniform Access Solution ("UAS") service provides an arrangement that
5 allows channels to function with one number per channel group. UAS
6 includes a DS1 facility with common equipment and a network connection
7 which provides switching for local exchange and toll network access.
8 Each DS1 facility utilizes 1 through 24 channels configured with trunk-side
9 termination and one number functionality. In other words, all 24 channels
10 on the DS1 facility are accessed via the same telephone number. This
11 service is targeted to the Enterprise business market, consisting of
12 medium to large-sized business customers with digital PBX equipment,
13 having a need for a group of employees receiving calls to be reached via a
14 single number. The UAS DS1 facility is offered at a monthly rate of
15 $150.00 (additional charges for common equipment and features also
16 apply), and rate stability plans with terms ranging from 3 to 10 years are
17 offered which provide escalating discounts based on length of term.[16]

18 **Q. DO COMPETITIVE ALTERNATIVES EXIST TO QWEST'S UNIFORM**
19 **ACCESS SOLUTION SERVICE?**

[16] Qwest Exchange and Network Services Price Cap Tariff, Section 15.3, Pages 17-21.

A. Yes. Carriers providing digital PBX trunks, with DID capability, each represent a competitive alternative to Qwest's UAS service. As shown in Exhibit DLT-3, for example, MCI offers its Local Trunk 2 Way Direct (Analog and Digital) service in the Phoenix and Tucson rate centers at $91.51 per trunk. SBC Telecom offers its Access Advantage Plus Trunk service, which provides a trunk side connection to support direct inward dialing, in the greater Phoenix and Tucson areas at $25.00 per month. Time Warner provides its Digital Trunk Service in the Phoenix and Tucson areas at a rate of $250.00 for the digital facility. Each of these services can be configured to serve the same need as Qwest's UAS service.

Q. DO YOU HAVE CURRENT EVIDENCE THAT COMPETITION IS ERODING QWEST'S UAS CUSTOMER BASE?

A. Yes. Qwest's UAS customers have largely migrated away from this service to competitive alternatives. In fact, the number of DS1 and DS3 UAS facilities in service has declined precipitously between December 2000 and March 2005 from Confidential XXX to XXX (confidential figures are shown in Confidential Exhibit DLT-1).

1 **h. Code Billing**

2 **Q. PLEASE DESCRIBE QWEST'S CODE BILLING SERVICE.**

3 A. Code billing is a special toll billing arrangement which enables the
4 customer to obtain details of toll calls through the use of code numbers
5 assigned by the Company. The customer may associate the code
6 numbers with specific stations, departments, projects, etc., for internal
7 accounting purposes. Bills for toll calls will be rendered in accordance
8 with the code number furnished to the toll operator at the time the call is
9 placed. This service is intended for use primarily in PBX applications but
10 may be used in conjunction with other business services. The recurring
11 rate for up to 200 codes is $38.20, with additional groups of 50 codes
12 priced at $9.55 per month.[17]

13 **Q. DO COMPETITIVE ALTERNATIVES CURRENTLY EXIST TO QWEST'S**
14 **CODE BILLING SERVICE?**

15 A. Yes. Most modern PBX equipment has the ability to track calls in a
16 fashion similar to Qwest's Code Billing service and ascribe them to the
17 department or extension from which they originated. According to
18 research entity Wikipedia:

19 Functionally, the PBX performs three main duties:

[17] Qwest Exchange and Network Services Price Cap Tariff, Section 10.5.2, Page 8.

- Establishing connections (circuits) between the telephone sets of two users.
- Maintaining such connections as long as the user requires them.
- Providing information for accounting purposes (e.g., metering calls).

Clearly, with such PBX functionality, the customer has the ability to track telephone usage of extensions served by the PBX. In essence, Qwest's Code Billing service provides a convenient means of tracking such calls and removing that burden from the customer.

Q. DO YOU HAVE CURRENT EVIDENCE THAT COMPETITION IS ERODING QWEST'S CODE BILLING CUSTOMER BASE?

A. Yes. Because Qwest's Code Billing service has competed with similar functionality available from PBX equipment for over 20 years, it has largely been displaced. The demand for Qwest's Code Billing service is now de minimis. Customers are clearly finding other options for this service. In January 2003 this service generated monthly revenue of only Confidential $XXX. As of September 2005, the monthly revenue for this service had declined to Confidential $XXX (confidential figures are shown in Confidential Exhibit DLT-1).

i. Service Packages

Q. PLEASE DESCRIBE THE LOCAL EXCHANGE SERVICE PACKAGES OFFERED BY QWEST IN ARIZONA.

A. Qwest now offers a range of local service packages typically consisting of a grouping of optional features coupled to a flat residential or business exchange access line at a discounted price. In general, the service packages offered to mass market residential and business customers are marketed under the "Qwest Choice" brand. For example, the Qwest Choice Business package is offered at $39.99 per month and consists of a flat business line and three features. The Qwest Choice Business Plus package is a similar bundled offering but provides over twenty features in the package. For residential customers, the Qwest Choice Home package is offered at $12.81 and includes three standard features while the Qwest Choice Home Plus package is priced at $19.81 and includes over twenty features. The Choice Home package rates exclude the price of the associated residential access line.[18] For the primary residential line customer, the combined access line and Choice Home package rate is $25.99.

Q. DOES COMPETITION FOR QWEST'S SERVICE PACKAGES CURRENTLY EXIST IN ARIZONA?

A. Yes. In fact, packaging of services is a preferred means by which many CLECs, wireless carriers and internet telephony providers now offer service. I will discuss current wireless and internet telephony competition in following sections. With regard to CLECs in Arizona, Exhibit DLT-3 shows a sampling of the packaged services available from a subset of the CLECs in the state. For example, Cox Communications offers its "Simply 3 Package," consisting of a residential access line, Caller ID, Voice Messaging and Call Waiting at $19.95 per month. It also offers a more robust package consisting of a residential line plus 13 features at $26.70 per month. Cox also offers a "Business Line Advantage" package for business customers at $38.00 per month. MCI offers a wide range of packages including local service, features and long distance to its business customers in the Phoenix and Tucson rate centers with prices ranging from $27.99 to $59.99 depending on the number of features in the package. SBC offers its "Phone Solutions for Business" package in the greater Phoenix and Tucson areas, consisting of local business service and 14 features, at $42.00 per month as well as a "Multi-Line for Business" package, consisting of local service and 5 features, at $36.00 per month. Sprint now offers its "Sprint Complete Sense" residential package to customers in Qwest's UNE Zone 1 wire centers, consisting of an access line, 250 long distance minutes per month and a range of

[18] Qwest Exchange and Network Services Price Cap Tariff, Section 5.9, Pages 168-176.9.

calling features for $44.99 per month, as well as a "Sprint Complete Sense for Business" package in Qwest's UNE Zone 1 and 2 wire centers, consisting of a business local exchange line, a range of custom calling features and discounted long distance, for $39.95 per month. Trinsic offers residential service packages, marketed as "Trinsic Value" and consisting of an access line, four calling features and 50 minutes of long distance calling at $32.99 in Qwest UNE Zone 1, $33.99 in UNE Zone 2 and $53.99 in UNE Zone 3. Arizona Dial Tone offers its "Essential Package" to residential customers in "most areas of Arizona," consisting of a flat-rated residential line, a set of calling features and inside wiring maintenance for $39.99 per month. This discussion is only a small representation of the range of competitive packages available from Arizona CLECs. Each of these offerings is detailed in Exhibit DLT-3.

Q. HAVE COMPETITIVE SERVICE PACKAGES IMPACTED QWEST'S RESIDENTIAL AND BUSINESS CUSTOMER BASE?

A. Yes. Qwest has lost a substantial proportion of its local exchange access line base to competition in Arizona. As shown in Exhibit DLT-3, a large number of CLECs, including Cox, AT&T, MCI, Sprint, Trinsic and others are actively marketing packaged local exchange services in Arizona. Additionally, similar packaged offerings by intermodal wireless and VoIP providers are widely available. These competitive services have had a

significant collective impact on Qwest's residential and business customer base as quantified earlier in my rebuttal.

j. Wireless Service Competition

Q. IN HIS ASSERTIONS REGARDING THE CURRENT STATE OF COMPETITION IN ARIZONA, DR. JOHNSON APPEARS TO DISREGARD WIRELESS SERVICES AS A VIABLE COMPETITIVE ALTERNATIVE TO QWEST LANDLINE SERVICES WHEN HE STATES "FEW LOCAL COMPETITORS HAVE ENJOYED SUCCESS IN PENETRATING THE LOCAL EXCHANGE MARKET." (JOHNSON AT 21). IS HE CORRECT IN DOING SO?

A. No. Wireless phones are now widely accepted by business and residential consumers alike for voice telephony. In addition, wireless providers are now augmenting their services with data applications such as dial-up wireless Internet access, text messaging and image transmission to bring additional functionality to their services and to attract new customers. The customer shift toward wireless substitution in Arizona can be seen by reviewing facts provided by the FCC in its most recent Local Telephone Competition Report.[19] From December 2000 to December 2004, the FCC's data shows that Incumbent telephone

[19] Local Telephone Competition: Status as of December 31, 2004, *Industry Analysis and Technology Division, Wireline Competition Bureau,* July 2005.

company access lines in Arizona decreased from 3,073,779 to 2,367,011 a reduction of 706,768.[20] Over this same period, CLEC access in the state increased from 165,597 to 792,272, an increase of 626,675.[21] On a net basis (Incumbent and CLEC lines combined), wireline access lines in Arizona declined by 80,093 from 2000 to 2004, suggesting that other forms of competition beyond wireline-based competition are impacting the market. In contrast, wireless subscriber counts in Arizona over this same timeframe grew from 1,855,115 to 3,299,222, an increase of 1,444,107, or 78%.[22] Since wireline and wireless services both provide voice telephony functionality and demand for voice telephone services should logically be growing at least on the same pace as population growth in Arizona, it is clear that wireless service is supplanting wireline service for many Arizonans.

Q. HAS THE FCC RELEASED ANY ADDITIONAL DATA SHOWING THE INCREASING TREND IN SUBSTITUTION OF WIRELESS SERVICE FOR TRADITIONAL WIRELINE SERVICES?

A. Yes. In its most recent Commercial Mobile Radio Service ("CMRS") competition report,[23] the FCC provides facts with regard to the percentage of households who have "cut the cord" (disconnected wireline telephone

[20] *Id, Table 9.*
[21] *Id., Table 8.*
[22] *Id., Table 13.*

service and rely exclusively on wireless service for their voice telecommunications needs). The FCC states:

> Total wireless substitution has grown significantly in recent years. According to a 2004 survey done for the Centers for Disease Control (CDC), 5.5 percent of adults lived in households with only wireless phones in the second half of 2004, up from 4.4 percent in the first half of 2004 and 2.8 percent in the first half of 2003.[24]

The FCC's data indicates a linear increase in the proportion of wireline subscribers who have "cut the cord," and there is no sign that this trend is abating. However, this data only tells part of the story. In many instances, subscribers remove a second landline in favor of wireless service and/or shift a significant amount of telephone usage to wireless service. In each of these instances, demand for Qwest wireline telephone service is reduced. The FCC states:

> Even when not "cutting the cord" completely, consumers appear increasingly to choose wireless service over traditional wireline service, particularly for certain uses. A recent study showed that one-third of households receive more than half of their calls on wireless phones, with 9 percent receiving almost all their calls wirelessly. In the *Ninth Report,* we discussed the pressures that wireless growth is placing on companies which offer wireline services. In 2004 these trends continued, as the number of landlines declined by around 1.2 percent quarterly in the second and third quarters of 2004, and wireline long distance voice revenues continued to erode. At the end of 2004, there were more wireless subscribers than wireline in the United States – 176

[23] Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, Tenth Report, September 30, 2005.
[24] *Id,* p. 72, ¶196.

1 million access lines versus more than 184 million wireless
2 subscribers.[25]

3 It is clear that the national wireless substitution trends identified by the
4 FCC are mirrored in Arizona.

5 **Q. DOES OTHER EVIDENCE EXIST SUPPORTING THE FCC'S**
6 **CONCLUSIONS THAT WIRELESS SERVICES ARE SUBSTITUTES**
7 **FOR TRADITIONAL WIRELINE SERVICE APPLICATIONS?**

8 A. Yes. Other independent experts have studied the phenomenon of
9 wireless substitution and echo the FCC's conclusions. For example, the
10 Yankee Group reports that "more than 36% of local calls and 60% of long
11 distance calls have been replaced by wireless."[26] Additionally, at the
12 Regional Oversight Committee ("ROC") meeting in September 2004,
13 attended by regulators from Qwest's 14 in-Region states, Western
14 Wireless' CEO John Stanton reported "increasing numbers of consumers
15 have cut the cord or are primarily using their wireless phone for their
16 telecommunication needs," and estimated the proportion of consumers
17 engaging in such substitution now exceeds 5% and is expected to
18 increase to 30% by 2008."[27] Independent research firm Instat/MDR
19 concurs with Mr. Stanton, as shown in a February 2004 CNET News.com
20 article, which states: "by 2008, nearly a third of all U.S. wireless

---

[25] *Id.*, p. 73, ¶197.

[26] *The Success of Wireline/Wireless Strategies Hinges on Delivering Consumer Value*, P. 7, The Yankee Group, October 2004.

1 subscribers won't have a landline phone in their home, according to a
2 forecast released Wednesday by high-tech market research firm
3 Instat/MDR. That's a dramatic increase in what's known as cord
4 cutting."[28] In short, there is no evidence that the rate of substitution of
5 wireless service for traditional wireline service is abating. Rather, all
6 evidence is that such substitution will continue to increase at an
7 exponential rate.

8 **Q. WHAT WIRELESS CARRIERS ARE NOW ACTIVE IN PROVIDING**
9 **SERVICES IN QWEST'S SERVICE TERRITORY IN ARIZONA?**

10 A. Competitive wireless service is now available in Qwest's service territory in
11 Arizona from various major carriers such as Sprint PCS, T-Mobile,
12 Verizon, Cingular, Cricket and Alltel. Virtually every Qwest customer
13 within Qwest's service territory in the state is within the wireless coverage
14 area of at least one of these providers.

15 **Q. DO YOU HAVE CURRENT EVIDENCE SHOWING THE SERVICES**
16 **OFFERED BY THESE PROVIDERS IS AN ATTRACTIVE**
17 **ALTERNATIVE TO QWEST'S LOCAL EXCHANGE SERVICES?**

18 A. Yes. Wireless services now provide functionality nearly identical to
19 wireline service, from the perspective that both provide switched voice

---

[27] Western Wireless ROC presentation, September 2004.
[28] *"Cord Cutting"Frays Phone Revenues,* CNET News.com, February 25, 2004.

communication capability, access to directory assistance, access to popular calling features (such as call waiting, caller I.D., voice messaging, etc), access to operator services, number portability (e.g.: customers may now port a wireline telephone number to a wireless carrier and vice versa) and access to E911 service. Beyond these similarities, wireless services provide tangible benefits to elderly or disabled persons not available with Qwest's wireline service: wireless service is highly portable and the small wireless telephones can easily be carried by an elderly person in a shirt pocket or the pocket of a housecoat. If such a person were to fall and be physically unable to reach a wireline telephone, the extra convenience of a wireless telephone readily at hand to summon emergency help could avert dire consequences.

From a price perspective, various options are available from the Arizona wireless carriers designed to meet the diverse needs of customers. In some instances, the customer may have a need for only standard telephone service, without any features, for use in occasionally contacting family members or for emergencies. The price for Qwest's standard flat residential telephone service in Arizona, including the EUCL charge, is $19.48 per month. Currently, T-Mobile offers its "Basic Plan" in Arizona, which includes 60 "anytime" minutes and 500 weekend/evening minutes,

at $19.99 per month.[29] Alltel offers its "Greater Freedom Plan," which includes 300 minutes, at $29.99 per month.[30] Cricket offers an "Unlimited Basic" plan in the greater Phoenix and Tucson areas at $30.00 per month, which includes unlimited local calling and free mobile-to-mobile calling.[31] It is noteworthy that Cricket is the most aggressive wireless carrier in marketing its service as a direct replacement for traditional landline telephone service. Even for the customer who wants only basic telephone access without associated features, these examples show that reasonably-priced wireless alternatives exist in Arizona.

Q. ARE WIRELESS SERVICE OPTIONS AVAILABLE FOR CUSTOMERS WHO DEMAND CALLING FEATURES IN ADDITION TO THE ABILITY TO PLACE AND RECEIVE LOCAL TELEPHONE CALLS?

A. Yes. Certain customers have a preference for a packaged service consisting of local calling and a fixed range of calling features. In Arizona, Qwest offers its Choice Home residential package at $32.99 (including the EUCL charge) designed for this type of customer. T-Mobile's "Basic Plus" plan, which includes 300 anytime minutes, free long distance, unlimited night and weekend minutes and call waiting, caller ID, 3 way calling and

[29] www.T-Mobile.com, visited 10/17/05.
[30] www.alltel.com, visited 10/18/05.
[31] www.mycricket.com, visited 10/18/05.

1 voice messaging, is available in Arizona at $29.99 per month.[32] Cricket
2 offers its "Unlimited Access" service for $45.00 per month, which includes
3 unlimited local calling, Call Waiting, Caller ID, 3-Way calling and Voice
4 Messaging as well as the benefit of mobility.[33] Alltel offers its Greater
5 Freedom Plan at $29.99 per month, which includes 300 anytime minutes,
6 Call Waiting, Caller I.D., 3-Way Calling and Voice Messaging. Each of
7 these plans, as well as representative wireless offerings of other wireless
8 carriers in Arizona, is shown in Exhibit DLT-4. While there are a wide
9 variety of additional calling plans available from the wireless providers
10 currently serving Arizona, this small sampling of plans shows that
11 packaged wireless plans that are directly competitive with Qwest's Choice
12 Home package are now readily available.

13 **Q. IS IT YOUR CONTENTION THAT WIRELESS SERVICE CAN**
14 **CURRENTLY BE CONSIDERED A DIRECT SUBSTITUTE FOR QWEST**
15 **WIRELINE SERVICES IN EVERY APPLICATION?**

16 A. No. Qwest does not maintain that wireless service is viewed by every
17 Arizona customer as a complete substitute for traditional wireline service.
18 A certain number of customers will never switch from wireline service to
19 wireless service no matter how attractive wireless service becomes.
20 However, it is clear, when current facts regarding wireless service

[32] www.T-Mobile.com, visited 10/17/05.

functionality, price and convenience are examined, wireless service is now a viable substitute for Qwest's wireline services for many Arizonans -- including RUCO's constituents -- and that the rate of such substitution will continue to increase. Clearly, this form of competition is real, continues to grow in intensity and represents a form of price constraining competition in the Arizona market.

k. Voice over Internet Protocol Competition

Q. IN SUGGESTING THE CURRENT ARIZONA TELECOMMUNICATIONS MARKET IS INSUFFICIENTLY COMPETITIVE TO WARRANT RUCO'S SUPPORT OF THE PROPOSED PRICE PLAN IN ARIZONA, DR. JOHNSON DISREGARDS THE PRESENCE OF VOICE OVER INTERNET PROTOCOL AS A VIABLE COMPETITIVE ALTERNATIVE TO QWEST'S LOCAL EXCHANGE SERVICES IN THE STATE. WOULD YOU COMMENT?

A. Dr. Johnson presented no facts in his surrebuttal to support the notion that VoIP does not represent a competitive substitute for Qwest's wireline service. As a preliminary matter, some contend that a broadband connection is needed to enable VoIP service and the price of the broadband connection renders VoIP non-price competitive with Qwest's

[33] www.mycricket.com, visited 10/18/05.

local exchange services. However, this precept implies that a customer only purchases broadband service to facilitate VoIP. In fact, Qwest does not contend that customers purchase broadband services strictly to facilitate VoIP. Rather, customers purchase broadband services for internet access and entertainment purposes. For these customers, there is no incremental cost for broadband when they elect to add VoIP service and the cost of broadband is therefore not a factor in their VoIP purchase decision.

Q. DO YOU HAVE EVIDENCE OF THE GROWTH OF BROADBAND INTERNET ACCESS SERVICE IN ARIZONA?

A. Yes. Broadband access lines in Arizona have grown at an astounding rate from 153,500 in December 2000 to 750,882 in December 2004, an increase of over 389%.[34] The FCC found that "99% of the country's population lives in the 95% of zip codes where a provider reports having at least one high-speed service subscriber."[35] In other words, broadband service is now widely available and Arizona customers have embraced this service in large and rapidly increasing numbers. Each of these customers represents a potential VoIP subscriber.

---

[34] *High Speed Services for Internet Access: Status as of December 31, 2004*, Industry Analysis and Technology Division, Wireline Competition Bureau, July 2005, table 8.
[35] *Id.*, P. 4.

1 **Q. WHICH PROVIDERS ARE NOW OFFERING VOIP SERVICES IN**
2 **ARIZONA?**
3 A. Currently, there are at least eight VoIP providers (excluding Qwest)
4 serving Arizona, including Vonage, Lingo/Primus, AT&T, MCI, Verizon,
5 SunRocket, Packet8, XO and Skype. Several of these providers, such as
6 Vonage, Sunrocket and Lingo/Primus focus on the residential and small
7 business markets while others, such as XO, focus strictly on the business
8 market. For example, XO announced on July 26 its launch of the
9 XOptions Flex service, "an integrated VoIP solution that offers business
10 customers combined unlimited local and long distance calling, dedicated
11 internet access and web hosting for a flat monthly rate."[36] Additionally, XO
12 recently received Internet Telephony's "Excellence Award for 2005." In
13 acknowledging this award, XO was quoted as saying:

14 "We're very excited to have XOptions Flex recognized as a
15 leading voice over IP solutions for businesses," said Craig
16 Collins, vice president of product management and
17 marketing communications at XO Communications. "This
18 recognition reflects not only Internet Telephony's review but
19 the strong endorsement of ***more than 1,500 businesses***
20 ***across the country that have signed on as XOptions***
21 ***Flex customers in just five months since it was***
22 ***launched.***"[37] (emphasis added).
23
24 Clearly, XO, already a significant competitor in the business market in
25 Arizona, has enjoyed a strong growth rate in its recently-introduced VoIP

[36] TR State News Wire, July 26, 2005.

business service. Additionally, Vonage, which is probably the best recognized independent residential VoIP provider, recently announced that it now has over 1 million subscribers in the U.S.[38]

Q. DO YOU HAVE EVIDENCE OF THE PROJECTED GROWTH RATE OF VOIP TELEPHONY SERVICES?

A. Yes. While VoIP providers such as Vonage are currently reporting impressive subscriber totals, industry experts forecast exponential VoIP growth. For example, Frost and Sullivan found that VoIP market revenue totaled $295.1 million in 2004 and expect it to reach $4,076.7 million in 2010, a growth rate of over 1,200%.[39] Additionally, the Yankee Group reported on October 12, 2005:

> As the US consumer broadband internet market passes a significant household penetration threshold, the addressable market for broadband content and applications is strengthening. More than one-third of US households – or more than half of all online US households – now subscribe to a high-speed internet service.[40]

Clearly, independent market analysts believe that VoIP service has tremendous growth potential and that a significant proportion of the population is now capable of utilizing this service.

---

[37] http://biz.yahoo.com/prnews/051003/nym136.html?.v=21

[38] http://www.vonage.com/corporate/aboutus_fastfacts.php

[39] Real World Network, Trend and Forecasts, *North American Residential VoIP Market to Increase Growth*, July 19, 2005.

Q. CAN YOU PROVIDE EXAMPLES OF THE RANGE OF VOIP OFFERINGS CURRENTLY AVAILABLE IN ARIZONA THAT REPRESENT ALTERNATIVES TO QWEST'S WIRELINE SERVICES?

A. Yes. VoIP services available in Arizona are feature-rich and typically include unlimited long distance calling in the standard service price. For example, Vonage offers a "Basic 500" plan which includes 500 local or toll minutes per month and a package of features including call waiting, caller ID, 3 way calling and voice messaging for $14.99 per month.[41] Vonage also has a "Premium Unlimited" package with unlimited local and long distance calling for $24.99 per month. In comparison, Qwest's stand-alone flat residential service rate (including the EUCL charge) is $19.48 per month (including no features as compared to Vonage's VoIP service which includes a variety of features at no additional charge), while the Qwest residential Choice Home (including EUCL) rate is $32.99 per month, and long distance calling is an additional charge for both of these Qwest service options. Similar to Vonage, SunRocket offers a feature-rich residential VoIP service with unlimited local and long distance calling at $24.95 per month (a prepaid $199 annual payment option is also offered for this service, which is equivalent to $17.00 per month).[42] Lingo/Primus offers a comparable residential VoIP plan at $19.95, MCI offers its VoIP

---

[40] Yankee Group DecisionNote Market Analysis, October 12, 2005.
[41] http://www.vonage.com, visited 8/10/05.

Neighborhood Unlimited plan for $29.99 and Verizon offers its Voicewing Unlimited plan at $19.99 per month. Details of these and other VoIP plans now available in Arizona are contained in Exhibit DLT-5.

Q. IN THE PAST, LACK OF ACCESS TO 911 EMERGENCY SERVICE PROVIDERS WAS IDENTIFIED AS A REASON THAT VOIP SERVICE MAY NOT BE CONSIDERED TO BE A DIRECT SUBSTITUTE FOR TRADITIONAL WIRELINE SERVICE. DOES THIS REMAIN TRUE IN THE CURRENT MARKET?

A. No. In fact, the primary issue regarding VoIP E911 currently being addressed by the industry is the problem of "nomadic" E911 in instances where customers transport their VoIP equipment to a location other than the location to which the equipment is registered and attempt to place an E911 call from the remote location.[43] Unless the VoIP provider is notified that the customer has changed locations, the E911 call will show the name and address of the location at which the VoIP equipment was originally registered. For example, if customer John Smith registers his VoIP equipment at 123 Main Street in Tucson, Arizona, subsequently takes his VoIP equipment with him on a business trip to Chicago and places an E911 call on that equipment from Chicago without notifying his VoIP service provider, the E911 operator will recognize his call as

[42] http://www.sunrocket.com, visited 8/11/05.

originating at 123 Main Street in Tucson. However, if the customer is not "nomadic" and simply uses his or her VoIP equipment at a fixed location as a landline replacement (and has properly notified the VoIP provider of the address of the fixed location), 911 calls from that fixed location are recognized by the E911 operator with the telephone number, name and address of the party at that location. In a recent article in USA Today, AT&T discussed a solution it has devised to address the problem of nomadic VoIP, as follows:

> AT&T's nomadic solution, called Heartbeat, uses its internet network to track the location of users. Here's how it works: when VoIP customers power down, AT&T's network will automatically suspend VoIP service. Once the phone adapter is plugged back in , AT&T will ask the user to verify his or her location. For customers who indicate they haven't moved, service will be instantly restored. If they have moved, they'll be directed to an 800 number or web page to register the new location.[44]

Again, so long as the VoIP subscriber properly registers his or her location with the VoIP provider, the E911 operator will automatically receive the 911 caller's name, telephone number and street address.

Q. HAVE YOU TAKEN ANY ACTIONS TO VERIFY THAT E911 SERVICE PERSONNEL ARE ABLE TO RECOGNIZE THE 911 CALLER'S

---

[43] The FCC has ordered all VoIP providers to make their VoIP services fully 911-capable by November 28, 2005, particularly in instances where the customer is "nomadic."

[44] *AT&T Solves VoIP's 911 Issue*, USA Today, October 12, 2005.

TELEPHONE NUMBER, NAME AND ADDRESS WHEN A CALL IS PLACED TO 911 FROM A VOIP-SERVED TELEPHONE?

A. Yes. I personally subscribed to SunRocket VoIP service in June 2005 and maintained that service until October 2005 as a means of testing VoIP service functionality in a residential application. Upon initiating service, I was directed by SunRocket to enter my name, telephone number and address into SunRocket's customer service website to ensure 911 emergency calls are accurately handled. After doing so, I placed a 911 test call and verified with the 911 service operator that my name, telephone number and street address appeared correctly on the 911 provider's equipment.

From the perspective of establishing VoIP telephone service, there is no dispute that extra steps are required of the customer to ensure E911 functionality. However, once these easy to follow steps are completed (and as long as the customer uses the VoIP service in the primary location at which it is registered), the customer can be assured of E911 functionality equivalent to that provided with standard wireline telephone service. To the extent E911 VoIP functionality has been considered a barrier to customer adoption of VoIP service, that barrier has been largely demolished and will be entirely removed by the end of 2005.

Q. IS THE AVAILABILITY OF VOIP SERVICES IN ARIZONA CURRENTLY LIMITED TO CUSTOMERS WITH DSL OR CABLE MODEM BROADBAND INTERNET ACCESS?

A. No. In fact, I participated as a witness in the Arizona Corporation Commissions' generic investigation into telecommunications competition in Arizona on February 4, 2005 (Docket No. T-00000I-04-0749). I was present when Brooke Schulz, Senior Vice President for Vonage, addressed the Commission. She testified:

> We actually have evidence of customers in Arizona using our service over satellite broadband.[45]

It appears, based on Ms. Schulz's assertion during this proceeding, that Arizona subscribers are now able to utilize wireless broadband connections to avail themselves of VoIP services. Clearly, the VoIP market continues to rapidly evolve as a competitive telecommunications option for an increasingly large customer base.

[45] Transcript of hearing, pp. 22-36.

IV. MR. ALBERT STERMAN (ACC)

Q. AT PAGE 2 OF HIS TESTIMONY, MR. STERMAN COMPLAINS THAT THE SERVICES RECLASSIFIED IN THE PROPOSED PRICE PLAN ARE NOT "TRULY COMPETITIVE UNLESS THEY ARE AVAILABLE AS WANTED FROM A VARIETY OF VENDORS." WOULD YOU COMMENT?

A. Yes. Apparently, Mr. Sterman's concern is that, if a service such as Qwest Choice Home cannot be purchased from a carrier other than Qwest as a stand-alone service, it should not be considered as being subject to competition. Mr. Sterman misses the point. In Arizona, it is a fact that a large number of competitors currently offer packaged services that compete directly with Qwest Choice Home service. He is correct that a customer cannot presently subscribe to a Qwest residential access line and separately purchase a package of calling features from a competitor of Qwest's. From a technical standpoint, since the access line and features related to that access line are provided from the same carrier's switch, one cannot be divorced from the other when providing service to the customer. However, a variety of competitive alternatives exist to Qwest packaged services from CLECs, wireless carriers and VoIP providers as discussed earlier in my rebuttal testimony.

Q. MR. STERMAN ASSERTS THAT "FEW LOCAL COMPETITORS HAVE ENJOYED SUCCESS IN PENETRATING THE LOCAL EXCHANGE MARKET." WOULD YOU COMMENT?

A. Yes. Mr. Sterman's statement appears to be his opinion, but he has not supplied any facts whatsoever to support his opinion. As discussed earlier in my rebuttal testimony, the facts are that a broad array of competitors, including CLECs, cable telephony providers, wireless carriers and VoIP providers are now active in the Arizona market. I provided data from independent research entity TNS Telecoms showing that Qwest now has approximately one third of the telecommunications connections within its service territory in the state. With regard to CLEC competition alone, the FCC found in its most recent Local Telephone Competition report that CLECs had captured 25% of the wireline service market in Arizona in December 2004, nearly one year ago.[46] Finally, as discussed earlier in my rebuttal testimony, CLECs are active in nearly every Qwest wire center in the state, wireless service is available from at least one carrier throughout Qwest's service territory and VoIP services are currently available from to customer with a broadband internet connection.

Q. FINALLY, MR. STERMAN ARGUES THAT "QWEST CONTINUES TO ENJOY A DOMINANT SHARE OF MOST ARIZONA

[46] Local Telephone Competition: Status as of December 31, 2004, *Industry Analysis and Technology Division, Wireline Competition Bureau,* July 2005, Table 6.

TELECOMMUNICATIONS MARKET (sic), AND ITS COMPETITORS ARE FAR TOO SMALL TO PROVIDE AN ADEQUATE SUBSTITUTE FOR CONTINUED PRICING CONSTRAINTS, SUCH AS THOSE CONTAINED IN THE CURRENT PLAN." WHAT CONCERNS DO YOU HAVE WITH HIS ARGUMENT?

A. I have several. First, Mr. Sterman presents absolutely no analysis or facts to support his contention that Qwest "enjoys a dominant market share" in Arizona. It is entirely unclear whether Mr. Sterman's focus in his assertion is on the wireline telecommunications market or whether his focus is on the broader market for voice communications. In either instance, he is incorrect that Qwest "dominates" the market. A wide variety of deregulated competitors have made, and continue to make, successful inroads into Qwest's market as discussed earlier in my testimony.

Second, Mr. Sterman ignores the consideration addressed in Dr. Johnson's testimony regarding Qwest witness Jerrold Thompson's statement that Qwest will continue to maintain statewide average pricing for its local telecommunications, and to the extent that supranormal competition in a particular part of the state drives Qwest to reduce prices, those price reductions will occur statewide. In effect, customers in rural areas of Qwest's service territory will realize the benefits of competitive pressures in more highly competitive areas of the state.

Finally, Mr. Sterman's reference to Qwest's competitors being "far too small to provide an adequate substitute for continued pricing constraints" is flatly off base. There can be no argument that Cox is a very significant competitor in the greater Phoenix and Tucson areas. There can be no argument that the soon-to-be merged SBC/AT&T and Verizon/MCI (each of which is already an active competitor in Arizona) are competitors of enormous scale and scope. There can be no argument that broadband services are enjoying exponential penetration growth rates and that the potential market for VoIP services will grow apace. Mr. Sterman's factually-unsupported opinion with regard to the texture of the competitive telecommunications market in Arizona should be given no weight.

V. CONCLUSION

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. In my rebuttal testimony, I addressed issues raised in the surrebuttal testimony of Dr. Ben Johnson and the settlement testimony of Mr. Albert Sterman. Both witnesses maintain the current telecommunications environment is not sufficiently competitive to warrant approval of Qwest's Price Plan. Both witnesses ignore the ever-growing effects of wireless and VoIP competition in the Arizona telecommunications market. Both witnesses ignore the fact that, under terms of the proposed Price Plan which call for statewide averaged local exchange rates, customers in rural areas of Arizona will benefit from the effects of competition in the more competitive areas of the state. Neither witness, while referring to the current competitive telecommunications market in Arizona, presents current facts to support his opinions.

The facts presented in my rebuttal with respect to CLEC-based competition as well as wireless and VoIP competition demonstrate that competition for Qwest's services in Arizona is robust and, in fact, continues to increase in intensity. In a competitive market such as this, it is appropriate that regulation should diminish. Qwest's proposed Price Plan is entirely appropriate in the competitive Arizona telecommunications market.

Q. IN VIEW OF THE EVIDENCE YOU HAVE PRESENTED, DO YOU HAVE A RECOMMENDATION TO OFFER THE COMMISSION?

A. Yes. The current telecommunications market contains a wide and varying array of competitors representing continually expanding price-constraining competition to Qwest's retail services. In view of this level of competition, I recommend the Qwest Price Plan as discussed in the testimonies of Mr. Thompson and Mr. Grate be approved.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL EXHIBITS

OF

DAVID L. TEITZEL

ON BEHALF OF

QWEST CORPORATION

OCTOBER 28, 2005

INDEX OF EXHIBITS

DESCRIPTION	EXHIBIT
Confidential Information	Confidential DLT-1
Qwest Retail and Wholesale Volumes in Arizona	Highly Confidential DLT-2
Sample of Selected CLEC Services in Arizona	DLT-3
Sample of Selected Wireless Services in Arizona	DLT-4
Sample of Selected VoIP Services in Arizona	DLT-5

CONFIDENTIAL INFORMATION

Page	Line Number	Confidential Information
12	15	REDACTED
14	16	REDACTED
14	17	REDACTED
16	10	REDACTED
18	8	REDACTED
20	12	REDACTED
22	16	REDACTED
24	19	REDACTED
24	20	REDACTED

QWEST RETAIL AND WHOLESALE VOLUMES IN THE PHOENIX MSA

Phoenix MSA Wire Centers	CLLI Code	Qwest Retail Bus. Access Lines 12/00	Qwest Retail Bus. Access Lines 12/03	Qwest Retail Bus. Access Lines 03/05	Diff Bus. 03/05 - 12/03	% Diff. Bus. 03/05 - 12/03	Qwest Retail Res. Access Lines 12/00	Qwest Retail Res. Access Lines 12/03	Qwest Retail Res. Access Lines 03/05	Diff Res. 03/05 - 12/03	% Diff. Res. 03/05 - 12/03	Qwest Total Retail Access Lines 12/00	Qwest Total Retail Access Lines 12/03	Qwest Total Retail Access Lines 03/05	Diff. Total 03/05 - 12/03	% Diff. Total 03/05 - 12/03
Agua Fria Sunrise	AGFIAZSRDS0															
Buckeye	BCKYAZMARS1															
Beardsley	BRDSAZMADS0															
Chandler Main	CHNDAZMADS0															
Chandler South	CHNDAZSODS0															
Chandler West	CHNDAZWEDS0															
Coolidge	CLDGAZMARS1															
Circle City	CRCYAZNMRS1															
Casa Grande	CSGRAZMADS0															
Cave Creek	CVCKAZMADS0															
Dudleyville	DDVLAZNMRS1															
Deer Valley	DRVYAZNODS0															
Eloy	ELOYAZ01RS1															
Florence	FLRNAZMARS1															
Ft. McDowell	FTMDAZMADS0															
Rio Verde	FTMDAZNORS1															
Coldwater (Goodyear)	GDYRAZCWDS0															
Gila Bend	GLBNAZMARS1															
Glendale	GLDLAZMADS0															
Higley	HGLYAZMADS1															
Queen Creek (Higley)	HGLYAZQCDS2															
Kearny	KRNYAZMARS1															
Litchfield Park	LTPKAZMADS0															
Gilbert (Mesa)	MESAAZGIDS0															
Mesa	MESAAZMADS0															
Mammoth	MMTHAZMARS1															
Maricopa	MRCPAZMARS1															
New River	NWRVAZMADS0															
Oracle	ORCLAZMARS1															
Foothills	PHNXAZ81DS0															
Bethany West (Phoenix)	PHNXAZBWDS0															
Cactus (Phoenix)	PHNXAZCADS0															
Phoenix East	PHNXAZEADS0															
Greenway (Phoenix)	PHNXAZGRDS0															
Laveen (Phoenix)	PHNXAZLVDS0															
Phoenix Main	PHNXAZMADS1															
Mid Rivers (Phoenix)	PHNXAZMRDS0															
Maryvale (Phoenix)	PHNXAZMYDS0															

REDACTED

QWEST RETAIL AND WHOLESALE VOLUMES IN THE PHOENIX MSA

Phoenix MSA Wire Centers	CLLI Code	Qwest Retail Bus. Access Lines 12/00	Qwest Retail Bus. Access Lines 12/03	Qwest Retail Bus. Access Lines 03/05	Diff Bus. 03/05 - 12/03	% Diff. Bus. 03/05 - 12/03	Qwest Retail Res. Access Lines 12/00	Qwest Retail Res. Access Lines 12/03	Qwest Retail Res. Access Lines 03/05	Diff Res. 03/05 - 12/03	% Diff. Res. 03/05 - 12/03	Qwest Total Retail Access Lines 12/00	Qwest Total Retail Access Lines 12/03	Qwest Total Retail Access Lines 03/05	Diff. Total 03/05 - 12/03	% Diff. Total 03/05 - 12/03
Phoenix Northeast	PHNXAZNEDS0															
Phoenix North	PHNXAZNODS1															
Phoenix Northwest	PHNXAZNWDS0															
Pecos (Phoenix)	PHNXAZPPDS0															
Peoria (Phoenix)	PHNXAZPRDS0															
Phoenix Southeast	PHNXAZSEDS0															
Phoenix South	PHNXAZSODS0															
Sunnyslope (Phoenix)	PHNXAZSYDS0															
Phoenix West	PHNXAZWEDS0															
Pinnacle Peak	PRVYAZPPDS0															
Scottsdale Main	SCDLAZMADS0															
Shea (Scottsdale)	SCDLAZSHDS0															
Thunderbird (Scottsdale)	SCDLAZTHDS0															
San Manuel	SNMNAZMADS0															
Superior	SPRRAZMARS1															
Super East	SPRSAZEADS0															
Super Main	SPRSAZMADS0															
Super West	SPRSAZWEDS0															
Stanfield	STFDAZMARS1															
Tempe	TEMPAZMADS0															
McClintock (Tempe)	TEMPAZMCDS0															
Tolleson	TLSNAZMADS0															
Wickenburg	WCBGAZMARS1															
White Tanks	WHTKAZMARS2															
Whitlow	WHTLAZMADS0															
Wintersburg	WNBGAZ01RS1															
Phoenix MSA TOTAL																

REDACTED

QWEST RETAIL AND WHOLESALE VOLUMES IN THE PHOENIX MSA

Phoenix MSA Wire Centers	CLLI Code	LIS Trunks 12/03	LIS Trunks 03/05	Unb. Loops 12/03	Unb. Loops 03/05	UNE-P Res. 12/03 [1]	QPP / UNE-P Res. 03/05	UNE-P Bus. 12/03 [1]	QPP / UNE-P Bus. 03/05	Resold Res. Lines 12/03	Resold Res. Lines 03/05	Resold Bus. Lines 12/03	Resold Bus. Lines 03/05
Agua Fria Sunrise	AGFIAZSRDS0												
Buckeye	BCKYAZMARS1												
Beardsley	BRDSAZMADS0												
Chandler Main	CHNDAZMADS0												
Chandler South	CHNDAZSODS0												
Chandler West	CHNDAZWEDS0												
Coolidge	CLDGAZMARS1												
Circle City	CRCYAZNMRS1												
Casa Grande	CSGRAZMADS0												
Cave Creek	CVCKAZMADS0												
Dudleyville	DDVLAZNMRS1												
Deer Valley	DRVYAZNODS0												
Eloy	ELOYAZ01RS1												
Florence	FLRNAZMARS1												
Ft. McDowell	FTMDAZMADS0												
Rio Verde	FTMDAZNORS1												
Coldwater (Goodyear)	GDYRAZCWDS0												
Gila Bend	GLBNAZMARS1												
Glendale	GLDLAZMADS0												
Higley	HGLYAZMADS1												
Queen Creek (Higley)	HGLYAZQCDS2												
Kearny	KRNYAZMARS1												
Litchfield Park	LTPKAZMADS0												
Gilbert (Mesa)	MESAAZGIDS0												
Mesa	MESAAZMADS0												
Mammoth	MMTHAZMARS1												
Maricopa	MRCPAZMARS1												
New River	NWRVAZMADS0												
Oracle	ORCLAZMARS1												
Foothills	PHNXAZ81DS0												
Bethany West (Phoenix)	PHNXAZBWDS0												
Cactus (Phoenix)	PHNXAZCADS0												
Phoenix East	PHNXAZEADS0												
Greenway (Phoenix)	PHNXAZGRDS0												
Laveen (Phoenix)	PHNXAZLVDS0												
Phoenix Main	PHNXAZMADS1												
Mid Rivers (Phoenix)	PHNXAZMRDS0												
Maryvale (Phoenix)	PHNXAZMYDS0												

REDACTED

HIGHLY CONFIDENTIAL

QWEST RETAIL AND WHOLESALE VOLUMES IN THE PHOENIX MSA

Phoenix MSA Wire Centers	CLLI Code	LIS Trunks 12/03	LIS Trunks 03/05	Unb. Loops 12/03	Unb. Loops 03/05	UNE-P Res. 12/03 [1]	QPP / UNE-P Res. 03/05	UNE-P Bus. 12/03 [1]	QPP / UNE-P Bus. 03/05	Resold Res. Lines 12/03	Resold Res. Lines 03/05	Resold Bus. Lines 12/03	Resold Bus. Lines 03/05
Phoenix Northeast	PHNXAZNEDS0												
Phoenix North	PHNXAZNODS1												
Phoenix Northwest	PHNXAZNWDS0												
Pecos (Phoenix)	PHNXAZPPDS0												
Peoria (Phoenix)	PHNXAZPRDS0												
Phoenix Southeast	PHNXAZSEDS0												
Phoenix South	PHNXAZSODS0												
Sunnyslope (Phoenix)	PHNXAZSYDS0												
Phoenix West	PHNXAZWEDS0												
Pinnacle Peak	PRVYAZPPDS0												
Scottsdale Main	SCDLAZMADS0												
Shea (Scottsdale)	SCDLAZSHDS0												
Thunderbird (Scottsdale)	SCDLAZTHDS0												
San Manuel	SNMNAZMADS0												
Superior	SPRRAZMARS1												
Super East	SPRSAZEADS0												
Super Main	SPRSAZMADS0												
Super West	SPRSAZWEDS0												
Stanfield	STFDAZMARS1												
Tempe	TEMPAZMADS0												
McClintock (Tempe)	TEMPAZMCDS0												
Tolleson	TLSNAZMADS0												
Wickenburg	WCBGAZMARS1												
White Tanks	WHTKAZMARS2												
Whitlow	WHTLAZMADS0												
Wintersburg	WNBGAZ01RS1												
Phoenix MSA TOTAL													

REDACTED

[1] Qwest maintains information regarding each access line (and the associated telephone numbers) served by CLECs via UNE-P, which is strictly a wholesale service to which no particular class of service is assigned. Qwest does not have tracking information in any retail or wholesale service database identifying UNE-P lines as being used for business or residential purposes. In an effort to determine the business/residential split of the UNE-P access lines in service, Qwest has compared each of the UNE-P telephone numbers (as of December 31, 2003) with the listings in the white pages database (as of March 3, 2004) to determine whether these listings are in the business or residential sections of the white pages database.

QWEST RETAIL AND WHOLESALE VOLUMES IN THE TUCSON MSA

Tucson MSA Wire Centers	CLLI Code	Qwest Retail Bus. Access Lines 12/00	Qwest Retail Bus. Access Lines 12/03	Qwest Retail Bus. Access Lines 03/05	Diff Bus. 03/05 - 12/03	% Diff. Bus. 03/05 - 12/03		Qwest Retail Res. Access Lines 12/00	Qwest Retail Res. Access Lines 12/03	Qwest Retail Res. Access Lines 03/05	Diff Res. 03/05 - 12/03	% Diff. Res. 03/05 - 12/03		Qwest Total Retail Access Lines 12/00	Qwest Total Retail Access Lines 12/03	Qwest Total Retail Access Lines 03/05	Diff. Total 03/05 - 12/03	% Diff. Total 03/05 - 12/03	
Coronado	CRNDAZMADS1																		
Green Valley	GNVYAZMADS0																		
Marana	MARNAZMARS1																		
Catalina (Tucson)	TCSNAZCADS0																		
Cortaro (Tucson)	TCSNAZCODS0																		
Craycroft (Tucson)	TCSNAZCRDS0																		
Tucson East	TCSNAZEADS0																		
Flowing Wells (Tucson)	TCSNAZFWDS0																		
Tucson Main	TCSNAZMADS1																		
Mt. Lemmon (Tucson)	TCSNAZMLRS2																		
Tucson North	TCSNAZNODS0																		
Rincon (Tucson)	TCSNAZRNDS0																		
Tucson Southeast	TCSNAZSEDS0																		
Tucson South	TCSNAZSODS0																		
Tucson Southwest	TCSNAZSWDS0																		
Tanque Verde (Tucson)	TCSNAZTVDS0																		
Tucson West	TCSNAZWERS1																		
Vail North	VAILAZNORS1																		
Vail South	VAILAZSODS0																		
TUCSON MSA TOTAL																			

REDACTED

QWEST RETAIL AND WHOLESALE VOLUMES IN THE TUCSON MSA

Tucson MSA Wire Centers	CLLI Code	LIS Trunks 12/03	LIS Trunks 032/05	Unb. Loops 12/03	Unb. Loops 03/05	UNE-P Res. 12/03 [1]	QPP / UNE-P Res. 03/05	UNE-P Bus. 12/03 [1]	QPP / UNE-P Bus. 03/05	Resold Res. Lines 12/03	Resold Res. Lines 03/05	Resold Bus. Lines 12/03	Resold Bus. Lines 03/05
Coronado	CRNDAZMADS1												
Green Valley	GNVYAZMADS0												
Marana	MARNAZMARS1												
Catalina (Tucson)	TCSNAZCADS0												
Cortaro (Tucson)	TCSNAZCODS0												
Craycroft (Tucson)	TCSNAZCRDS0												
Tucson East	TCSNAZEADS0												
Flowing Wells (Tucson)	TCSNAZFWDS0												
Tucson Main	TCSNAZMADS1												
Mt. Lemmon (Tucson)	TCSNAZMLRS2												
Tucson North	TCSNAZNODS0												
Rincon (Tucson)	TCSNAZRNDS0												
Tucson Southeast	TCSNAZSEDS0												
Tucson South	TCSNAZSODS0												
Tucson Southwest	TCSNAZSWDS0												
Tanque Verde (Tucson)	TCSNAZTVDS0												
Tucson West	TCSNAZWERS1												
Vail North	VAILAZNORS1												
Vail South	VAILAZSODS0												
TUCSON MSA TOTAL													

REDACTED

[1] Qwest maintains information regarding each access line (and the associated telephone numbers) served by CLECs via UNE-P, which is strictly a wholesale service to which no particular class of service is assigned. Qwest does not have tracking information in any retail or wholesale service database identifying UNE-P lines as being used for business or residential purposes. In an effort to determine the business/residential split of the UNE-P access lines in service, Qwest has compared each of the UNE-P telephone numbers (as of December 31, 2003) with the listings in the white pages database (as of March 3, 2004) to determine whether these listings are in the business or residential sections of the white pages database.

All Other Wire Centers	CLLI Code	Qwest Retail Bus. Access Lines 12/00	Qwest Retail Bus. Access Lines 12/03	Qwest Retail Bus. Access Lines 03/05	Diff Bus. 03/05 - 12/03	% Diff. Bus. 03/05 - 12/03		Qwest Retail Res. Access Lines 12/00	Qwest Retail Res. Access Lines 12/03	Qwest Retail Res. Access Lines 03/05	Diff Res. 03/05 - 12/03	% Diff. Res. 03/05 - 12/03		Qwest Total Retail Access Lines 12/00	Qwest Total Retail Access Lines 12/03	Qwest Total Retail Access Lines 03/05	Diff. Total 03/05 - 12/03	% Diff. Total 03/05 - 12/03
Ashfork	ASFKAZMARS1																	
Bisbee	BISBAZMARS1																	
Black Canyon	BLCNAZMARS1																	
Benson	BNSNAZMADS0																	
St. David (Benson)	BNSNAZSDDS0																	
Chino Valley	CHVYAZMADS0																	
Camp Verde	CMVRAZMARS1																	
Cottonwood Main	CTWDAZMADS0																	
Cottonwood South	CTWDAZSORS1																	
Douglas	DGLSAZMARS1																	
Flagstaff East	FLGSAZEADS0																	
Flagstaff Main	FLGSAZMADS0																	
Flagstaff South	FLGSAZSORS1																	
Globe	GLOBAZMARS1																	
Grand Canyon	GRCNAZMARS1																	
Humboldt	HMBLAZMARS1																	
Hayden	HYDNAZMARS1																	
Joseph City	JSCYAZMARS1																	
Miami	MIAMAZMARS1																	
Munds Park	MSPKAZMADS0																	
Nogales Main	NGLSAZMARS1																	
Nogales Midway	NGLSAZMWDS0																	
Page	PAGEAZMADS0																	
Pima	PIMAAZMARS1																	
Pine	PINEAZMARS1																	
Palominas	PLMNAZMARS1																	
Prescott East	PRSCAZEARS0																	
Prescott Main	PRSCAZMADS0																	
Elgin (Patagonia)	PTGNAZELRS1																	
Patagonia Main	PTGNAZMARS1																	
Payson	PYSNAZMADS0																	
Sedona Main	SEDNAZMADS0																	
Sedona South	SEDNAZSORS3																	
Safford	SFFRAZMADS0																	
Somerton	SMTNAZMARS1																	
Sierra Vista Main	SRVSAZMADS0																	
Sierra Vista North	SRVSAZNORS1																	
Sierra Vista South	SRVSAZSODS0																	
Tombstone	TMBSAZMARS1																	

REDACTED

All Other Wire Centers	CLLI Code	Qwest Retail Bus. Access Lines 12/00	Qwest Retail Bus. Access Lines 12/03	Qwest Retail Bus. Access Lines 03/05	Diff Bus. 03/05 - 12/03	% Diff. Bus. 03/05 - 12/03		Qwest Retail Res. Access Lines 12/00	Qwest Retail Res. Access Lines 12/03	Qwest Retail Res. Access Lines 03/05	Diff Res. 03/05 - 12/03	% Diff. Res. 03/05 - 12/03		Qwest Total Retail Access Lines 12/00	Qwest Total Retail Access Lines 12/03	Qwest Total Retail Access Lines 03/05	Diff. Total 03/05 - 12/03	% Diff. Total 03/05 - 12/03	
Tonto Creek	TNCKAZMARS1																		
Tubac	TUBCAZMARS1																		
Willcox	WLCXAZMARS1																		
Williams	WLMSAZMARS1																		
Wellton	WLTNAZMARS1																		
Winslow	WNSLAZMADS1																		
Yarnell	YRNLAZMARS1																		
Fortuna (Yuma)	YUMAAZFTDS1																		
Yuma Main	YUMAAZMADS0																		
Yuma Southeast	YUMAAZSEDS0																		
ALL OTHER TOTAL																			

REDACTED

All Other Wire Centers	CLLI Code	LIS Trunks 12/03	LIS Trunks 03/05	Unb. Loops 12/03	Unb. Loops 03/05	UNE-P Res. 12/03 [1]	QPP / UNE-P Res. 03/05	UNE-P Bus. 12/03 [1]	QPP / UNE-P Bus. 03/05	Resold Res. Lines 12/03	Resold Res. Lines 03/05	Resold Bus. Lines 12/03	Resold Bus. Lines 03/05
Ashfork	ASFKAZMARS1												
Bisbee	BISBAZMARS1												
Black Canyon	BLCNAZMARS1												
Benson	BNSNAZMADS0												
St. David (Benson)	BNSNAZSDDS0												
Chino Valley	CHVYAZMADS0												
Camp Verde	CMVRAZMARS1												
Cottonwood Main	CTWDAZMADS0												
Cottonwood South	CTWDAZSORS1												
Douglas	DGLSAZMARS1												
Flagstaff East	FLGSAZEADS0												
Flagstaff Main	FLGSAZMADS0												
Flagstaff South	FLGSAZSORS1												
Globe	GLOBAZMARS1												
Grand Canyon	GRCNAZMARS1												
Humboldt	HMBLAZMARS1												
Hayden	HYDNAZMARS1												
Joseph City	JSCYAZMARS1												
Miami	MIAMAZMARS1												
Munds Park	MSPKAZMADS0												
Nogales Main	NGLSAZMARS1												
Nogales Midway	NGLSAZMWDS0												
Page	PAGEAZMADS0												
Pima	PIMAAZMARS1												
Pine	PINEAZMARS1												
Palominas	PLMNAZMARS1												
Prescott East	PRSCAZEARS0												
Prescott Main	PRSCAZMADS0												
Elgin (Patagonia)	PTGNAZELRS1												
Patagonia Main	PTGNAZMARS1												
Payson	PYSNAZMADS0												
Sedona Main	SEDNAZMADS0												
Sedona South	SEDNAZSORS3												
Safford	SFFRAZMADS0												
Somerton	SMTNAZMARS1												
Sierra Vista Main	SRVSAZMADS0												
Sierra Vista North	SRVSAZNORS1												
Sierra Vista South	SRVSAZSODS0												
Tombstone	TMBSAZMARS1												

REDACTED

All Other Wire Centers	CLLI Code	LIS Trunks 12/03	LIS Trunks 03/05	Unb. Loops 12/03	Unb. Loops 03/05	UNE-P Res. 12/03 [1]	QPP / UNE-P Res. 03/05	UNE-P Bus. 12/03 [1]	QPP / UNE-P Bus. 03/05	Resold Res. Lines 12/03	Resold Res. Lines 03/05	Resold Bus. Lines 12/03	Resold Bus. Lines 03/05
Tonto Creek	TNCKAZMARS1												
Tubac	TUBCAZMARS1												
Willcox	WLCXAZMARS1												
Williams	WLMSAZMARS1												
Wellton	WLTNAZMARS1												
Winslow	WNSLAZMADS1												
Yarnell	YRNLAZMARS1												
Fortuna (Yuma)	YUMAAZFTDS1												
Yuma Main	YUMAAZMADS0												
Yuma Southeast	YUMAAZSEDS0												
ALL OTHER TOTAL													

REDACTED

[1] Qwest maintains information regarding each access line (and the associated telephone numbers) served by CLECs via UNE-P, which is strictly a wholesale service to which no particular class of service is assigned. Qwest does not have tracking information in any retail or wholesale service database identifying UNE-P lines as being used for business or residential purposes. In an effort to determine the business/residential split of the UNE-P access lines in service, Qwest has compared each of the UNE-P telephone numbers (as of December 31, 2003) with the listings in the white pages database (as of March 3, 2004) to determine whether these listings are in the business or residential sections of the white pages database.

SAMPLE OF SELECTED CLEC SERVICES IN ARIZONA

Carrier	Certification Date	Service Name	Service Description	Pricing	Target Market	Availability	Source
Arizona Dialtone, Inc.		Basic Service	Flat rate residential line; includes Universal Service Charge, Federal Taxes, and SLC	$29.98 per month	Residential	Most areas of Arizona	www.arizonadialtone.com visited 10-17-05
		Essential Package	Basic Service plus features, Caller ID, Inside Wire Maintenance Plan	$39.99 per month	Residential	Most areas of Arizona	www.arizonadialtone.com visited 10-17-05
		Essential Package Plus	Essential Package plus Voice Mail	$47.98 per month	Residential	Most areas of Arizona	www.arizonadialtone.com visited 10-17-05
		Basic Monthly Exchange Service	Residential Service	$19.99 - $49.99 per month	Residential	Most areas of Arizona	Arizona DialTone Inc, Arizona Tariff No. 3 reviewed 10-17-05
		Basic Monthly Exchange Service	Business Flat Rate Service	$18.99 - $99.99 per month	Business	Most areas of Arizona	Arizona DialTone Inc, Arizona Tariff No. 3 reviewed 10-17-05
		Prepaid Residential Local Exchange Service	Basic Rate	$15.00 - $45.00 per month	Residential	Most areas of Arizona	Arizona DialTone Inc, Arizona Tariff No. 3 reviewed 10-17-05
AT&T		AT&T CallVantage Service Plan	VoIP service; unlimited local and long distance calling in the US and to Canada	$29.99 per month	Residential	Qwest Territory	www.local.att.com, visited 10-17-05
		At&T CallVantage Local Plan	VoIP service; includes local calls; calls to Canada and US territories are 4¢ per minute	$19.99 per month	Residential	Qwest Territory	www.local.att.com, visited 10-17-05
		AT&T CallVantage Small Office Plan	VoIP service; includes two lines; unlimited domestic calls; calls to Canada on 1st line; non-local calls up to 500 minutes per month on 2nd line	$49.99 per month	Small Business	Qwest Territory	www.local.att.com, visited 10-17-05
		AT&T One Rate USA Plan	Local line, 4 features, unlimited direct dial long distance and local toll	$49.95 per month	Residential	Qwest Territory	AT&T, Arizona Local Exchange Service Tariff - reviewed 10-17-05.
		Call Plan Unlimited	Local Service	$19.95 per month	Residential	Qwest Territory	AT&T, Arizona Local Exchange Service Tariff - reviewed 10-17-05.
		Call Plan Unlimited Plus	Local Service	$14.95 per month	Residential	Qwest Territory	AT&T, Arizona Local Exchange Service Tariff - reviewed 10-17-05.
		Call Plan Deluxe	Local service	$29.95 per month	Residential	Qwest Territory	AT&T, Arizona Local Exchange Service Tariff - reviewed 10-17-05.
		AT&T Local Exchange Service	Main and Additional Business Line associated with ACC Business	$29.50 per month	Business	Qwest Territory	AT&T, Arizona Local Exchange Service Tariff - reviewed 10-17-05.

SAMPLE OF SELECTED CLEC SERVICES IN ARIZONA

Carrier	Certification Date	Service Name	Service Description	Pricing	Target Market	Availability	Source
SBC Telecom		SBC Phone Solution for Business	Local service, 14 features	$42 per month	Business	Agua Fria, Buckeye, Casa Grande, Cave Creek, Circle City, Coolidge, Coronado, Deer Valley, Eloy, Florence, Fort McDowell, Green Valley, Higley, Marana, Maricopa, New River, Paradise Valley, Phoenix Metropolitan, Superstition, Tubac, Tucson, Vail, Wickenburg	SBC Telecom, Inc., Local Exchange Tariff No. 1, Section 4, reviewed 10-17-05
		SBC Multi-Line for Business	Local Service, 5 features	$36.00 per month	Business	SAME	SBC Telecom, Inc., Local Exchange Tariff No. 1, Section 4, reviewed 10-17-05
		Basic Business Line	5 or more lines at a single location	$29.00 per month	Business	SAME	SBC Telecom, Inc., Local Exchange Tariff No. 1, Section 4, reviewed 10-17-05
		Access Advantage Plus Line - SBC Phone Solution for Business	Provides the customer with local access to the public switched network with a line-side digital voice grade connection	$18.00 - $25.00 per month per channel depending on term	Business	SAME	SBC Telecom, Inc., Local Exchange Tariff No. 1, Section 4, reviewed 10-17-05
		Access Advantage Plus Line - SBC Multi-Line for Business	Provides the customer with local access to the public switched network with a line-side digital voice grade connection	$13.00 - $20.00 per month per channel depending on term	Business	SAME	SBC Telecom, Inc., Local Exchange Tariff No. 1, Section 4, reviewed 10-17-05
		Access Advantage Plus Trunk	Provides the customer with local access to the public switched network, with a trunk-side digital voice grade connection	$18.00 - $25.00 per month per Trunk depending on term	Business	SAME	SBC Telecom, Inc., Local Exchange Tariff No. 1, Section 4, reviewed 10-17-05
		SBC Phone Solution for Residence	Local service, 16 features	$30.00 per month	Residential	SAME	SBC Telecom, Inc., Local Exchange Tariff No. 1, Section 4, reviewed 10-17-05
		SBC Multi-Line for Residence	Local service	$16.00 per month	Residential	SAME	SBC Telecom, Inc., Local Exchange Tariff No. 1, Section 4, reviewed 10-17-05
Sprint		Sprint Basic	Unlimited local calling	$34.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05

SAMPLE OF SELECTED CLEC SERVICES IN ARIZONA

Carrier	Certification Date	Service Name	Service Description	Pricing	Target Market	Availability	Source
		Sprint Complete Sense 250SM	Unlimited local, 250 anytime Dial 1 Minutes for toll and domestic long distance, custom calling features	$44.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense 250SM with International	Unlimited local, 250 anytime Dial 1 Minutes for toll and domestic long distance, custom calling features, discounted International calling	$47.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense PlusSM	Unlimited local calling	$19.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense PlusSM with International	Unlimited local calling with discounted international calling	$22.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense 50SM	Unlimited local, 50 anytime Dial 1 Minutes for toll and domestic long distance, custom calling features	$34.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense 50SM with International	Unlimited local, 50 anytime Dial 1 Minutes for toll and domestic long distance, custom calling features, discounted international calling	$37.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense UnlimitedSM II	Unlimited local, unlimited anytime Dial 1 Minutes for toll and domestic long distance, custom calling features	$49.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense UnlimitedSM II with International	Unlimited local, unlimited anytime Dial 1 Minutes for toll and domestic long distance, custom calling features, discounted international calling	$52.99 per month	Residence	All or portions of Qwest Wire centers in UNE Zones 1	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Local BusinessSM	Unlimited local calling.	$59.95 per month	Business	All or portions of Qwest Wire centers in UNE Zones 1 and 2	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense for BusinessSM	Unlimited local calling, custom calling feature, discounted long distance calling.	$39.95 per month	Business	All or portions of Qwest Wire centers in UNE Zones 1 and 2	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense for BusinessSM with International	Unlimited local calling, custom calling feature, discounted long distance and international calling.	$45.90 per month	Business	All or portions of Qwest Wire centers in UNE Zones 1 and 2	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05

SAMPLE OF SELECTED CLEC SERVICES IN ARIZONA

Carrier	Certification Date	Service Name	Service Description	Pricing	Target Market	Availability	Source
		Sprint Complete Sense for BusinessSM Unlimited	Unlimited local calling, custom calling feature, unlimited long distance calling.	$74.95 per month	Business	All or portions of Qwest Wire centers in UNE Zones 1 and 2	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense for BusinessSM Unlimited with International	Unlimited local calling, custom calling feature, unlimited long distance and discounted international calling.	$80.90 per month	Business	All or portions of Qwest Wire centers in UNE Zones 1 and 2	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense for BusinessSM Premium	Unlimited local calling, custom calling feature, unlimited long distance calling, Voice Mail.	$89.95 per month	Business	All or portions of Qwest Wire centers in UNE Zones 1 and 2	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
		Sprint Complete Sense for BusinessSM Premium with International	Unlimited local calling, custom calling feature, unlimited long distance and discounted international calling, Voice Mail.	$95.90 per month	Business	All or portions of Qwest Wire centers in UNE Zones 1 and 2	Sprint Arizona Local Exchange Tariff No. 4, reviewed 10-17-05
Time Warner		Basic Business Line	Provides a customer with one or more analog, voice grade telephonic communications channel	$31.05 - $33.75 per month depending on term; Non-IBL/VersiPak Customers	Business	Phoenix and Tucson	Time Warner Arizona Tariff No. 1, Section 3, reviewed 10-17-05
		Basic Business Line	Provides a customer with one or more analog, voice grade telephonic communications channel	$40.50 - $55.50 per month depending on term; qualified IBL/VersiPak Customers	Business	Phoenix and Tucson	Time Warner Arizona Tariff No. 1, Section 3, reviewed 10-17-05
		PBX Analog Trunk Service	Provides a customer with a single, voice-grade telephonic communications channel from a customer-provided PBX to the public switched telecommunications network	$46.88 - $51.98 per month depending on term; Non-IBL/VersiPak Customers	Business	Phoenix and Tucson	Time Warner Arizona Tariff No. 1, Section 3, reviewed 10-17-05
		PBX Analog Trunk Service	Provides a customer with a single, voice-grade telephonic communications channel from a customer-provided PBX to the public switched telecommunications network	$48.75 - $57.00 per month depending on term; qualified IBL/VersiPak Customers	Business	Phoenix and Tucson	Time Warner Arizona Tariff No. 1, Section 4, reviewed 10-17-05

SAMPLE OF SELECTED CLEC SERVICES IN ARIZONA

Carrier	Certification Date	Service Name	Service Description	Pricing	Target Market	Availability	Source
		Digital Trunk Service	Provides a customer with connection to the Company switch via a DS1 digital fiber optic transmission facility operating at 1.544 Mbps.	Digital Facility - $250.00 per month. Plus per month trunk charges of $19.00 - $54.00 in Phoenis and $13.50 - 51.00 in Tucson depending on term	Business	Phoenix and Tucson	Time Warner Arizona Tariff No. 1, Section 4, reviewed 10-17-05
Trinsic Communications, Inc. (formerly known as Z-Tel Communications, Inc.)		Trinsic Value with PVA	Basic Local Residential Local Exchange Line with 4 custom calling features and 50 minutes of long distance calling	Primary Line per month: $32.99 UNI Zone 1, $33.99 UNI Zone 2, $53.99 UNI Zone 3	Residential	Qwest Territory	Trinsic Arizona Tariff No. 5, Section 4 and 10, reviewed 10-17-05
		Trinsic Value with PVA	Basic Local Residential Local Exchange Line with 4 custom calling features and 50 minutes of long distance calling	Secondary Line per month: $28.00 UNI Zone 1, $28.00 UNI Zone 2, $49.00 UNI Zone 3	Residential	Qwest Territory	Trinsic Arizona Tariff No. 5, Section 4 and 10, reviewed 10-17-05
		Trinsic Spectrum Local Plus PPS	Local Business Exchange Line with or without Hunting	$26.00 per month	Business	Qwest Territory	Trinsic Arizona Tariff No. 5, Section 4 and 10, reviewed 10-17-05
XO Arizona, LLC		Basic Business Line	Local service	$30.35 per month for 1 or 2 years, $28.40 per month for 3 years	Business	Phoenix Metropolitan Area	XO Arizona, Local Exchange Services Tariff No. 1, Section X, reviewed 10-17-05
		PX Analog Trunk Service	Analog voice grade channels for traffic	In Only: $37.80 - $41.25 ; Out Only: $30-95 - $33.85: Two-Way: $34.95 - $37.85. All rates per month depending on term.	Business	Phoenix Metropolitan Area	XO Arizona, Local Exchange Services Tariff No. 1, Section X, reviewed 10-17-05

SAMPLE OF SELECTED WIRELESS SERVICES IN ARIZONA

	Sprint PCS		
	Fair and Flexible America Plans		
RATES/CHARGES	**Option 1**	**Option 2**	**Option 3**
Price	$29.99	$34.99	$55.99
Anytime Minutes	200	400	1000
Overage	**$5 per 50 minutes up to 700. Above 700, 10¢ each**	**$5 per 50 minutes up to 900. Above 900, 10¢ each**	**$5 per 50 minutes up to 1500. Above 1500, 10¢ each**
FEATURES			
Call Waiting	$0.00	$0.00	$0.00
Caller ID	$0.00	$0.00	$0.00
3-Way Calling	$0.00	$0.00	$0.00
Voicemail	$0.00	$0.00	$0.00
Total Monthly Rate w/Features	**$40.00**	**$55.00**	**$105.00**
PLAN DETAILS			
Free Long Distance	YES-Nationwide	YES-Nationwide	YES-Nationwide
Plan Description	Plan includes Unlimited Night and Weekend Minutes. Hours for Night & Weekend Minutes starting at 9 p.m. are Mon.-Thurs. from 9 p.m. to 7 a.m., and Fri. 9 p.m. to Mon. 7 a.m. No Roaming Charges.	Plan includes Unlimited Night and Weekend Minutes. Hours for Night & Weekend Minutes starting at 9 p.m. are Mon.-Thurs. from 9 p.m. to 7 a.m., and Fri. 9 p.m. to Mon. 7 a.m. No Roaming Charges.	Plan includes Unlimited Night and Weekend Minutes. Hours for Night & Weekend Minutes starting at 9 p.m. are Mon.-Thurs. from 9 p.m. to 7 a.m., and Fri. 9 p.m. to Mon. 7 a.m. No Roaming Charges.

Source: www.sprint.com visited on 10/17/05. Plans are based on Phoenix area.

Sourc

Cingular			
Cingular Nation GSM Plans			
			Prepay
$39.99	$59.99	$79.99	See Below
450 Rollover	900 Rollover	1350 Rollover	
45¢ per add'l minute	**40¢ per add'l minute**	**35¢ per add'l minute**	
$0.00	$0.00	$0.00	$0.00
$0.00	$0.00	$0.00	$0.00
$0.00	$0.00	$0.00	$0.00
$0.00	$0.00	$0.00	$0.00
$39.99	**$59.99**	**$79.99**	**All features above included**
YES-Nationwide	YES-Nationwide	YES-Nationwide	YES-Nationwide
Includes 5000 Night and Weekends minutes, unlimited Mobile to Mobile minutes, Nights are 9:00 p.m. to 6:00 a.m. Weekends are 9:00 p.m. Friday to 6:00 a.m. Monday	Includes Unlimited Night and Weekends minutes, unlimited Mobile to Mobile minutes, Nights are 9:00 p.m. to 6:00 a.m. Weekends are 9:00 p.m. Friday to 6:00 a.m. Monday	Includes Unlimited Night and Weekends minutes, unlimited Mobile to Mobile minutes,Nights are 9:00 p.m. to 6:00 a.m. Weekends are 9:00 p.m. Friday to 6:00 a.m. Monday	Two options: -Unlimited Mobile to Mobile: $1.00 per day access charge only on days when you use your phone; get unlimited mobile to mobile calling to over 50 million Cingular customers and pay 10 cents per minute for all other calls. OR -$0.25 per minute: one simple rate for all your calls.

Source: www.cingular.com visited on 10/17/05. Plans are based on Phoenix area.

Rollover Minutes accumulate and expire through 12 rolling bill periods. Bill Period 1 (activation) unused Anytime Minutes will not carry over. Bill Period 2 unused Anytime Minutes will begin to carry over. Rollover Minutes accumulated starting with Bill Period 2 will expire each bill period as they reach a 12 bill period age. Rollover Minutes will also expire immediately upon default or if customer changes to a non-Rollover plan.

SAMPLE OF SELECTED WIRELESS SERVICES IN ARIZONA

Cricket				
Unlimited Basic	Unlimited Classic	Unlimited Plus	Unlimited Access	Prepaid
$30.00	$35.00	$45.00	$45.00	10¢ per minute
Unlimited	Unlimited	Unlimited	Unlimited	None
NA	NA	NA	NA	NA
$0.00	$0.00	$0.00	$0.00	$0.00
Not included	Not included	Not included	$0.00	$0.00
Not included	Not included	Not included	$0.00	$0.00
Not included	Not included	Not included	$0.00	$0.00
$30.00	**$35.00**	**$45.00**	**$45.00**	**10¢ per minute**
No - 8¢ per minute	No - 8¢ per minute	YES-Nationwide	YES-Nationwide	**10¢ per minute**
Unlimited Local Calls from customer's Cricket Service area. Free Incoming Calls, Free Mobile-to-Mobile minutes.	Unlimited Local Calls from customer's Cricket Service area. Free Incoming Calls, Free Mobile-to-Mobile minutes. For an additional $5 per month get Voice Mail, Caller ID, plus 2 Directory Assistance calls per month.	Unlimited Local and Long Distance calls from customer's Cricket Service area. Free Incoming Calls, Free Mobile-to-Mobile minutes. For an additional $5 per month get Voice Mail, Caller ID, plus 2 Directory Assistance calls per month.	Unlimited Night and Weekend Minutes for $5 extra. 50 state toll free calling from your home area. Two way Text messaging also included.	Free incoming calls and Text messages.

Source: www.mycricket.com visited on 10/18/05. Plans based on Phoenix area.

AllTel			
Greater Freedom Plans			
$29.99	**$39.99**	**$49.99**	**$59.99**
$29.99	$39.99	$49.99	$59.99
300	1000	1000	1200
45¢ per minute	**40¢ per minute**	**40¢ per minute**	**40¢ per minute**

$0.00	$0.00	$0.00	$0.00
$0.00	$2.99	$0.00	$0.00
$0.00	$0.00	$0.00	$0.00
$0.00	$1.99	$0.00	$0.00
$29.99	**$39.99**	**$49.99**	**$59.99**

No - 15¢ per minute	YES-Nationwide	YES-Nationwide	YES-Nationwide
		Night minutes are Mon. — Thurs. 9 p.m. — 5:59 a.m. Weekend minutes are Fri. 9 p.m. — Mon. 5:59 a.m. Unlimited Nights/Weekends and Mobile-to-Mobile.	Night minutes are Mon. — Thurs. 9 p.m. — 5:59 a.m. Weekend minutes are Fri. 9 p.m. — Mon. 5:59 a.m. Unlimited Nights/Weekends and Mobile-to-Mobile.

Source: www.alltel.com visited on 10/18/05

SAMPLE OF SELECTED VOIP SERVICES IN ARIZONA

Residential	Vonage				Lingo/Primus				
	Premium Unlimited	Basic 500			Lingo Link	Basic	Unlimited		
Basic Rate -	$24.99	$14.99	$49.99	$39.99	$7.95	$14.95	$19.95	$49.95	$99.95
FEATURES									
Call Waiting	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Caller ID	$0.00	$0.00	$0.00	$0.00	NA	$0.00	$0.00	$0.00	$0.00
3-Way Calling	$0.00	$0.00	$0.00	$0.00	NA	$0.00	$0.00	$0.00	$0.00
Voicemail	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total Monthly Rate w/Features	**$24.99**	**$14.99**	**$49.99**	**$39.99**	**$7.95**	**$14.95**	**$19.95**	**$49.95**	**$99.95**
PLAN DETAILS									
Unlimited Local Calls	Yes	500 minutes of local or LD	Yes	1500 minutes of local or LD	Unlimited Calling to other Lingo customers only.	500 Calling Minutes	Yes	Yes	Yes
Free Long Distance	Yes - Nationwide, Canada & Puerto Rico	500 minutes of local or LD-Nationwide, Canada & Puerto Rico	Yes - Nationwide, Canada & Puerto Rico	1500 minutes of local or LD-Nationwide, Canada & Puerto Rico	Unlimited Calling to other Lingo customers only.	500 Calling Minutes to US, Canada and Western Europe.	Unlimited calling to US, Canada and Western Europe.	Unlimited calling to US, Canada and Western Europe.	Unlimited calling to US, Canada, Western Europe and add'l coutnies
Installation Chg/Activation Fee	FREE	FREE	FREE	FREE	$29.95	$29.95	$29.95	$29.95	$29.95
Other Details			Free dedicated FAX line.		First month is free.	First month is free.	First month is free.	Free Fax line with 500 minutes of faxing.	*Select international business VoIP subscription includes calls from Lingo business VoIP subscribers to 35 additional countries.

www.twcMinnesota.com visited on 8/10/05
www.vonage.com visited on 8/10/05
www.lingo.com visited on 8/10

SAMPLE OF SELECTED VOIP SERVICES IN ARIZONA

AT&T			MCI				Verizon		SunRocket	
CallVantage			Neighborhood Broadband				Voicewing		Signature Service	
Local Plan	Service Plan	[illegible]	Value	500	Unlimited	[illegible]	Voicewing 500	Voicewing Unlimited	Monthly Edition	Annual Edition
$19.99	$29.99	$49.99	$9.99	$19.99	$29.99		$19.95	$19.99	$24.95	$199 per year
$0.00	$0.00	$0.00	$0.00	$0.00	$0.00		$0.00	$0.00	No	No
$0.00	$0.00	$0.00	$0.00	$0.00	$0.00		$0.00	$0.00	$0.00	$0.00
$0.00	$0.00	$0.00	$0.00	$0.00	$0.00		$0.00	$0.00	No	No
$0.00	$0.00	$0.00	$0.00	$0.00	$0.00		$0.00	$0.00	$0.00	$0.00
$19.99	**$29.99**	**$49.99**	**$9.99**	**$19.99**	**$29.99**	**Not Publicly A**	**$19.95**	**$19.99**	**$24.95**	**$199 per year**
Yes	Yes	Yes	3¢ a minute	500 minutes of combined Local and LD	Yes	Unknown	500 outbound minutes to anywhere in the U.S.- 4¢/minute	Yes	Yes	Yes
No - 4¢ a minute	Yes - US and Canada	Yes - US and Canada	3¢ a minute	500 minutes of combined Local and LD	Unlimited Calls to US and Canada	Unknown	500 outbound minutes to anywhere in the U.S.- 4¢/minute thereafter	Unlimited LD to anywhere in US including Puerto Rico	Unlimited calling to US and Canada	Unlimited calling to US and Canada
$29.95	$29.95	$29.95				Unknown	Free if ordered online.	Free if ordered online.	Free	Free
CallVantage customers do not pay Federal USF or FCC Line Charges and pay lower Federal Excise Tax.	CallVantage customers do not pay Federal USF or FCC Line Charges and pay lower Federal Excise Tax.	CallVantage customers do not pay Federal USF or FCC Line Charges and pay lower Federal Excise Tax.								

www.usa.att.com/callvantage visited on 8/10
www.mci.com visited on 8/10
www.verizon.com visited on 8/10
www.sunrocket.com vistited on 8/11

SAMPLE OF SELECTED VOIP SERVICES IN ARIZONA

Packet8					Skype
Freedom Unlimited	Freedom Int'l	[illegible]	[illegible]	[illegible]	Skype for Windows
$19.95	$19.95	$39.95	$19.95	$9.95	FREE
$0.00	$0.00	$0.00	No	No	No
$0.00	$0.00	$0.00	No	No	$0.00
$0.00	$0.00	$0.00	No	No	No
$0.00	$0.00	$0.00	$0.00	No	$0.00
$19.95	**$19.95**	**$39.95**	**$19.95**	**$19.95**	**$199 per year**
Yes	1,000 PSTN minutes	Yes	250 minutes	NA	Skype to Skyp calls are free.
Yes	1,000 PSTN minutes	Yes - US and Canada	250 minutes	NA	Skype to Skype calls are free. Skypout users can call many worldwide locations for 23¢ per minute
Free	Free	$39	$39	$19.95	Free
International rates apply to all outgoing calls outside of the US (including Alaska and Hawaii) and Canada.	International rates apply to all outgoing calls outside of the US (including Alaska and Hawaii) and Canada. Other International plans are available - Unlimited Plus Asia - $49.90; Unlimited Plus Europe - $49.90 and Unlimited Plus Eurasia - $79.80.	Virtual Office service costs: - $39.95 per extension, per month, plus 3% FET. - $99 for the equipment (special business telephone and broadband adapter). - $39.00 for activation - $1.50 Regulatory Recovery Fee - $18.95 for shipping	Virtual Office Metered Extension is just like our current unlimited extension for Virtual Office differing only in price and the minutes included. The new metered extension includes 250 minutes of calling to the US and Canada, + 3.9 cents a minute thereaf	Virtual Extension is an extension that can be reached from the auto-attendant, by an extension call and by a DID. The extension is not associated with a physical Virtual Office telephone but can be forwarded out to remote numbers for 3.9 cents per minute	Skype Voicemail is sold on a subscription basis: a 12 month subscription is 15 euros and 3 months is 5 euros.

www.packet8.com visited on 8/11
www.skyp.com visited on 8/11

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**
STATE OF WASHINGTON COUNTY OF KING	) :	**AFFIDAVIT OF DAVID L. TEITZEL** **SS**

David L. Teitzel, of lawful age being first duly sworn, deposes and states:

1. My name is David L. Teitzel. I am Staff Director - Public Policy for Qwest Services Corporation in Seattle, Washington. I have caused to be filed written rebuttal testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

David L. Teitzel

SUBSCRIBED AND SWORN to before me this 14th day of October, 2005.

LORI L. WHITE
COMMISSION EXPIRES
NOTARY
PUBLIC
7-10-07
STATE OF WASHINGTON

Notary Public

My Commission Expires: 7/10/07

DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672

Q-37 Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

PHILIP E. GRATE

REBUTTAL TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

OCTOBER 28, 2005

TESTIMONY INDEX

Page

EXECUTIVE SUMMARY I

I. IDENTIFICATION OF WITNESS 1

II. PURPOSE OF TESTIMONY 1

III. REBUTTAL OF MARYLEE DIAZ CORTEZ 2

Giving Full Credit for the Suspended April 1, 2005 Rate Reduction 2

IV. REBUTTAL OF BEN JOHNSON, PH. D. 8

Appropriate Benchmark 9

Alleged Problems with Service Baskets and Competition 12

Inflation-Minus-4.2%-Productivity Adjustment 12

Productivity Achieved 16

Summary of changes 22

Output Growth Since 2004 24

Prospects for Future Productivity Improvement 28

Practical Application of Productivity Offset in RUCO's Proposal 28

RUCO's Recommendation 34

EXECUTIVE SUMMARY

Rebuttal of Marylee Diaz Cortez, CPA

Decision No. 67734 requires Qwest to demonstrate that the terms of the Renewed Price Plan give ratepayers "full credit for the value of the April 1, 2005 productivity adjustment..." that was suspended. Section 10 of the Agreement satisfies this requirement by providing that during Year 1 of the Plan Qwest's opportunity to increase rates up to its stipulated $31.8 million revenue deficiency is reduced by $12 million for the April 1, 2005 productivity adjustment. Ms. Diaz Cortez argues that the $12 million limitation on Qwest's opportunity to increase its rates does not satisfy Qwest's obligation because it "does not render ratepayers in a better position than they were before the settlement agreement."

Ms. Diaz Cortez incorrectly asserts that in order to give ratepayers full credit for a suspended rate reduction, ratepayers must receive a rate reduction. However, Decision No. 67734 does not call for a rate reduction. It calls for ratepayers to receive full credit for the rate reduction. RUCO fails to acknowledge that because Qwest is entitled to recover its stipulated $31.8 million revenue deficiency, reducing that recovery by $12 million in Year 1 bestows a $12 million benefit on Arizona ratepayers that gives them full credit for the rate reduction that would have been in effect between April 1, 2005 and April 1, 2006. RUCO also fails to acknowledge that the Agreement stipulates a revenue

deficiency that is $127.7 million smaller than the $159.5 revenue deficiency that RUCO advocated.

Rebuttal of Ben Johnson, Ph.D.

Dr. Johnson argues that, as a matter of policy, the Agreement should be rejected unless it is as good as or better than the current Price Plan for residential and other mass market consumers. I testify that it would be inappropriate for the Commission to adopt RUCO's parochial criteria for evaluating the Agreement. The constituents of the public interest are not limited to just those Qwest customers that RUCO represents. They also include all other customers to whom Qwest provides service, Qwest's investors, Qwest's employees, Qwest's competitors and Arizona's economy. The testimony of Jerrold Thompson recounts the many provisions of the revised Price Plan designed specifically to benefit consumers. Dr. Johnson's testimony fails to mention these consumer benefits, much less to meaningfully incorporate them into his assessment of the Revised Price Plan.

Dr. Johnson argues the Revised Price Plan should be benchmarked against the current Price Plan. I disagree. The proper benchmark is current conditions including the current state of competition in Arizona telephony and the Company's current financial performance and productivity. Mr. Teitzel's rebuttal testimony provides a thorough review of the current state of competition in Arizona telephony. My testimony addresses

Qwest's financial performance and productivity. I conclude that after more than century of relatively steady access line growth, Qwest's loss of 26 percent of it retail access lines in the last four calendar years marks an unprecedented and fundamental change in the course Arizona telephony that has a profound effect on the Company's financial performance and productivity. A revised price plan must reflect these fundamental changes.

Dr. Johnson identifies certain features of the Revised Price Plan that he considers problematic. One such problem is that it does not subject certain services to annual adjustments for inflation minus a 4.2 percent Productivity Offset that is a feature of the current Price Plan. My testimony explains the origin of the 4.2 percent Productivity Offset and provides a financial explanation of the reasons why it's elimination under the Revised Price Plan is appropriate.

I analyze the practical application of RUCO's proposed regulatory regime under which the vast majority of Qwest's rates would continue to be adjusted by an annual inflation minus 4.2 percent Productivity Offset. I show that under RUCO's proposal Qwest is virtually assured of being unable to recover any significant portion of its revenue deficiency and explain why it is probable that the continuation of the 4.2 percent Productivity Offset would exacerbate Qwest's revenue deficiency.

Arguing that "It is not yet time to begin thinking about providing the Company with the type of extreme pricing flexibility that it seeks through this proposal," Dr. Johnson recommends that the Agreement be rejected. My testimony offers an alternative perspective, that of the Staff of the New York Public Service Commission which released a White Paper on Competition in New York in late September. The White Paper concluded that every residential service that Verizon New York sells except for a basic service offering should have full pricing flexibility.

Unlike RUCO, the NYPSC Staff conducted an analysis of access line and minutes-of-use loss of incumbent local exchange companies from which they concluded, "It is clear based upon the continued loss of access lines and minutes of use...that the current system is imposing unreasonable burdens on incumbent telephone companies."

I then compare the data the NYPSC Staff reviewed for Verizon New York with the same data for Qwest Arizona. The comparison shows remarkably similar levels of access line loss, minutes of use loss, revenue declines and pre-tax operating return declines.

RUCO's conclusions and the NYPSC Staff's conclusion stand in stark contrast to one another. RUCO justifies its opposition to the Agreement on the grounds that Qwest retains substantial "residual monopoly power" in Arizona. The NYPSC Staff concludes that "The provision of telecommunications services is no longer a natural monopoly. A regulatory regime that ignores that reality will not work." Qwest's Arizona financial

data—especially its rapid and unprecedented access line and local service revenue losses—refutes RUCO's conclusion and supports the same conclusion for Arizona that the NYPSC Staff reached for New York.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. ARE YOU THE SAME PHILIP E. GRATE WHO FILED DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AND DIRECT, REBUTTAL AND REJOINDER TESTIMONY IN THIS PROCEEDING?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN SUPPORT OF AGREEMENT?

A. This testimony is in rebuttal of testimony offered on behalf of the Residential Utility Consumer Office (RUCO) in opposition of the Commission's adoption of the agreement among Qwest Corporation ("Qwest"), the Arizona Corporation Commission Utilities Division Staff ("Staff"), the Department of Defense and All Other Federal Executive Agencies, the regulated subsidiaries of MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Utility Investors Association, Cox Arizona Telcom, LLC, and XO Communications Services, Inc., (collectively "the Parties") to a Settlement Agreement ("Agreement") of the pending Qwest application for renewal

of its current Price Plan with modifications. Specifically I respond to the Supplemental Testimonies in opposition to the Agreement of Marylee Diaz Cortez, CPA and Ben Johnson, Ph.D.

III. REBUTTAL OF MARYLEE DIAZ CORTEZ

Giving Full Credit for the Suspended April 1, 2005 Rate Reduction

Q. TO WHAT ISSUE RAISED IN MS. DIAZ CORTEZ'S TESTIMONY ARE YOU RESPONDING?

A. Ms. Diaz Cortez argues that the Agreement does not satisfy a requirement set forth in the Commission's Decision No. 67734.

Q. PLEASE EXPLAIN THE REQUIREMENT.

A. The Commission approved a three year Price Plan (current Price Plan) for Qwest effective April 1, 2001.[1] Among other things, it called for adjustments to Basket 1 rates to reflect inflation and a productivity factor set at 4.2 percent. The price adjustments were to be made annually on April 1. Although the three year term of the current Price Plan ended in 2004, the Commission ordered Qwest to continue the annual price adjustments until the Commission either modifies the current Price Plan or terminates it.[2]

---

[1] Decision No. 63487.
[2] Decision Nos. 66772 and 67047.

On Qwest's motion to suspend the inflation-minus productivity factor adjustment scheduled for April 1, 2005, the Commission entered Decision No. 67734 which made the following finding:

> [T]he Commission certainly has the discretion to suspend the April 1, 2005 reduction, to accommodate comprehensive settlement discussions in this case. We do not believe that a mere suspension of the April 1, 2005 reduction would violate Scates (footnote omitted), or the principle that the Commission cannot modify rates absent a fair value finding. We are not terminating the April 1, 2005 adjustment. The liability associated with the April 1, 2005 adjustment will continue to accrue. We will address the accrued liability for the April 1, 2005 adjustment in the final rate order in this docket.[3]

The Commission also found:

> Qwest has the burden of demonstrating that the terms of any Renewed Plan or other form of rate regulation that may ultimately be approved, whether produced by settlement or through litigation, include full credit for the value of the April 1, 2005 productivity adjustment being given to ratepayers.[4]

Ms. Diaz Cortez maintains that the Agreement does not satisfy this requirement.

Q. WHY DOES MS. DIAZ CORTEZ BELIEVE THE AGREEMENT DOES NOT SATISFY THIS REQUIREMENT?

A. According to Ms. Diaz Cortez: "RUCO does not believe the provisions of the settlement regarding the productivity adjustment 'include credit for the *full* value'."[5]

---

[3] Decision No. 67734.
[4] *Id.*
[5] Supplemental Testimony in opposition to Qwest's Settlement Agreement of Marylee Diaz Cortez, CPA, page 5, lines 26 to 27.

1 Ms. Diaz Cortez maintains that had Qwest implemented a rate reduction on April 1,
2 2005, it "would have put ratepayers in a better position than they had been prior to
3 the April 1, 2005 adjustment."[6] Had the rate reduction been implemented April 1,
4 2005, she argues, ratepayers would have realized a $12 million reduction in rates by
5 April 1, 2006.[7] She believes that the Agreement does not demonstrate that
6 ratepayers receive full credit for the value of the April 1, 2005 productivity adjustment
7 because it "does not render ratepayers in a better position than they were before the
8 settlement agreement."[8] She believes that because the Agreement does not call for
9 a temporary $12 million rate reduction, it does not put ratepayers in a better position
10 than they were prior to April 1, 2005.[9]

11 **Q. DO YOU AGREE?**

12 A. No. Ms. Diaz Cortez believes that unless ratepayers enjoy a temporary rate
13 reduction, they have not received full credit for the value of the April 1, 2005
14 productivity adjustment.[10] I disagree. Ms. Diaz Cortez equates full credit with a rate
15 reduction. Decision No. 67734 does not. Had the Commission intended that the
16 obligation to give ratepayers full credit be satisfied exclusively through a temporary
17 rate reduction, Decision No. 67734 would have said so.

---

[6] *Id.* page 7, line 3 to line 6
[7] *Id.*, page 7, line 3
[8] *Id.* page 7, line 6 to line 8
[9] *Id.* page 5, line 30 to page 6, line 11.
[10] "The agreement merely restricts the amount that Qwest can *raise* prices in Basket 2. Thus, the provisions of the settlement agreement do not give ratepayers full credit for the value of 1the productivity adjustment as required by Decision No. 67734." Supplemental Testimony in opposition to Qwest's Settlement Agreement of Marylee Diaz Cortez, CPA, page 6, line 8 to line 11.

Further, if a Basket 1 rate reduction were the only acceptable means of providing ratepayers with full credit for the suspended April 1, 2005 productivity adjustment, there would have been no reason to suspend it. However, because Decision No. 67734 did just that, it is clear that the Commission recognized that parties to a settlement could provide for satisfaction of the liability by means other than a rate reduction.

Q. PLEASE EXPLAIN HOW THE AGREEMENT PROVIDES RATEPAYERS FULL CREDIT FOR THE VALUE OF THE APRIL 1, 2005 PRODUCTIVITY ADJUSTMENT.

A. In Decision No. 66772 the Commission concluded: "The Commission cannot order termination of the Plan, or adopt a modified Plan without making a finding of fair value and a determination that the rates therein are just and reasonable." Thus, ratepayers are subject to the finding of Qwest's revenue requirement in this proceeding.[11] Ms. Diaz Cortez's direct testimony was pre-filed November 18, 2004. It claimed that Qwest's revenue deficiency is $159.5 million.[12] Section 2 of the Agreement stipulates a revenue deficiency of $31.8 million. Thus, compared to RUCO's position, the Agreement puts ratepayers in a better position by the difference between $159.5 million and $31.8 million or $127.7 million. Neither Ms.

[11] RUCO wholly supported this position in its Response to Emergency Motion to Suspend the Inflation Minus Productivity Factor Adjustment, dated 8 February 2005, p. 4, line 12 to page 5, line 3.
[12] Docket Nos. T-01051B-03-0454 & T-0000D-00-0672, Direct Testimony of Marylee Diaz Cortez, p. 2, line 7 to line 8. Rebuttal Testimony of Marylee Diaz Cortez, Schedule MDC-1, Column F, Line 8.

1 Diaz Cortez's nor Dr. Johnson's testimony acknowledges this benefit of the
2 Agreement to ratepayers.

3 Section 10 of the Agreement provides that during Year 1 of the Plan, Qwest's
4 opportunity to increase rates up to its stipulated $31.8 million revenue deficiency is
5 reduced by $12 million for the April 1, 2005 productivity adjustment. This $12
6 million limitation on Qwest's opportunity to increase its rates to recover its revenue
7 deficiency provides full credit for the $12 million annual reduction in rates that would
8 have been in effect between April 1, 2005 and April 1, 2006, when it is assumed the
9 revised Plan will take effect.

10 Decision No. 66772 requires a revenue requirement finding. To the extent the
11 finding is of a revenue deficiency, Qwest is entitled to recover it in rates. RUCO's
12 testimony opposing the Agreement fails even to acknowledge the revenue deficiency
13 much less Qwest's right to recover it. Prohibiting Qwest from recovering $12 million
14 of revenue deficiency that it is otherwise entitled to recover provides Arizona
15 ratepayers full credit for the April 1, 2005 rate reduction by shielding them from $12
16 million of Qwest rate increases for one year.

17 The $12 million prohibition places Arizona ratepayers in a better position than if
18 Qwest's opportunity were not so limited because it shields them from $12 million of
19 rate increases necessary for Qwest to recover its revenue deficiency. It also places

1 Qwest in a $12 million worse position than were there no such prohibition. RUCO
2 opposes the $12 million prohibition simply because it is not what RUCO prefers.

3 **Q. WHAT DOES RUCO PREFER?**

4 A. RUCO vigorously opposed Qwest's motion to suspend the April 1, 2005 productivity
5 adjustment because it wanted Arizona ratepayers to enjoy a rate decrease.[13] The
6 Commission's purpose in granting Qwest's motion was to avoid a temporary rate
7 decrease followed by a subsequent rate increase under a revised Price Plan that
8 could cause consumer confusion.[14] Now RUCO argues that the only way Qwest's
9 obligation can be satisfied is if ratepayers enjoy a temporary rate decrease. Thus,
10 under the pretense of opposing the Agreement, RUCO now seeks to undo what the
11 Commission intended to achieve with Decision 67734.

12 **Q. HOW DOES MS. DIAZ CORTEZ PROPOSE THAT RATEPAYERS ENJOY A**
13 **TEMPORARY RATE REDUCTION?**

14 A. She recommends that all Qwest 1FR and 1FB customers receive a credit on their
15 monthly bills equal to a twelve month amortization of the value of the April 1, 2005
16 productivity adjustment that was foregone during the suspension period.[15]

---

[13] Response to Emergency Motion to Suspend the Inflation Minus Productivity Factor Adjustment, 8 February 2005.
[14] Decision No. 67734, p. 6, lines 2 through 7.
[15] Docket Nos. T-01051B-03-0454 & T-0000D-00-0672, Testimony of Marylee Diaz Cortez, p. 6, l. 16.

Q. HAD THE COMMISSION DENIED THE MOTION TO SUSPEND THE APRIL 1, 2005 RATE REDUCTION, WHAT WOULD HAVE HAPPENED?

A. The rate reduction would have been included in Qwest's revenue requirement calculation as a pro-forma adjustment. Thus, Qwest's revenue deficiency would have been greater by the amount of the rate decrease.

Q. WOULD QWEST HAVE REDUCED 1FR AND 1FB RATES?

A. No. The current Price Plan requires Qwest to choose which rates it will adjust in order to implement the Basket 1 inflation-minus-productivity adjustment. Qwest has never chosen to implement a Basket 1 adjustment by reducing 1FR or 1FB rates. Nor would Qwest have reduced 1FR or 1FB rates April 1, 2005. Under the cover of opposing the Agreement, RUCO aims to bootstrap a rate reduction on 1FR and 1FB services whose prices would not have been reduced even if the Commission had not suspended the April 1, 2005 adjustment.

IV. REBUTTAL OF BEN JOHNSON, PH. D.

Q. TO WHICH PORTION OF DR. JOHNSON'S TESTIMONY ARE YOU RESPONDING?

A. I am responding to Dr. Johnson's testimony regarding the benchmark he proposes for evaluating the merits of the Agreement, his testimony regarding service baskets and competition and his proposal that the Commission reject the Agreement.

1 ***Appropriate Benchmark***

2 **Q. HOW WOULD DR. JOHNSON HAVE THE COMMISSION EVALUATE THE**
3 **AGREEMENT?**

4 A. Dr. Johnson testifies:

5 [I]f the proposed settlement is worse for [residential and other mass market
6 consumer] customers than the existing plan, it fails to advance important public
7 policy goals, or it fails to adequately address important policy issues which were
8 supposed to be dealt with in this proceeding. (sic) the Commission should reject
9 the proposed settlement...

10 In other words, Dr. Johnson argues that, as a matter of policy, the Agreement should
11 be rejected unless it is as good as or better than the current Price Plan for residential
12 and other mass market consumers.

13 **Q. DO YOU AGREE?**

14 A. As a preliminary matter I should point out that Jerrold Thompson's testimony
15 recounts the many provisions of the revised Plan designed specifically to benefit
16 consumers. Dr. Johnson's testimony fails to mention these consumer benefits,
17 much less to meaningfully incorporate them into his assessment of the Revised
18 Price Plan.

19 That notwithstanding, it would be inappropriate for the Commission to adopt RUCO's
20 parochial criteria for evaluating the Agreement. The constituents of the public
21 interest are not limited to just those Qwest customers that RUCO represents. They

also include all other customers to whom Qwest provides service, Qwest's investors, Qwest's employees, Qwest's competitors and Arizona's economy.

Q. WHAT BENCHMARK DOES RUCO PROPOSE FOR EVALUATING THE MERITS OF THE AGREEMENT?

A. Dr. Johnson states:

> When analyzing the proposed settlement, the Commission should determine whether the proposal is in the public interest. In order to make such a determination, the Commission needs a benchmark to evaluate the merits of the proposed settlement. <u>That benchmark should be the status quo</u>. In evaluating whether the settlement is an improvement over the status quo, the Commission should focus on whether or not the proposed settlement furthers important public policy objectives, such as establishing robust and effective competition in the telecommunications market, preventing the exploitation of monopoly power where competition is not fully effective, and preserving and promoting universal service.[16] (emphasis added)

In other words, Dr. Johnson would have the Commission gauge the Revised Price Plan against the Current Price Plan.

Q. DOES QWEST AGREE WITH DR. JOHNSON'S PROPOSED BENCHMARK?

A. No. The proper benchmark for evaluating the public interest is current conditions—including the current state of competition in Arizona telephony and the Company's current financial performance and productivity—not a plan based on conditions that existed well over half a decade ago. Mr. Teitzel's rebuttal testimony provides a thorough review of the current state of competition in Arizona telephony and

[16] Docket No's. T-01051B-03-0454 and T-00000D-00-0672, Responsive Testimony of Ben Johnson, Ph.D. On Behalf of the RUCO, p. 7, line 22 to p. 8. line 4.

1 concludes that competition in Arizona is now robust and intensifying. My testimony
2 addresses Qwest's financial performance and productivity. I conclude that after
3 more than century of relatively steady access line growth, Qwest's loss of 26 percent
4 of it retail access lines in the last four calendar years marks an unprecedented and
5 fundamental change in the course Arizona telephony that has profoundly curtailed
6 the Company's financial productivity. A revised price plan must reflect these
7 fundamental changes.

8 **Q. IS THE AGREEMENT IN THE PUBLIC INTEREST?**

9 A. Despite RUCO's withdrawal from settlement negotiations, the Agreement achieves a
10 reasonable balance between the interests of RUCO's constituents and the interests
11 of other affected parties—in light of the current state of telephony in Arizona and
12 Qwest's financial condition.

13 The parties to the Agreement represent a broad cross section of constituencies to
14 the public interest. All of these parties agree the Agreement is in the pubic interest.
15 RUCO's parochial criteria for evaluating the plan and its failure to acknowledge the
16 Plan's many consumer benefits has blinded it to the broader public interest and to
17 the balance the settlement parties have achieved with the Revised Price Plan.

Alleged Problems with Service Baskets and Competition

Inflation-Minus-4.2%-Productivity Adjustment

Q. DOES DR. JOHNSON IDENTIFY OTHER PROBLEMS WITH THE TERMS OF THE AGREEMENT?

A. Yes. Using the status quo of the current Price Plan as his benchmark, Dr. Johnson evaluates the terms of the Revised Price Plan and concludes that it has specific problems when compared to the current Price Plan. Specifically, beginning on page 12, line 22, Dr. Johnson's testimony provides:

> Under the current plan, individual rates for additional local exchange access lines are capped at the prices that were in place when the current plan was first approved. Further, these services are in Basket 1, and are therefore subject to an overall basket price cap equal to the change in GDP-PI minus 4.2%. To the extent inflation is less than 4.2%, at least some of the prices for basket 1 services must decline.
>
> In contrast, under the proposed plan, prices for additional access lines (for both business and residential customers) will no longer be subject to a hard cap, and they will no longer be subject to mandatory reductions in prices when inflation runs less than 4.2%. In fact, under the proposed settlement, revenues from Basket 2 services can increase up to $43.8 million, so the additional line rates could immediately be increased by 25%, and Qwest could thereafter increase these prices by as much as 25% per year, until they reach monopoly profit-maximizing levels ("whatever the traffic will bear").
>
> Similar problems apply to exchange zone increment charges applicable to additional lines, as well as rates for PBX trunks and caller ID block. Even more rapid movement to monopoly profit-maximizing price levels will be possible with respect to services that will be moved from the current basket 1 to the proposed basket 3. These include Stand-by Line Service, Home Business Line Service, Uniform Call Distribution, Code Billing and certain service bundles. Price increases for these services are currently constrained by the requirement that prices not increase by more than inflation minus 4.2% (an allowance for cost reductions due to productivity), as part of basket 1. Under the proposed plan, these services would be moved to basket 3, and Qwest would be given

essentially unlimited freedom to raise prices, even if competition is weak or nonexistent. (emphasis added)

Q. PLEASE EXPLAIN THE INFLATION-MINUS-4.2-PERCENT-PRODUCTIVITY ADJUSTMENT.

A. Under the current Price Plan, the rates of Basic/Essential Non-competitive Services in Basket 1 are capped by a Price Cap Index subject to annual adjustment by an Inflation-minus-Productivity indexing mechanism. The Price Cap Index is capped at zero but has no lower bound under the indexing mechanism. The indexing mechanism measures inflation as the annual percent change in the Gross Domestic Product Price Index and establishes an annual Productivity Offset of 4.2 percent.

Q. WHAT IS THE PURPOSE OF THE 4.2 PERCENT PRODUCTIVITY OFFSET?

A. In its Decision adopting the current Price Plan, the Commission stated that the purpose of the Productivity Offset in a price cap plan is to pass on a carrier's "reasonably anticipated increases in productivity" to consumers through rates.[17]

Q. ON WHAT DATA WAS THE 4.2 PERCENT ANNUAL PRODUCTIVITY OFFSET BASED?

A. The 4.2 percent Productivity Offset was based on an analysis of Qwest's historic productivity growth in Arizona from 1995 through 1998.[18] The analysis showed that

[17] Docket No. T-01051B-99-0105 ET AL, Decision No. 63487, p. 9, line 26.
[18] Docket No. T-01051B-99-0105 ET AL, Decision No. 63487, p. 10, line 9.

Qwest's productivity in Arizona during this four year period was 3.7 percent. Qwest Corporation—Exhibit PEG-SR01 provides the calculation of the 3.7 percent.

Q. WHY WAS THE PRODUCTIVITY OFFSET USED IN THE CURRENT PRICE PLAN SET AT 4.2 PERCENT INSTEAD OF 3.7 PERCENT?

A. The 4.2 percent Productivity Offset was the sum of Qwest's 3.7 percent productivity in Arizona measured over the four year period from 1995 to 1998 and a 0.5 percent "consumer dividend."[19]

Q. PLEASE EXPLAIN WHAT "PRODUCTIVITY" IS.

A. As explained in a study carried out on behalf of the National Association of Accountants:

> Productivity in its economic sense, is "a relationship of output to associated inputs, in real (physical volume) terms." Usually the relationship is expressed as the ratio of output to input, where the input may include one or more of the factors of production such as labor, capital, fuel, materials, and land. * * *
>
> Unfortunately, this rather straightforward definition of productivity is usually impossible to apply in practice. How does one define the numerator, physical output? It is easy enough if the output is a single uniform product—for example, steel of a single variety; however, if the output consists of several different products, a simple calculation of output is impossible. Similarly, the input defies simple definition if more than one factor—for example, labor hours and tons of material—are included.
>
> To avoid the need for aggregating unlike terms in the numerator or denominator of the productivity ratio, analysts have substituted dollar values for physical values in numerator and denominator or both. Thus, instead of using a

[19] Docket No. T-01051B-99-0105 ET AL, Decision No. 63487, p. 5, line 14.

measure like number of tons of steel per labor hour as a productivity ratio, the analyst might substitute sales per employee or sales to total cost input.[20]

Q. SEVERAL OF YOUR EXHIBITS ARE PRODUCTIVITY CALCULATIONS. DO THOSE CALCULATIONS RELY ON DOLLAR VALUES FOR BOTH INPUTS AND OUTPUTS?

A. Yes. My testimony includes exhibits of productivity calculations in which inputs are measured as the dollar value of costs and outputs are measured by the dollar value of sales adjusted for price changes. Operating expense inputs are adjusted for general price inflation.

Q. DO YOU AGREE WITH DR. JOHNSON THAT THE REVISED PRICE PLAN'S ELIMINATION OF THE INFLATION-MINUS-4.2-PERCENT-PRODUCTIVITY ADJUSTMENT IS A PROBLEM?

A. No, I believe it is appropriate for two reasons. First, the Agreement does not eliminate the 4.2 percent Productivity Offset alone. It also eliminates the adjustment for inflation. Thus, the Agreement effectively establishes a Productivity Offset equal to the rate of inflation.

The second reason is that the 4.2 percent Productivity Offset was established in reliance on circumstances that no longer exist. The following testimony explains how circumstances have changed.

---

[20] *How U.S. Firms Measure Productivity*, A study carried out on behalf of the National Association of Accountants, New York, New York. Jerome Kraus, York College, City University of New York (1984).

Productivity Achieved

Q. DID QWEST ACHIEVE THE ANTICIPATED 3.7 PERCENT ANNUAL PRODUCTIVITY GROWTH IN ARIZONA AFTER 1998?

A. No. In the six calendar years following 1998, Qwest achieved average annual productivity growth of negative 3.0 percent. Qwest Corporation—Exhibit PEG-SR02 provides the calculation. This calculation uses the same algorithms that were used to derive a 3.7 percent productivity value for the four years ending December 1998 and the 0.8 percent productivity value for the ten years ending December 1998 that is discussed below.

Q. WHY HASN'T QWEST ACHIEVED 3.7 PERCENT PRODUCTIVITY GROWTH IN ARIZONA SINCE 1998?

A. There are two principal reasons. The first is that the 3.7 percent target was overly optimistic. In the ten years ending with 1998 Qwest's outputs grew an average of 4.1 percent while its inputs grew an average of 3.3 percent.[21] Hence, on average, Qwest achieved 0.8 percent (4.1 percent less 3.3 percent) annual productivity growth in Arizona during those ten years. Qwest Corporation—Exhibit PEG-SR03 sets forth this calculation. In the proceeding under which the current Price Plan was established in Docket No. T-01051B-99-0105, Qwest provided this calculation in response to Staff data request SPR 3-001.

[21] *See* Qwest Corporation—Exhibit PEG-SR03.

The 0.8 percent average annual productivity growth rate during those ten years was 2.9 percentage points less than the 3.7 percent growth rate used in the Agreement. In fact, the 3.7 percent average annual Arizona productivity growth rate that Qwest achieved in the four years ending 1998 was the highest the Company had achieved in Arizona in any four year period during the ten years from 1989 through 1998.

Apparently, the productivity achieved in the last four years of the ten-year period was presumed to be a better predictor of future ongoing conditions than the whole of the ten-year period.

Q. WHAT IS THE SECOND REASON WHY QWEST ACHIEVED LESS THAN THE 3.7 PERCENT PRODUCTIVITY ANTICIPATED IN THE AGREEMENT?

A. An unprecedented change in Qwest's business substantially eroded Qwest's productivity in Arizona. In his pre-filed direct testimony, Dr. Johnson testified that the long term historical downward trend in real telephone prices is largely the result of increasing economies of scale and the underlying declining cost nature of the telephone industry.[22] In the six years following 1998—particularly the years of 2002, 2003 and 2004—Qwest's results ran counter to the historical trend Dr. Johnson described; Qwest suffered <u>decreasing</u> economies of scale and <u>increasing</u> cost per unit of output.

[22] Docket No. T-01051B-03-0454 and T-0000D-00-0672, Direct Testimony of Ben Johnson, page 88, lines 4 and 5.

In the ten years ending with 1998, Qwest's inputs grew at an average annual rate of 3.3 percent. In the six years following 1998, the average annual rate of growth of Qwest's inputs was 1.2 percent, a decrease of 2.1 percentage points from the average of the prior ten years.

However, during that same period the average annual growth of Qwest's outputs declined to a rate of negative 1.8 percent, a decrease of 5.9 percentage points compared to the prior ten years. Hence, the decline in outputs exceeded the decline in inputs by 3.8 percentage points and dropped Qwest's average annual productivity growth from positive 0.8 percent to negative 3.0 percent. The following schedule compares the average rate of input and output growth that Qwest achieved in Arizona during the two periods.

	1989-1998	1999-2004	Change
Ave. Annual Output Growth Rate	4.1%	-1.8%	-5.9%
Ave. Annual Input Growth Rate	3.3%	1.2%	-2.1%
Ave. Annual Productivity Growth Rate	0.8%	-3.0%	-3.8%

The schedule shows that the input growth rate slowed substantially after 1998. The slowing of input growth improves productivity growth. However, the output growth rate slowed much more than input growth. In fact, it slowed so much that, instead of growing, output has been shrinking at an average rate of 1.8 percent annually over the past six years. Although the growth rate of inputs and outputs declined, output declined substantially faster, thereby driving the decrease in annual productivity.

Q. IF THE SAME ASSUMPTION USED TO DETERMINE QWEST'S PRODUCTIVITY GROWTH RATE FOR PURPOSES OF THE CURRENT PRICE PLAN WERE USED, WHAT WOULD THE PRODUCTIVITY GROWTH RATE BE NOW?

A. The data used to establish a 3.7 percent historical productivity growth rate was based on the then most recent four years of historical data, 1995 through 1998. Qwest's Arizona intrastate productivity over the most recent four years—2001 through 2004—is negative 4.0 percent. Qwest Corporation—Exhibit PEG-SR04 provides the calculation.

The following schedule compares the average rate of input and output growth that Qwest achieved in Arizona during the period 1995 through 1998 with the input and output growth rate for the period 2001 through 2004.

	1995-1998	2001-2004	Change
Ave. Annual Output Growth Rate	6.1%	-5.9%	-12.0%
Ave. Annual Input Growth Rate	2.4%	-1.9%	-4.3%
Ave. Annual Productivity Growth Rate	3.7%	-4.0%	-7.7%

The schedule shows that between the two four-year periods the annual productivity growth rate slowed from positive 3.7 percent to negative 4.0 percent, a 7.7 percentage point drop. Although input growth slowed 4.3 percentage points between the two periods, it was overcome by a severe drop in output growth of 12.0 percentage points.

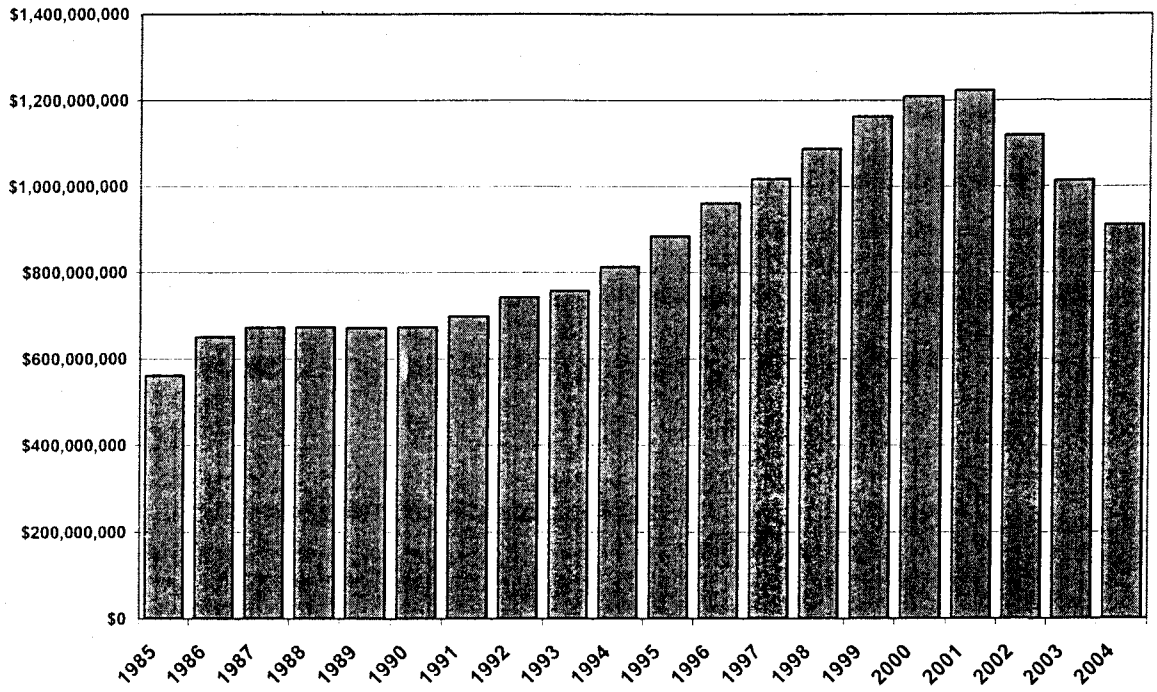
Q. DID THE RETAIL AND WHOLESALE RATE CHANGES UNDER QWEST'S ARIZONA PRICE PLAN CONTRIBUTE TO QWEST'S OUTPUT DECLINE?

A. No. The calculation of output in my exhibits removes the effect of price changes, including the price changes in April of 2001, 2002, 2003 and 2004.

Q. WHEN THE COMMISSION APPROVED THE CURRENT PRICE PLAN IN EARLY 2001, WOULD A REVIEW OF THE HISTORICAL FINANCIAL DATA AVAILABLE AT THAT TIME HAVE SUGGESTED SIGNIFICANT OUTPUT DECLINES WERE ABOUT TO BEGIN?

No. Simply reviewing the historical revenue data available in early 2001 without market analysis of the impending explosion of competition in Arizona would not have indicated a severe revenue decline was about to commence. At that point, competition was growing but its effects were still limited and financially manifest themselves principally as declines in intrastate toll revenues. The following graph charts Qwest's Arizona intrastate revenues over the past 20 years.

ARIZONA JR INTRASTATE REVENUES



The graph shows that Qwest's total intrastate revenues remained flat or grew from 1985 through 2001. So, by itself, a review of available revenue data would not have suggested a precipitous decline was about to occur. From 1995 through 1998—the years from which the 3.7 percent productivity growth rate used in the current Price Plan was derived—the Company achieved some of the strongest revenue growth of the 20 year period. Conversely, during the years 2001 through 2004—the years in which annual productivity was <u>negative</u> 4.0 percent—revenues declined severely in all but the first year.

Q. HAVE YOU PREPARED AN ANALYSIS OF QWEST'S ARIZONA INTRASTATE REVENUES OVER THE PAST DECADE?

A. Yes. An analysis of the four major categories of intrastate revenue can be found in Qwest Corporation—Exhibit PEG-SR05.

Summary of changes

Q. PLEASE SUMMARIZE AND COMPARE CHANGES IN THE FOUR REVENUE CATEGORIES DURING THE FOUR-YEAR PERIOD ENDING WITH 1998 AND THE FOUR-YEAR PERIOD ENDING WITH 2004.

A. The following schedule summarizes and compares the changes over the two four-year periods.

	Arizona Intrastate Revenues ($M) Growth in Annual Revenues		
	1995 through 1998	2001 through 2004	Swing Between Four-year Periods
Local Service	276	(267)	(544)
Access Service	32	(50)	(82)
Long Distance Service	(59)	(16)	43
Misc. Excluding Inter-Area Rent Comp	24	9	(15)
Total	273	(325)	(598)

The schedule shows that in the four years ending with 1998, Qwest's annual revenues increased $273 million. In the four years ending with 2004, Qwest's annual revenues decreased $325 million. The swing in revenue growth between the

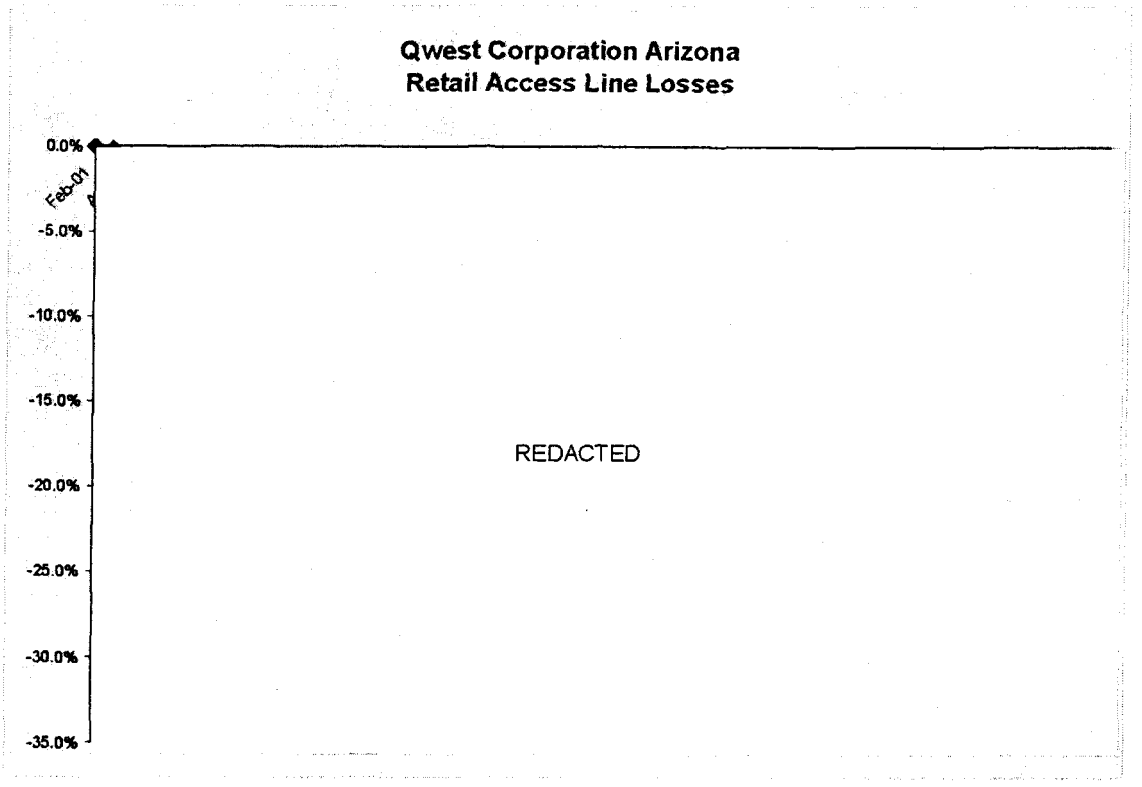
two periods is negative $598 million. By far, the most significant cause of that swing was a negative $544 million swing in local service revenue growth. The change in local service revenue growth is explained by a change in access line growth. In the four years between 1994 and 1998 Qwest's Arizona retail access line count grew 28 percent while in the four years between January 2001 and January 2005, Qwest's Arizona retail access line count fell 26 percent. Dr. Johnson's criticism of the Agreement for eliminating the 4.2 percent Productivity Offset ignores these fundamental changes in Qwest's business in Arizona.

1 ***Output Growth Since 2004***

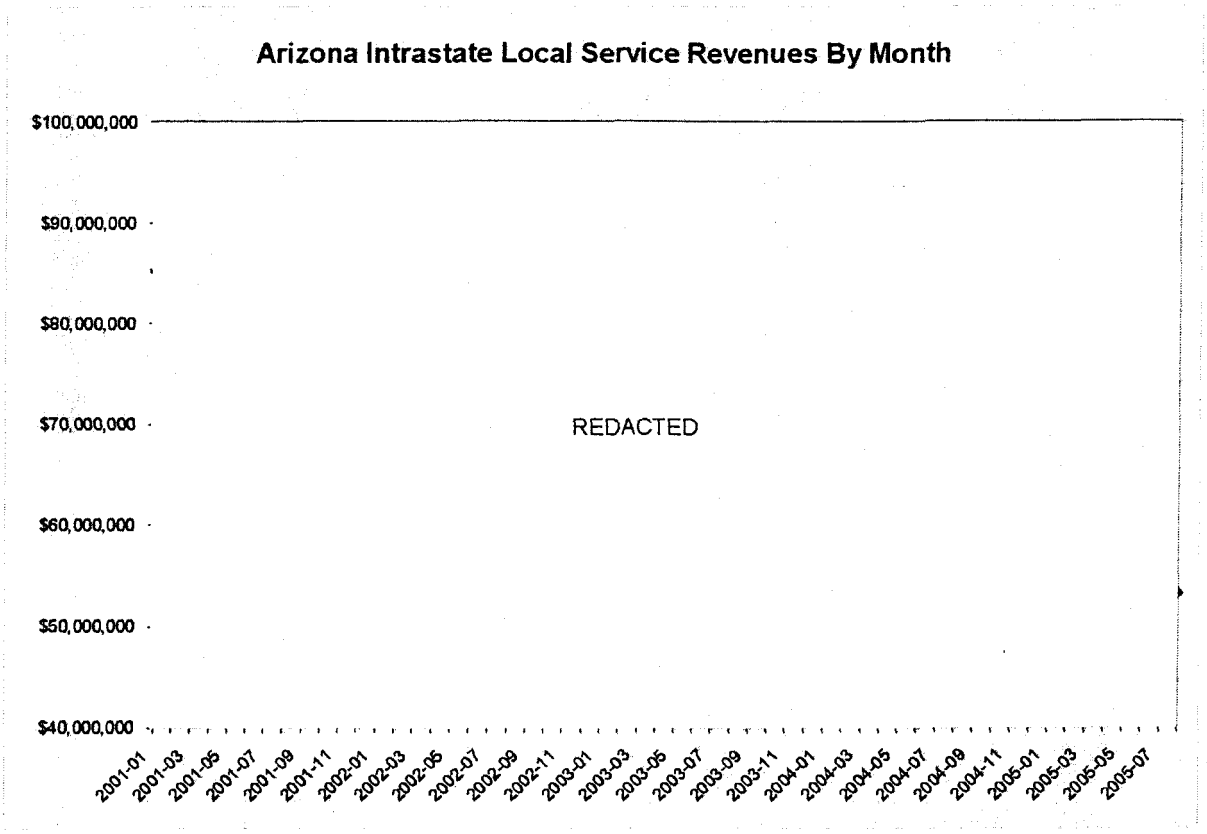
2 **Q. YOUR OUTPUT AND REVENUE ANALYSES END WITH DECEMBER 2004. DID**
3 **QWEST RETURN TO PRE-1999 LEVELS OF OUTPUT GROWTH IN 2005?**

4 A. No. Qwest's Arizona output continues to decline in 2005. In the first three quarters
5 of 2005, Qwest's retail access line count REDACTED access lines.
6 In the four years and seven months between February 2001 and September 2005
7 Qwest's retail access line count REDACTED Despite operating in a
8 market with a growing demand for telephone service REDACTED
9 REDACTED The following graph charts the continuing decline.[23]

[23] In March 2002 roughly 58,000 access lines attributable to services to Internet Service Providers (ISPs) migrated from a retail business unit to the Inter-Exchange Carrier (IEC) business unit (which sells under the wholesale category) in order to give these customers a more specialized service.



Given continuing access line losses, it is not surprising that Qwest's Arizona local service revenues continue their decline. The following graph charts Qwest's Arizona monthly local service revenues since the beginning of 2001.



The graph shows that the monthly local service revenues decline that began in 2001 continues unabated in 2005. As explained in the discussion of local service revenues in Qwest Corporation—Exhibit PEG-SR05, local service revenues declined at an average annual rate of 8.9 percent over the three years of 2002, 2003 and 2004. Rate decreases under the current Price Plan contributed to this decline. During 2005 Qwest's local service revenues continued to decline REDACTED REDACTED annual rate. Because there were no rate decreases in 2005, the REDACTED annual decline rate in 2005 is attributable exclusively to output decreases.

In the four and a half years since February 2001 when Qwest's retail access lines peaked, **Qwest's local service monthly revenues in Arizona have declined** REDACTED **percent**. The decline is driven principally by the loss of REDACTED of Qwest's retail access lines. During the same four and a half year period, total Arizona intrastate monthly revenues have declined REDACTED .

1 ***Prospects for Future Productivity Improvement***

2 **Q. WHEN WILL QWEST'S PRODUCTIVITY RETURN TO ITS PRE-1999 LEVELS OF**
3 **GROWTH?**

4 A. Nobody knows if Qwest's productivity will recover to pre-1999 levels, let alone when.
5 The available data regarding long-term telephone industry productivity is almost
6 entirely from the monopoly era of telephony. It does not reflect robust competition's
7 withering effect on output, such as the effect seen in Arizona since 2001. Hence, it
8 is an unreliable predictor of future ILEC productivity improvement generally or of
9 Qwest's Arizona future productivity improvement in particular.

10 ***Practical Application of Productivity Offset in RUCO's Proposal***

11 **Q. WHAT REGULATORY REGIME DOES RUCO PROPOSE FOR QWEST?**

12 A. RUCO proposes a regulatory regime that establishes three baskets: Moderate
13 Pricing Flexibility Services; High Pricing Flexibility Services; and Total Pricing
14 Flexibility Services.[24]

15 RUCO would subject services and serving geographies in its proposed Moderate
16 Pricing Flexibility Services basket to both a basket-wide revenue cap and a 25
17 percent rate element cap. The basket-wide cap would be essentially identical to the
18 cap applied to the Basket 1 Basic Services in the current Plan including the annual

[24] Docket No's. T-01051B-03-0454 and T-00000D-00-0672, Direct Testimony of Ben Johnson, Ph.D. on behalf of the RUCO, page 168, line 4

adjustment for inflation (GDP-PI) minus the 4.2 percent Productivity Offset that Dr. Johnson discusses in the quote on pages 12 and 13 of this testimony.[25]

RUCO would subject services and serving geographies under its proposed High Pricing Flexibility Services basket to a basket-wide revenue cap of two times the yearly change in the GDP-PI, as well as a rate element cap of 25% per year.[26]

RUCO would cap rates for services and serving territories in its proposed Total Pricing Flexibility Services basket in accordance with the maximum rate provisions of existing Commission rules A.A.C. R14-2-1109 and A.A.C. R14-2-1110.[27]

Q. HOW WOULD RUCO EMPLOY THIS REGULATORY REGIME?

A. Under RUCO's proposed regime, each service, and each geographic area of Arizona is analyzed based on available evidence concerning their competitive characteristics to determine the basket into which it should go.[28] RUCO concludes that it would be reasonable for the Commission to put 1FR service provided in the Phoenix-Main and Tucson-Main wire centers into the High Pricing Flexibility basket, while keeping 1FR service in all other wire centers in the Moderate Pricing Flexibility basket.[29] RUCO concludes that it would be reasonable for the Commission to keep 1FB service in its proposed Moderate Pricing Flexibility basket except for four wire

[25] *Id.* page 183, line 21
[26] *Id.* page 188, line 17
[27] *Id.* page 190, line 3
[28] *Id.* page 169, line 15
[29] *Id.* page 175, line 9

1 centers. RUCO would place 1FB service in the Phoenix-Pecos, Tucson- Southwest,
2 and Phoenix-Foothills wire centers in its proposed High Pricing Flexibility basket and
3 the Phoenix-Main wire center in its proposed Total Pricing Flexibility basket.[30]

4 **Q. DOES RUCO BELIEVE ITS PROPOSED REGULATORY REGIME WILL WORK?**

5 A. Yes. Marylee Diaz Cortez testifies that RUCO's proposal affords Qwest the
6 opportunity to recover a $159.5 million revenue requirement (deficiency). She
7 claims that by providing "additional pricing flexibility for Qwest in its truly competitive
8 markets... Qwest will have additional pricing freedom to compete in the
9 telecommunication markets and the opportunity to increase its revenue streams so
10 as to realize its recommended rate of return."[31]

11 **Q. IS MS. DIAZ CORTEZ CORRECT?**

12 A. No. RUCO's proposed regulatory regime does not afford Qwest a reasonable
13 opportunity to recover its $31.8 million stipulated revenue deficiency, let alone a
14 $159.5 million revenue deficiency.

---

[30] *Id.* page 175, line 22

[31] Docket No's. T-01051B-03-0454 and T-00000D-00-0672, Direct Testimony of Marylee Diaz Cortez, page 3, lines 11 to 18.

Q. WHAT PORTION OF QWEST'S REVENUE DEFICIENCY WOULD QWEST BE ABLE TO RECOVER FROM SERVICES CATEGORIZED INTO RUCO'S PROPOSED MODERATE PRICING FLEXIBILITY SERVICES BASKET?

A. In all probability, none. In fact, it is likely that RUCO's proposed Moderate Pricing Flexibility Services basket would exacerbate Qwest's revenue deficiency. Under RUCO's proposal, Qwest's revenue deficiency would be recoverable from the Moderate Pricing Flexibility Services basket only if the GDP-PI exceeds 4.2 percent. To the extent the GDP-PI is less than 4.2 percent, the Moderate Pricing Flexibility Services basket would actually increase Qwest's revenue deficiency by forcing rate reductions equal to the difference between the GDP-PI and 4.2 percent.

Over the past 10 years the annual increase in the GDP-PI has been 1.9 percent. So it is not unlikely that under RUCO's proposed regulatory regime, Qwest would be required to reduce prices by an amount in the vicinity of 2.3 percent (4.2 percent minus 1.9 percent) per year for all services and geographic areas categorized in RUCO's proposed Moderate Pricing Flexibility Services basket. Under its analysis of competition, RUCO proposes to place almost all of Qwest's services and geographic areas in this basket. That leaves Qwest to recover its growing revenue deficiency from services RUCO would assign to its proposed High Pricing Flexibility Services and Total Pricing Flexibility baskets.

Q. WHAT PORTION OF QWEST'S REVENUE DEFICIENCY WOULD QWEST BE ABLE TO RECOVER FROM SERVICES CATEGORIZED INTO RUCO'S PROPOSED HIGH PRICING FLEXIBILITY SERVICES BASKET?

A. Very little. RUCO would subject services in the High Pricing Flexibility Services basket to a basket-wide revenue cap subject to adjustment by two times the yearly change in the GDP-PI, as well as a rate element cap of 25% per year.[32] Assuming the GDP-PI continues to increase an average of 1.9 percent annually, Qwest could raise rates on services and geographic areas in this basket by roughly 3.8 percent annually.

Under RUCO's proposal, the High Pricing Flexibility Services basket would include residential service provided in the Phoenix-Main and Tucson-Main wire centers and business services in the Phoenix-Pecos, Tucson-Southwest, and Phoenix-Foothills wire centers. As of September 2005, these wire centers had a total of REDACTED business access lines and xxxxx residential access lines. Conservatively assuming that each business access line generates $250 of revenues monthly and each residential access line generates $50 monthly, the total annual revenue from this basket would be approximately $26.9 million. A 3.8 percent increase on that revenue stream would be just over $1 million. By the third year of the three years term of the Revised Price Plan, the revenue increase would cumulate to $3.2 million,

[32] *Id.* page 188, line 17

assuming Qwest lost no more access lines from these highly competitive wire centers during those three years.

Q. WHAT PORTION OF QWEST'S REVENUE DEFICIENCY WOULD QWEST NEED TO RECOVER FROM RUCO'S PROPOSED TOTAL PRICING FLEXIBILITY SERVICES BASKET?

A. Marylee Diaz Cortez testifies that Qwest's revenue deficiency is $159.5 million. Under RUCO's proposal, Qwest would be unlikely to recover any revenue deficiency from RUCO's proposed Moderate Pricing Flexibility Basket. Assuming Qwest can recover a highly optimistic $3.2 million from RUCO's proposed High Pricing Flexibility Services basket, Qwest would need to recover the remaining $156.3 million from its Total Pricing Flexibility Services basket.

Q. IS IT POSSIBLE THAT QWEST COULD INCREASE RATES $156.5 MILLION IN RUCO'S PROPOSED TOTAL PRICING FLEXIBILITY SERVICES BASKET?

A. Under RUCO's proposal, the Total Pricing Flexibility Services basket would include business service in the Phoenix-Main wire center. This wire center has REDACTED business access lines. In order to recover $156.3 million from XXXXX access lines, Qwest would need to increase revenues generated from each access line an average of $4,520 per year or $377 per month.

RUCO's proposed regulatory regime assigns these access lines to its proposed Total Pricing Flexibility Services basket because these access lines are subject to

1 what Dr. Johnson considers to be effective competition.[33] Consequently, it is difficult
2 to understand how RUCO expects that Qwest could increase the business service
3 rates in this basket at all, let alone $377 per month per access line.

4 **Q. WHAT DO YOU CONCLUDE FROM YOUR ANALYISIS OF THE PRACTICAL**
5 **APPLICATION OF RUCO'S PROPOSAL?**

6 A. Under RUCO's proposal Qwest is virtually assured of being unable to recover any
7 significant portion of its revenue deficiency. RUCO proposes a regulatory regime
8 that ignores reality. It will not work.

9 ***RUCO's Recommendation***

10 **Q. WHAT DOES RUCO RECOMMEND THE COMMISSION DO?**

11 A. RUCO recommends the Commission reject the proposed settlement, and move
12 forward with a full hearing on all of the issues that were raised during the earlier
13 stages of this proceeding.[34]

14 **Q. WHY DOES RUCO MAKE THIS RECOMMENDATION?**

15 A. Asserting that "Qwest continues to enjoy a dominant share of most Arizona
16 telecommunications market[s], and its competitors are far too small to provide an
17 adequate substitute for continued pricing constraints, such as those contained in the

[33] Docket No's. T-01051B-03-0454 and T-00000D-00-0672, Direct Testimony of Ben Johnson, Ph.D. on behalf of the RUCO, page 189, line 19
[34] Docket No's. T-01051B-03-0454 and T-00000D-00-0672, Responsive Testimony of Ben Johnson, Ph.D. on behalf of the RUCO, page 23, line 21

current plan" RUCO believes: "It is not yet time to begin thinking about providing the Company with the type of extreme pricing flexibility that it seeks through this proposal."

Q. DO YOU AGREE?

A. No. My evaluation of Qwest's financial performance over the past four and a half years fully corroborates Mr. Teitzel's conclusion that Qwest faces robust competition in Arizona. Qwest's rapidly declining revenue streams indicate that Qwest needs at least the flexibility provided in the Agreement in order to have a reasonable opportunity to recover its revenue deficiency, as established by the Agreement. RUCO's testimony in opposition to the Agreement fails to address both the level of Qwest's competitive loses and the Company's revenue deficiency.

Q. HAS ANY OTHER STATE JURSIDICTION RECENTLY EVALUATED THE EFFECT OF ROBUST COMPETITION ON ITS ILECS?

A. Yes. Many commissions are investigating issues of competition in the telephone industry. A very recent example is New York. In July 2005 the New York Public Service Commission (NYPSC) ordered the Department of Public Service Staff (NYPSC Staff) to prepare a white paper on competition in New York. The NYPSC Staff's September 21, 2005 White Paper provides a general overview of the changing telecommunications market and a proposal for a regulatory regime they believe to be appropriate to today's competitive telecommunications market. It is located on the Internet at:

1 http://www3.dps.state.ny.us/pscweb/WebFileRoom.nsf/Web/C764431686152058852
2 57083006ADF64/$File/05c0616.coverltr.09.21.05.pdf?OpenElement

3 **Q. DID THE WHITE PAPER CONCLUDE THAT IT IS NOT YET TIME TO BEGIN**
4 **THINKING ABOUT THE KIND OF THE PRICING FELXIBILITY SPECIFIED IN THE**
5 **AGEEMENT?**

6 A. No. On the contrary the NYPSC Staff's White Paper proposed far greater pricing
7 flexibility than the Agreement proposes. Specifically, the White Paper proposes the
8 following for residential services:[35]

9 1. All local exchange companies would be required to make a basic service
10 offering—defined as a single, residential line with no features, offered as a stand-
11 alone service universally throughout all exchanges of all local exchange
12 companies in the state—at a rate of $24.95.[36] The NYPSC Staff recognized that
13 some current basic offerings in New York are considerably lower than $24.95 but
14 concluded they stem from a legacy regulatory regime that borrowed higher
15 revenue margins from more lucrative markets to keep rates lower than they
16 would be in a competitive market, where such pricing strategies are no longer
17 workable.[37]

[35] The NYPSC Staff noted: "The framework we propose is applicable to the residential market only. Analogous flexibility already exists in the Enterprise market and Special Services market." NYPSC Staff White Paper, page 41, footnote 91
[36] *Id.* pp. 41 and 42
[37] *Id.* p. 43

2. For New York State's two largest Incumbent Local Exchange Providers—Verizon New York and Frontier of Rochester—the NYSPC Staff proposed full pricing flexibility for all residential services other than the basic service offering. Under this proposal, prices for these services would be offered on a statewide basis throughout each company's serving territory. Thus, the NYPSC Staff concluded, customers in noncompetitive areas of each company would be protected by the market constraints of the competitive areas of each company.[38]

Q. ON WHAT RATIONALE DID THE NYPSC STAFF RELY TO CONCLUDE THAT EVERY RESIDENTIAL SERVICE EXCEPT FOR THE BASIC SERVICE OFFERING SHOULD HAVE FULL PRICING FLEXIBILITY?

A. The NYPSC Staff conducted an analysis of access line and minutes-of-use loss of incumbent local exchange companies in New York. From this analysis they concluded, "It is clear based upon the continued loss of access lines and minutes of use described above that the current system is imposing unreasonable burdens on incumbent telephone companies."[39]

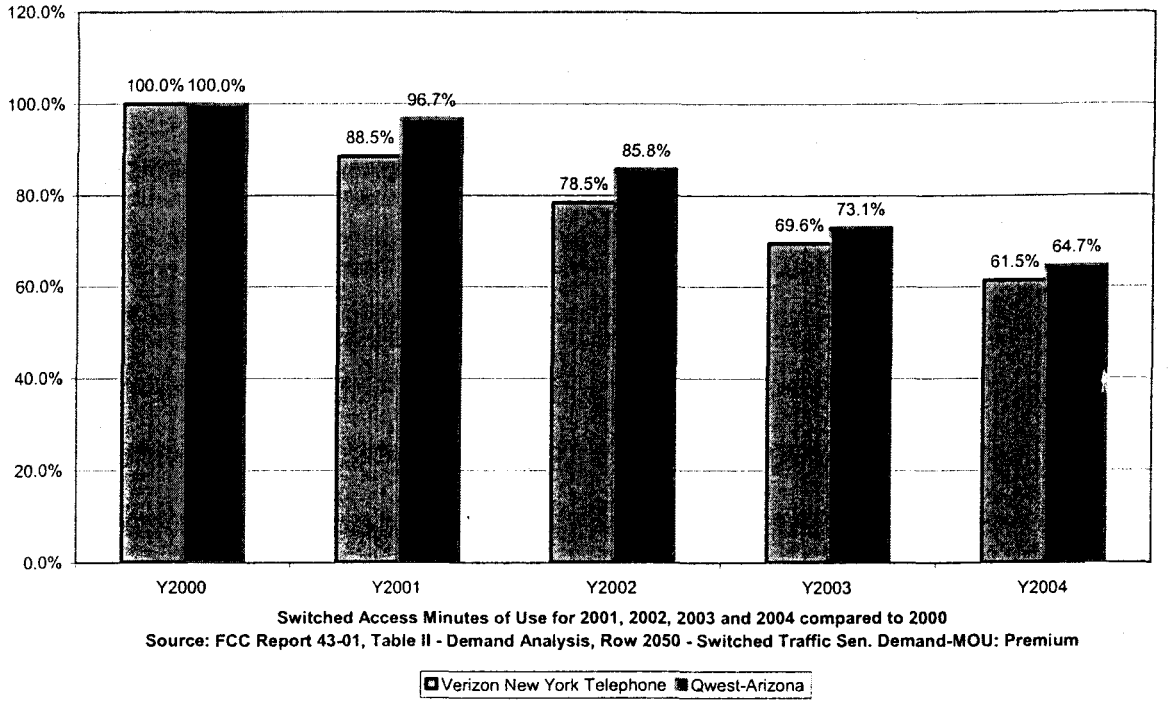
Q. ARE QWEST'S LOSS OF ACCESS LINES AND MINUTES OF USE IN ARIZONA SIMILAR TO VERIZON NEW YORK'S?

A. Yes. The following chart shows the change in switched access minutes of use of the two companies.

---

[38] *Id.* p. 47
[39] *Id.* p. 40

Switched Access Minutes of Use Since End of Year 2000

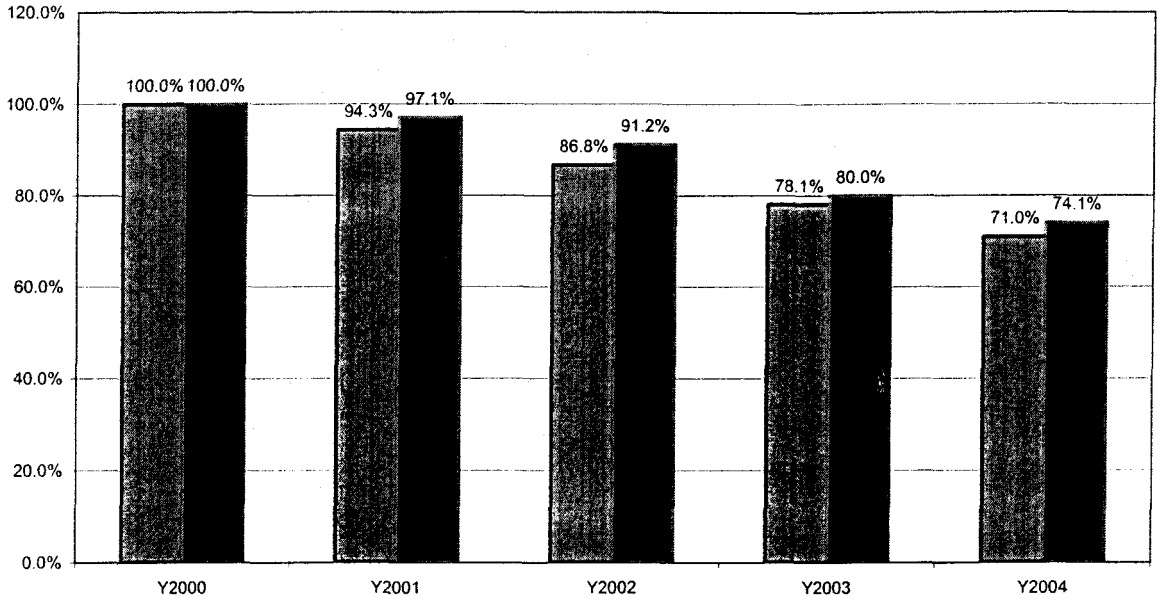


The chart shows that between 2000 and 2004, Qwest Arizona's and Verizon New York's minutes of use as reported on FCC Report 43-01 declined to 65 percent and 62 percent respectively from their 2000 levels.[40] Hence, during the four year period, Qwest Arizona and Verizon New York lost almost the same portion of their minutes of use—35 percent and 38 percent respectively.

The following chart compares the access line loss of the two companies.

[40] The minutes of use data for Verizon New York that the graph presents are the same minutes of use data that the NYPSC Staff analyzed and presented in its White Paper, page 36, Table 2.

Access Line Loss Since End of Year 2000



Access Lines at EoY 2001, 2002, 2003 and 2004 as a percent of EoY 2000
Source: FCC Report 43-01, Table II - Demand Analysis, Row 2150 - Total Billable Access Lines

Verizon New York Telephone ■ Qwest-Arizona

This chart shows that, as reported on FCC Report 43-01 for the years 2000 through 2004, Qwest Arizona's access line count declined to 74 percent of the year end 2000 level while Verizon New York's access line count declined slightly more, to 71 percent. Hence, during the four year period, Qwest Arizona and Verizon New York lost very nearly the same portion of their access lines—26 percent and 29 percent respectively.

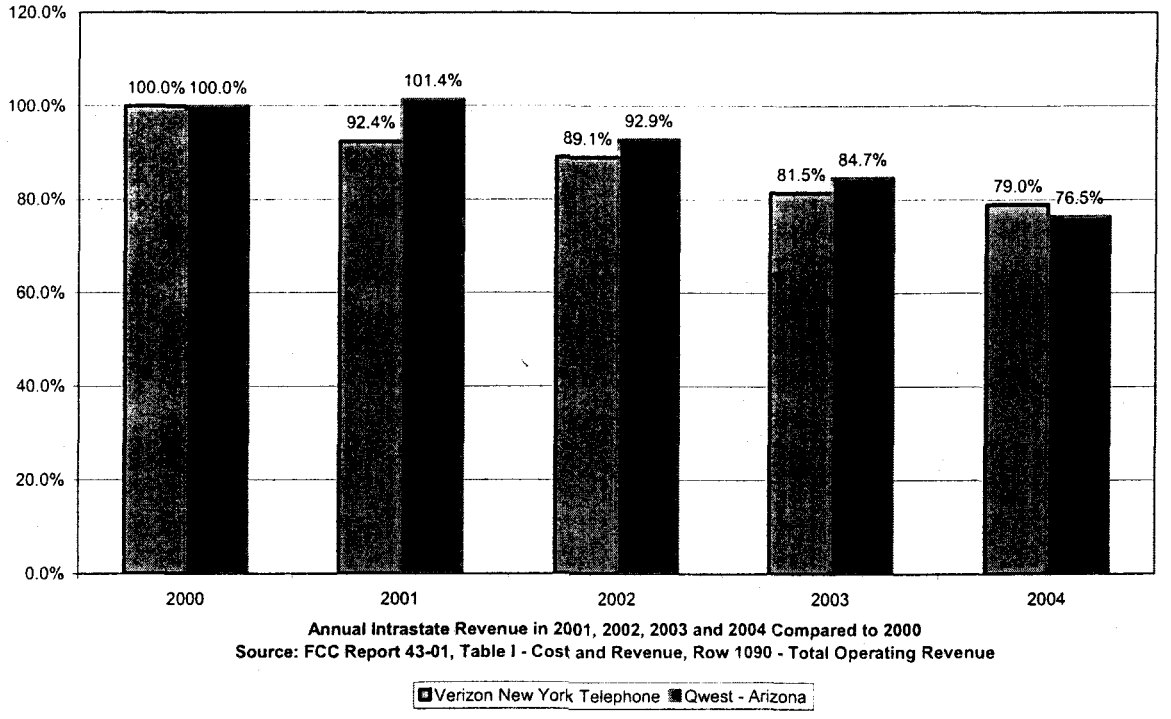
Q. WHAT DID THE STAFF OF THE NYPSC DEDUCE FROM VERIZON NEW YORK'S LOSS OF MINUTES OF USE AND ACCESS LINES?

A. The NYPSC Staff concluded: "With these declines in access lines and usage, it is not surprising that Verizon's revenue streams have also declined."

Q. HOW DOES THE REVENUE LOSS OF VERIZON NEW YORK COMPARE WITH THE REVENUE LOSS OF QWEST ARIZONA?

A. Both Qwest Arizona and Verizon New York have experienced similar levels of intrastate revenue losses as shown by the following chart.

Intrastate Revenues



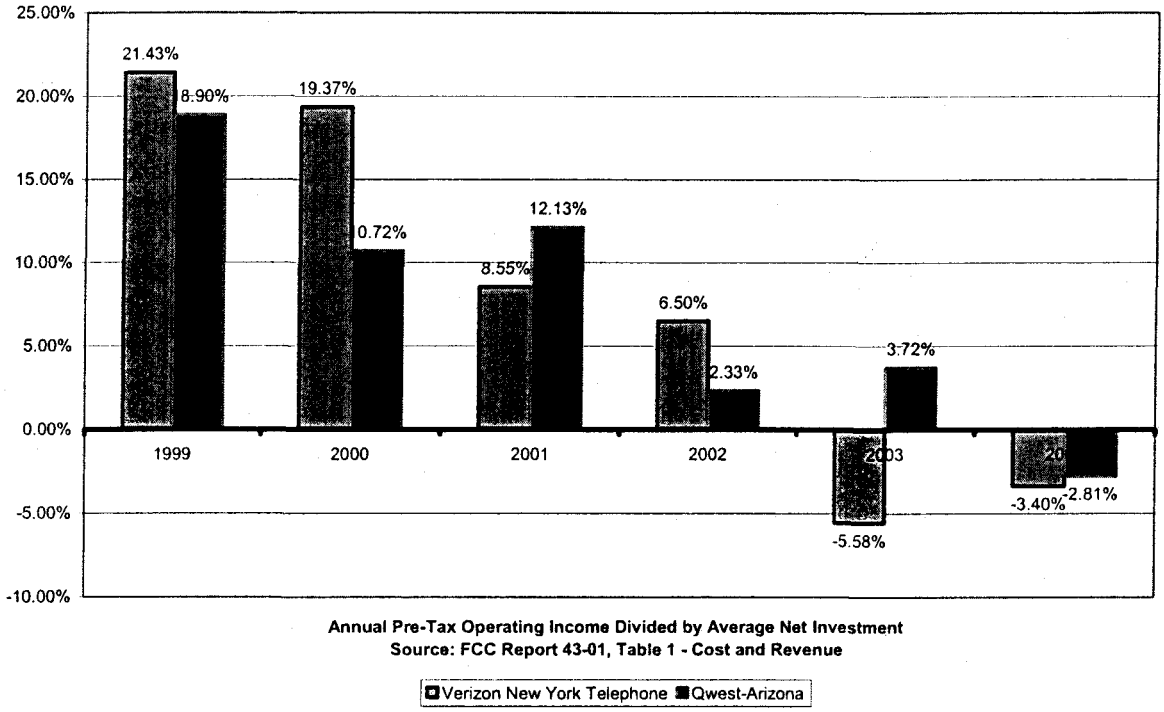
Annual Intrastate Revenue in 2001, 2002, 2003 and 2004 Compared to 2000
Source: FCC Report 43-01, Table I - Cost and Revenue, Row 1090 - Total Operating Revenue

The graph shows that during the four year period from 2000 to 2004, Qwest's intrastate revenues as reported on FCC Report 43-01 declined to 77 percent of the 2000 level while Verizon New York's declined to 79 percent. Hence, during the four year period, Qwest Arizona and Verizon New York lost almost the same portion of their intrastate revenues—23 percent and 21 percent respectively. The rate decreases that went into effect in April of 2002, 2003 and 2004 under the inflation-minus-productivity rate adjustments of Qwest's Arizona Price Plan exacerbated Qwest Arizona's revenue losses and help to explain why Qwest Arizona lost more intrastate revenues than did Verizon New York.

Q. HOW DOES THE FINANCIAL PERFORMANCE OF VERIZON NEW YORK COMPARE WITH THE FINANCIAL PERFORMANCE OF QWEST ARIZONA?

A. The following chart shows the return on average net investment derived from intrastate pretax operating income for Qwest Arizona and Verizon New York. In order to make the rates of return more directly comparable, the data used to compute them was taken from FCC Report 43-01, which is on the FCC (MR) basis of accounting. I selected intrastate pretax operating income as the measure of return because it presents the clearest picture of the results of operations of the two jurisdictions and avoids introducing differences attributable to different tax rates and non-operating items.

Pre-tax Operating Return on Investment



The data show that measured on a directly comparable basis (the MR basis of accounting), both companies' returns have suffered a precipitous decline over the past six years. Verizon's return declined 24.8 percentage points over the six year period while Qwest's declined 21.7 percentage points. The six-year decline and the negative returns that both companies now achieve both indicate that Verizon New York and Qwest Arizona are suffering similar degrees of financial pressure.

Q. WHAT DO YOU CONCLUDE FROM A COMPARISON OF QWEST ARIZONA AND VERIZON NEW YORK?

A. Comparative financial data indicate that the level of competition Qwest Arizona and Verizon New York face is substantially the same. Over the past four calendar years, Qwest's minutes of use and access lines loss rates in Arizona are only slightly less than Verizon New York's. Qwest Arizona's rate of revenue loss slightly exceeds Verizon New York's.

Q. PLEASE COMPARE THE CONCLUSIONS THAT RUCO REACHED WITH REGARD TO QWEST ARIZONA AND THE NYPSC STAFF REACHED WITH REGARD TO VERIZON NEW YORK.

A. RUCO claims:

> Clearly, the existing level of competition in many parts of Qwest's Arizona service territory is not strong enough to prevent Qwest from imposing substantial price increases on residential customers if the settlement is approved. Under the proposed settlement, Qwest would be granted far too much pricing flexibility in markets where it faces very little competitive pressure, and thus it will be able to exploit its residual market power to the detriment of its residential customers and the public generally.[41] (emphasis added)

In contrast, the NPYSC Staff concluded: "Even if one accepts the arguments that cellular, cable and other broadband alternatives are not perfect substitutes for ILEC services, it is clear that those services are having a profound effect on the financial health of the incumbents."[42] "The provision of telecommunications services is no

[41] Docket No's. T-01051B-03-0454 and T-00000D-00-0672, Responsive Testimony of Ben Johnson, Ph.D. on behalf of the RUCO, page 21, line 4
[42] *Id.* p. 38

longer a natural monopoly. A regulatory regime that ignores that reality will not work."[43]

RUCO complains:

> The balance struck in the proposed settlement is clearly oriented toward changes in the current plan that will enable Qwest to extract additional revenues and profits from markets where the Company continues to enjoy a substantial degree of monopoly power, rather than changes that would better enable the Company to cut prices in markets where this is necessitated by increased competitive pressures.[44]

In contrast, an analysis of Verizon New York's access line and minute of use losses and their effect on its financial performance led the NYPSC Staff to propose that virtually all of Verizon New York's intrastate residential services except for a basic service offering have full pricing flexibility.

Q. TO WHAT DO YOU ASCRIBE THESE MARKEDLY DIFFERENT CONCLUSIONS?

A. The NYPSC Staff took account of Verizon New York's rapid declines in access lines, minutes of use and financial performance. RUCO's testimony does not acknowledge these factors. Instead, RUCO claims that Qwest maintains "residual monopoly power," and "residual market power."

---

[43] *Id.* p. 40

[44] Docket No's. T-01051B-03-0454 and T-00000D-00-0672, Responsive Testimony of Ben Johnson, Ph.D. on behalf of the RUCO, page 22, line 9

Q. DOES THE COMMISSION'S 2003 DECISION TO SUPPORT THE ENTRY OF QWEST'S PARENT INTO THE INTERSTATE LONG DISTANCE BUSINESS CORROBORATE RUCO'S RESIDUAL MARKET POWER HYPOTHESIS?

A. No. By enacting the Telecommunications Act of 1996 Congress created Section 271 of Title 47. It provides that Qwest's Section 272 affiliate can enter the interLATA long distance telephone business under certain conditions. One of those conditions is that Qwest satisfy a "competitive checklist" that contains requirements designed to open local telephone service markets to competition. In September 2003 the Commission concluded as a matter of law that Qwest had satisfied all the criteria for a determination that provision of interLATA service by Qwest's Section 272 affilate was in the public interest. Among those criteria was a determination that the local markets for telephone service are open to competition in Arizona.[45]

Q. DOES QWEST'S LOSS OF ACCESS LINES SUPPORT RUCO'S MONOPOLY HYPOTHESIS?

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

A. No. Since February 2001 Qwest has lost xx percent of its Arizona retail access lines. Qwest's unprecedented and rapid access line loss over the past four and a half years contradicts the RUCO's assertion that Qwest retains market power in Arizona.

Q. DO QWEST'S RAPIDLY DECLINING LOCAL SERVICE REVENUES SUPPORT RUCO'S HYPOTHESIS?

A. No. In the four and a half years since February 2001 when Qwest's retail access lines peaked, Qwest's monthly local service revenues in Arizona have declined REDACTED percent. Arizona's population is growing. If Qwest retained monopoly power over telephony in Arizona, it would not be suffering these declines.

Q. THEN ON WHAT BASIS DOES RUCO ASSERT THAT QWEST MAINTAINS "RESIDUAL MONOPOLY POWER," AND "RESIDUAL MARKET POWER" OVER RETAIL SERVICES?

A. RUCO claims that significant barriers to entry remain in many portions of the Arizona telecommunications market, particularly in residential areas and rural parts of the state.[46]

Q. DO YOU AGREE?

No. The facts prove otherwise. With regard to residential service, Qwest's count of consumer access lines[47] has declined over xx percent since it peaked in February

[46] Docket No's. T-01051B-03-0454 and T-00000D-00-0672, Responsive Testimony of Ben Johnson, Ph.D. on behalf of the RUCO, page 21, line 10.

1 2001. Qwest is losing residential customers at a rapid rate even as Arizona's
2 population has grown. If significant barriers to entry in the residential market
3 existed, Qwest would not be experiencing a rapid and unprecedented loss of
4 consumer access lines.

5 Regarding rural markets, telephone service is open to competition statewide in
6 Arizona, not just in the urban portions of the state. Qwest's is obligated to rent the
7 elements of its network to CLECs on an unbundled basis and at wholesale prices
8 wherever it has facilities, not just in the urban portions of the state and not just for
9 serving business customers. As Mr. Teitzel's testimony explains, most carriers in
10 Arizona utilize statewide average pricing. This is true not only for Arizona but for all
11 14 states where Qwest Communications operates. As Mr. Thompson explains, it is
12 hardly surprising that telecommunications carriers rely on statewide average pricing
13 because it is very difficult and very expensive to manage geographically de-
14 averaged telecommunications prices.

15 To be sure, there are differences in the cost of providing service to different
16 geographic areas and different market segments within Qwest's service territory in
17 Arizona. And certainly rational competitors prefer high margin customers over low
18 margin customers. Consequently, as Qwest losses more high margin customers to
19 competition, statewide average pricing will put Qwest's financial viability under
20 growing pressure. However, contrary to what Dr. Johnson would lead the

[47] The count of consumer access lines excludes public access lines.

Commission to believe, the Price Plan specifically contemplates the possibility that the Commission will decide to allow changes to Qwest's statewide average pricing.

Regardless, Qwest cannot raise its rates above competitive market prices in any market or any locale in Arizona without harming its sales volumes and profits. Qwest's access line and revenue losses in a growing market for telephony demonstrate the success Qwest's competitors have enjoyed and show that competition in Arizona is highly effective.

Q. WHAT DO YOU CONCLUDE ABOUT RUCO'S OPPOSTITION TO THE AGREEMENT?

A. Qwest's precipitous decline in retail access lines and in intrastate revenues—particularly local service revenues—disprove the hypothesis that Qwest retains a monopoly over telecommunications markets in Arizona. As Mr. Teitzel's testimony explains, TNS Telecoms, an independent research entity, found that for 2nd Quarter 2005, Qwest had a 33% share of communications connections in its Arizona service territory, as compared to a 65% connections share in 2nd Quarter 2000. The financial data I have observed indicate competition in Arizona is meeting with great success and squarely refutes RUCO's contention that it is not time to begin thinking about the pricing flexibility afforded by the terms of the Agreement.

If Qwest is to remain financially viable then it must have the flexibility to price services to respond to competition. The Agreement provides necessary additional

pricing flexibility. It also protects ratepayers from paying monopoly prices by capping the amount Qwest can raise prices to a revenue deficiency amount that is far less than the revenue deficiency RUCO calculated for Qwest. RUCO's opposition to the Agreement ignores both the extent of competition in Arizona and Qwest's financial condition. The Agreement should be adopted.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY IN SUPPORT OF THE SETTLEMENT?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS	)	**DOCKET NO. T-00000D-00-0672**

REBUTTAL EXHIBITS

OF

PHILIP E. GRATE

ON BEHALF OF

QWEST CORPORATION

OCTOBER 28, 2005

INDEX OF EXHIBITS

DESCRIPTION	EXHIBIT
Calculation of Qwest productivity growth in Arizona from 1995 through 1998	PEG-SR01
Calculation of Qwest productivity growth in Arizona from 2000 through 2004	PEG-SR02
Calculation of Qwest productivity growth in Arizona from 1989 through 1998	PEG-SR03
Calculation of Qwest productivity growth in Arizona from 2001 through 2004	PEG-SR04
Analysis of Qwest's Arizona intrastate revenues between 1994 and 2005	PEG-SR05

Arizona Productivity Analysis - 1995 to 1998
MR Intrastate
($000's)

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Rebuttal Testimony of Phillip E. Grate
Exhibit PEG-SR01

Line No.	Item	Source	1994	1995	1996	1997	1998*
INPUTS							
1	Intrastate Expenses						
2	Maintenance	1990's Report	179,310	187,774	205,041	200,848	206,061
3	Engineering/Network/Access/Other	1990's Report	68,910	71,773	65,179	48,964	52,927
4	Customer Operations	1990's Report	140,269	153,528	161,304	172,445	164,816
5	Corporate Operations	1990's Report	120,992	116,446	127,985	143,530	155,888
6	TOTAL EXPENSE		509,481	529,521	559,509	565,787	579,692
7	DEFLATED EXPENSE (1988 $)	L6/L28*100	418,431	423,614	438,271	433,366	439,729
8	YEAR OVER YEAR GROWTH	(L7 Curr. Yr./Prev. Yr.)-1		1.2%	3.5%	-1.1%	1.5%
	CAPITAL - Intrastate Investment						
9	Average Gross Plant In Service	1990's Report	2,748,270	2,896,085	3,075,298	3,249,626	3,351,980
10	Year over Year Additions	L9 Curr. Yr. - Prev. Yr.		147,815	179,213	174,328	102,354
11	Deflated Additions (1988 $)	L10/L28*100		118,251	140,380	133,527	77,641
12	Plant in Service Without Inflation	L11+Prev. Yr. L12	2,639,976	2,758,228	2,898,609	3,032,137	3,109,778
13	Auth Rate of Return	Input	9.75%	9.75%	9.75%	9.75%	9.75%
14	TOTAL CAPITAL EXPENSE	L12*L13	257,398	268,927	282,614	295,633	303,203
15	YEAR OVER YEAR GROWTH	(L14 Curr. Yr./Prev. Yr.)-1		4.5%	5.1%	4.6%	2.6%
16	TOTAL EXPENSE	L7+L14	675,828	692,541	720,885	728,999	742,932
17	YEAR OVER YEAR GROWTH	(L16 Curr. Yr./Prev. Yr.)-1		2.5%	4.1%	1.1%	1.9%
OUTPUTS							
18	REVENUES						
19	Operating Revenues	1990's Report	813,423	884,920	961,388	1,017,826	1,072,695
20A	Rate Adjustments	Notes	-15,153	-31,579	-34,308	-40,795	-61,575
20B	Intentionally Blank						
20C	Intentionally Blank						
21	TOTAL ADJUSTED REVENUES	L19+L20	798,270	853,341	927,080	977,031	1,011,120
22	YEAR OVER YEAR GROWTH			6.9%	8.6%	5.4%	3.5%
23	**Growth in Outputs (Revenues)**	**L22**		**6.9%**	**8.6%**	**5.4%**	**3.5%**
24	**Growth in Inputs (Expenses)**	**L17**		**2.5%**	**4.1%**	**1.1%**	**1.9%**
25	**Productivity**	**L23-L24**		**4.4%**	**4.5%**	**4.3%**	**1.6%**
					AVERAGE PRODUCTIVITY 1995-1998		**3.7%**
					CONSUMER DIVIDEND		**0.5%**
					TOTAL PRODUCTIVITY FACTOR		**4.2%**
26	Inflation Data (GDPPI)	Bureau of Economic Analysis	105.2	108	110.3	112.8	113.9
27	Growth	(L26 Curr. Yr./Prev. Yr.)-1		2.66%	2.13%	2.27%	0.98%
28	Indexed (1988=100)	L28 Prev. Yr.*(1+L27)	121.76	125.00	127.66	130.56	131.83

Notes: 1998 based on September 1998 YTD results annualized.
Rate Adjustments as provided in response to data request SPI 3-001 in Docket No. T-01051B-99-0105.

ARIZONA PRODUCTIVITY ANALYSIS - 1999-2004
($00)
MR INTRASTATE

INPUTS

	Item	Source	1998	1999	2000	2001	2002	2003	2004
	Intrastate Expenses								
1	Maintenance	1990's Report	215,125	228,263	280,085	260,126	212,023	201,064	235,272
2	Engineering/Network/Access/Other	1990's Report	51,807	68,021	82,190	70,715	72,466	66,027	56,829
3	Customer Operations	1990's Report	167,342	175,807	171,174	169,831	180,334	165,222	155,231
4	Corporate Operations	1990's Report	158,192	134,887	173,799	147,192	116,450	159,617	132,684
5	TOTAL EXPENSE	L1..L4	592,466	606,978	707,248	647,864	581,273	591,930	580,016
6	DEFLATED EXPENSE (1999 $)	L5/L28*100	592,466	598,339	682,318	610,366	538,216	537,169	512,887
7	YEAR OVER YEAR GROWTH	(L6/Prev. Yr. L6)-1		1.0%	14.0%	-10.5%	-11.8%	-0.2%	-4.5%
8	CAPITAL - Intrastate Investment								
9	Average Gross Plant In Service	1990's Report	3,360,035	3,520,055	3,876,721	4,305,946	4,648,621	4,818,122	4,940,958
10	Year over Year Additions	L9 Curr. Yr. - Prev. Yr.		160,020	356,666	429,225	342,675	169,501	122,836
11	Deflated Additions (1999 $)	L10/L28*100		157,742	344,094	404,382	317,292	153,820	108,619
12	Plant in Service Without Inflation	L11+Prev. Yr. L12	3,360,035	3,517,777	3,861,871	4,266,252	4,583,544	4,737,364	4,845,984
13	Auth Rate of Return		9.75%	9.75%	9.75%	9.61%	9.61%	9.61%	9.61%
14	TOTAL CAPITAL EXPENSE	L12*L13	327,603	342,983	376,532	409,987	440,479	455,261	465,699
15	YEAR OVER YEAR GROWTH	(L14/Prev. Yr. L14)-1		4.7%	9.8%	8.9%	7.4%	3.4%	2.3%
16	TOTAL EXPENSE	L6+L14	920,069	941,322	1,058,850	1,020,353	978,694	992,430	978,586
17	YEAR OVER YEAR GROWTH	(L16/Prev. Yr. L16)-1		2.3%	12.5%	-3.6%	-4.1%	1.4%	-1.4%

OUTPUTS

	REVENUES								
18	Operating Revenues	1990's Report	1,088,033	1,163,288	1,210,058	1,223,921	1,119,538	1,014,846	911,843
19a	Surcharge		-18,402	-14,255					
19b	2001 Rate Increase*					-17,475	-21,419	-19,890	-18,307
19c	2002 Rate Decrease*						10,950	13,557	12,478
19d	2003 Rate Decrease*							21,342	27,337
19e	2004 Rate Decrease*								14,550
20	TOTAL ADJUSTED REVENUES	L18 + Sum L19	1,069,631	1,149,033	1,210,058	1,206,446	1,109,069	1,029,855	947,901
21	YEAR OVER YEAR GROWTH	(L20/Prev. Yr. L20)-1		7.4%	5.3%	-0.3%	-8.1%	-7.1%	-8.0%
22	**Growth in Outputs (Revenues)**	**L21**		**7.4%**	**5.3%**	**-0.3%**	**-8.1%**	**-7.1%**	**-8.0%**
23	**Growth in Inputs (Expenses)**	**L17**		**2.3%**	**12.5%**	**-3.6%**	**-4.1%**	**1.4%**	**-1.4%**
24	**Productivity**	**L22-L23**		**5.1%**	**-7.2%**	**3.3%**	**-4.0%**	**-8.5%**	**-6.6%**
25					**AVE. ANNUAL OUTPUT GROWTH 1999-2004**				**-1.8%**
					AVE. ANNUAL INPUT GROWTH 1999-2004				**1.2%**
					AVE. ANNUAL PRODUCTIVITY GROWTH 1999-2004				**-3.0%**
26	Inflation Data (GDPPI)	*Bureau of Economic Analysis*	96.475	97.868	100.000	102.402	104.193	106.310	109.102
27	Growth	(L26 Curr. Yr./Prev. Yr.)-1		1.44%	2.18%	2.40%	1.75%	2.03%	2.63%
28	Indexed (1998=100)	L28 Prev. Yr. * (1+L27)	100.00	101.44	103.65	106.14	108.00	110.19	113.09

GDPPI is from U.S Dept of Commerce, Bureau of Economic Analysis; Table 1.1.4 Price Indexes for GDP (Indexed 2000=100) as of 08/31/2005.
2001 removes 9 months of the $23.3M Rate Increase from Order 63487 Docket No. T-01051B-00-0369
2002 removes 9 months of $14.6M Decrease from 2002 Price Cap Rate Filing plus 12 months of prior years price changes adjusted for negative growth.
2003 removes 9 mos of $28.3M decrease from 2003 Price Cap Filing plus 1 month of $1.4M Basket 3 decrease in Dec-03 plus 12 months of prior years price changes adjusted for negative growth.
2004 removes 9 mos of $18.8M decrease effective April 1st and $0.6M basket 3 decrease effective May 7th plus 12 months of prior years price changes adjusted for negative growth.

Arizona Productivity Analysis 1989 to 1998
($000's)
MR Intrastate

Line No.	Item	Source	1988	1989	1990	1991	1992	1993
INPUTS								
1	Intrastate Expenses							
2	Maintenance	1990's Report	138,385	140,901	143,255	141,875	156,370	165,577
3	Engineering/Network/Access/Other	1990's Report	39,510	53,348	57,164	56,224	60,702	64,212
4	Customer Operations	1990's Report	93,974	103,582	98,790	97,066	120,156	128,013
5	Corporate Operations	1990's Report	85,645	97,555	91,983	126,804	113,849	117,402
6	TOTAL EXPENSE		357,514	395,386	391,192	421,969	451,077	475,204
7	DEFLATED EXPENSE (1988 $)	L6/L28*100	357,514	379,571	360,330	374,313	389,731	399,782
8	YEAR OVER YEAR GROWTH	(L7 Curr. Yr./Prev. Yr.)-1		6.2%	-5.1%	3.9%	4.1%	2.6%
	CAPITAL - Intrastate Investment							
9	Average Gross Plant In Service	1990's Report	1,842,444	1,941,350	2,104,562	2,326,946	2,472,103	2,609,547
10	Year over Year Additions	L9 Curr. Yr. - Prev. Yr.		98,906	163,212	222,384	145,157	137,444
11	Deflated Additions (1988 $)	L10/L28*100		94,950	150,336	197,269	125,416	115,630
12	Plant in Service Without Inflation	L11+Prev. Yr. L12	1,842,444	1,937,394	2,087,730	2,284,999	2,410,414	2,526,044
13	Auth Rate of Return	Input	9.75%	9.75%	9.75%	9.75%	9.75%	9.75%
14	TOTAL CAPITAL EXPENSE	L12*L13	179,638	188,896	203,554	222,787	235,015	246,289
15	YEAR OVER YEAR GROWTH	(L14 Curr. Yr./Prev. Yr.)-1		5.2%	7.8%	9.4%	5.5%	4.8%
16	TOTAL EXPENSE	L7+L14	537,152	568,466	563,884	597,101	624,746	646,071
17	YEAR OVER YEAR GROWTH	(L16 Curr. Yr./Prev. Yr.)-1		5.8%	-0.8%	5.9%	4.6%	3.4%
OUTPUTS								
18	REVENUES							
19	Operating Revenues	1990's Report	673,757	670,789	669,591	698,835	742,749	758,234
20	Rate Adjustments	Input	4,260	30,108	37,300	4,666	-26,500	-14,125
21	TOTAL ADJUSTED REVENUES	L19+L20	678,017	700,897	706,891	703,501	716,249	744,109
22	YEAR OVER YEAR GROWTH			3.4%	0.9%	-0.5%	1.8%	3.9%
23	**Growth in Outputs (Revenues)**	**L22**		**3.4%**	**0.9%**	**-0.5%**	**1.8%**	**3.9%**
24	**Growth in Inputs (Expenses)**	**L17**		**5.8%**	**-0.8%**	**5.9%**	**4.6%**	**3.4%**
25	**Productivity**	**L23-L24**		**-2.5%**	**1.7%**	**-6.4%**	**-2.8%**	**0.5%**

*1998 based on September 1998 YTD results annualized

Inflation Data (GDPPI)	Bureau of Economic Analysis	86.4	90	93.8	97.4	100	102.7
Growth	(L26 Curr. Yr./Prev. Yr.)-1		4.17%	4.22%	3.84%	2.67%	2.70%
Indexed (1988=100)	L28 Prev. Yr.*(1+L27)	100	104.17	108.56	112.73	115.74	118.87

Arizona Productivity Analysis 1989 to 1998
($000's)
MR Intrastate

Line No.	Item	Source	1994	1995	1996	1997	1998*
INPUTS							
1	Intrastate Expenses						
2	Maintenance	1990's Report	179,310	187,774	205,041	200,848	206,061
3	Engineering/Network/Access/Other	1990's Report	68,910	71,773	65,179	48,964	52,927
4	Customer Operations	1990's Report	140,269	153,528	161,304	172,445	164,816
5	Corporate Operations	1990's Report	120,992	116,446	127,985	143,530	155,888
6	TOTAL EXPENSE		509,481	529,521	559,509	565,787	579,692
7	DEFLATED EXPENSE (1988 $)	L6/L28*100	418,433	423,617	438,274	433,369	439,731
8	YEAR OVER YEAR GROWTH	(L7 Curr. Yr./Prev. Yr.)-1	4.7%	1.2%	3.5%	-1.1%	1.5%
	CAPITAL - Intrastate Investment						
9	Average Gross Plant In Service	1990's Report	2,748,270	2,896,085	3,075,298	3,249,626	3,351,980
10	Year over Year Additions	L9 Curr. Yr. - Prev. Yr.	138,723	147,815	179,213	174,328	102,354
11	Deflated Additions (1988 $)	L10/L28*100	113,932	118,252	140,381	133,528	77,642
12	Plant in Service Without Inflation	L11+Prev. Yr. L12	2,639,976	2,758,228	2,898,609	3,032,137	3,109,778
13	Auth Rate of Return	Input	9.75%	9.75%	9.75%	9.75%	9.75%
14	TOTAL CAPITAL EXPENSE	L12*L13	257,398	268,927	282,614	295,633	303,203
15	YEAR OVER YEAR GROWTH	(L14 Curr. Yr./Prev. Yr.)-1	4.5%	4.5%	5.1%	4.6%	2.6%
16	TOTAL EXPENSE	L7+L14	675,831	692,544	720,888	729,002	742,935
17	YEAR OVER YEAR GROWTH	(L16 Curr. Yr./Prev. Yr.)-1	4.6%	2.5%	4.1%	1.1%	1.9%
OUTPUTS							
18	REVENUES						
19	Operating Revenues	1990's Report	813,423	884,920	961,388	1,017,826	1,072,695
20	Rate Adjustments	Input	-15,153	-31,579	-34,308	-40,795	-61,575
21	TOTAL ADJUSTED REVENUES	L19+L20	798,270	853,341	927,080	977,031	1,011,120
22	YEAR OVER YEAR GROWTH		7.3%	6.9%	8.6%	5.4%	3.5%
23	**Growth in Outputs (Revenues)**	**L22**	**7.3%**	**6.9%**	**8.6%**	**5.4%**	**3.5%**
24	**Growth in Inputs (Expenses)**	**L17**	**4.6%**	**2.5%**	**4.1%**	**1.1%**	**1.9%**
25	**Productivity**	**L23-L24**	**2.7%**	**4.4%**	**4.5%**	**4.3%**	**1.6%**
					AVERAGE PRODUCTIVITY 1989-1998		**0.8%**

*1998 based on September 1998 YTD results annualized

Inflation Data (GDPPI)	Bureau of Economic Analysis	105.2	108	110.3	112.8	113.9
Growth	(L26 Curr. Yr./Prev. Yr.)-1	2.43%	2.66%	2.13%	2.27%	0.98%
Indexed (1988=100)	L28 Prev. Yr.*(1+L27)	121.76	125.00	127.66	130.56	131.83

ARIZONA PRODUCTIVITY ANALYSIS - 2001-2004
($000)
MR INTRASTATE

INPUTS

	Item	Source	2000	2001	2002	2003	2004
	Intrastate Expenses						
1	Maintenance	1990's Report	280,085	260,126	212,023	201,064	235,272
2	Engineering/Network/Access/Other	1990's Report	82,190	70,715	72,466	66,027	56,829
3	Customer Operations	1990's Report	171,174	169,831	180,334	165,222	155,231
4	Corporate Operations	1990's Report	173,799	147,192	116,450	159,617	132,684
5	TOTAL EXPENSE	L1..L4	707,248	647,864	581,273	591,930	580,016
6	DEFLATED EXPENSE (1999 $)	L5/L28*100	682,318	610,366	538,216	537,169	512,887
7	YEAR OVER YEAR GROWTH	(L6/Prev. Yr. L6)-1		-10.5%	-11.8%	-0.2%	-4.5%
8	CAPITAL - Intrastate Investment						
9	Average Gross Plant In Service	1990's Report	3,876,721	4,305,946	4,648,621	4,818,122	4,940,958
10	Year over Year Additions	L9 Curr. Yr. - Prev. Yr.		429,225	342,675	169,501	122,836
11	Deflated Additions (1999 $)	L10/L28*100		404,382	317,292	153,820	108,619
12	Plant in Service Without Inflation	L11+Prev. Yr. L12	3,876,721	4,281,103	4,598,394	4,752,214	4,860,834
13	Auth Rate of Return		9.75%	9.61%	9.61%	9.61%	9.61%
14	TOTAL CAPITAL EXPENSE	L12*L13	377,980	411,414	441,906	456,688	467,126
15	YEAR OVER YEAR GROWTH	(L14/Prev. Yr. L14)-1		8.8%	7.4%	3.3%	2.3%
16	TOTAL EXPENSE	L6+L14	1,060,298	1,021,780	980,121	993,857	980,014
17	YEAR OVER YEAR GROWTH	(L16/Prev. Yr. L16)-1		-3.6%	-4.1%	1.4%	-1.4%

OUTPUTS

	REVENUES						
18	Operating Revenues	1990's Report	1,210,058	1,223,921	1,119,538	1,014,846	911,843
19a	[blank]						
19b	2001 Rate Increase*			-17,475	-21,419	-19,890	-18,307
19c	2002 Rate Decrease*				10,950	13,557	12,478
19d	2003 Rate Decrease*					21,342	27,337
19e	2004 Rate Decrease*						14,550
20	TOTAL ADJUSTED REVENUES	L18 + Sum L19	1,210,058	1,206,446	1,109,069	1,029,855	947,901
21	YEAR OVER YEAR GROWTH	(L20/Prev. Yr. L20)-1		-0.3%	-8.1%	-7.1%	-8.0%
22	**Growth in Outputs (Revenues)**	**L21**		**-0.3%**	**-8.1%**	**-7.1%**	**-8.0%**
23	**Growth in Inputs (Expenses)**	**L17**		**-3.6%**	**-4.1%**	**1.4%**	**-1.4%**
24	**Productivity**	**L22-L23**		**3.3%**	**-4.0%**	**-8.5%**	**-6.6%**
25			**AVE. ANNUAL OUTPUT GROWTH 2001-2004**				**-5.9%**
			AVE. ANNUAL INPUT GROWTH 2001-2004				**-1.9%**
			AVE. ANNUAL PRODUCTIVITY GROWTH 2001-2004				**-4.0%**
26	Inflation Data (GDPPI)	Bureau of Economic Analysis	100.000	102.402	104.193	106.310	109.102
27	Growth	(L26 Curr. Yr./Prev. Yr.)-1		2.40%	1.75%	2.03%	2.63%
28	Indexed (1998=100)	L28 Prev. Yr. * (1+L27)	103.65	106.14	108.00	110.19	113.09

*Note:

GDPPI is from U.S Dept of Commerce, Bureau of Economic Analysis; Table 1.1.4 Price Indexes for GDP (Indexed 2000=100) as of 08/31/2005.
2001 removes 9 months of the $23.3M Rate Increase from Order 63487 Docket No. T-01051B-00-0369
2002 removes 9 months of $14.6M Decrease from 2002 Price Cap Rate Filing plus 12 months of prior years price changes adjusted for negative growth.
2003 removes 9 mos of $28.3M decrease from 2003 Price Cap Filing plus 1 month of $1.4M Basket 3 decrease in Dec-03 plus 12 months of prior years price changes adjusted for negative growth.
2004 removes 9 mos of $18.8M decrease effective April 1st and $0.6M basket 3 decrease effective May 7th plus 12 months of prior years price changes adjusted for negative growth.

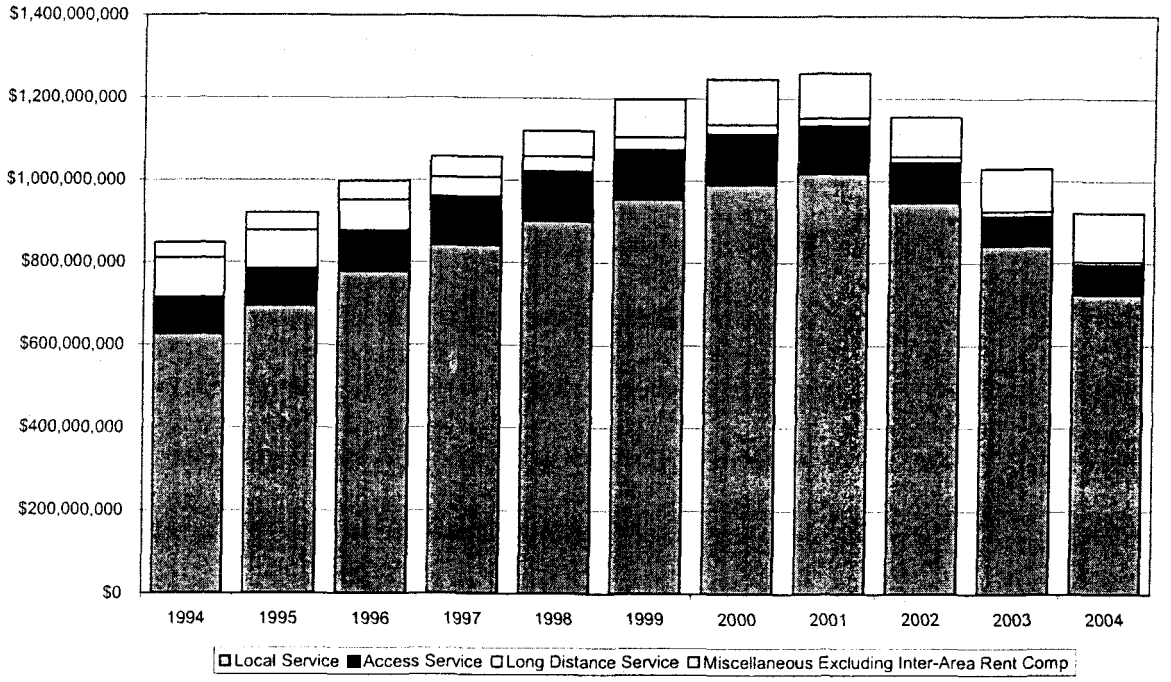
Analysis of Arizona Intrastate Revenues

Q. PLEASE DESCRIBE THE COMPONENTS OF ARIZONA INTRASTATE REVENUES.

A. There are four categories of revenues shown on Qwest's year-to-date December 1990s report for Arizona, examples of which are provided as Qwest Corporation—Confidential Exhibit PEG-S02 to my Direct Testimony in Support of Settlement. The categories are local service, access service, long distance service, and miscellaneous revenues. The following graph charts the intrastate revenues from the four categories over the past eleven calendar years. In order to portray a more accurate picture of Arizona intrastate revenues during the eleven-year period the graph excludes intrastate inter-area rent compensation from miscellaneous revenue.[48]

[48] A more detailed explanation of the reason for excluding inter-area rent compensation can be found in the discussion of miscellaneous revenue below.

Arizona Intrastate
Annual Revenues Excluding Inter-area Rent Compensation



As depicted by the graph, total intrastate revenues excluding inter-area rent compensation peaked at $1,262 million in 2001. Three years later they had fallen to $923 million, a decline of $339 million or 27 percent. Over the three years of 2002, 2003 and 2004, Arizona intrastate revenues excluding inter-area rent compensation declined at an average annual rate of 8.3 percent. Over the four years from 2001 through 2004, the average annual rate of revenue decline was 7.3 percent. Not surprisingly, Qwest achieved an average annual output growth rate of negative 5.9 percent during these four years.

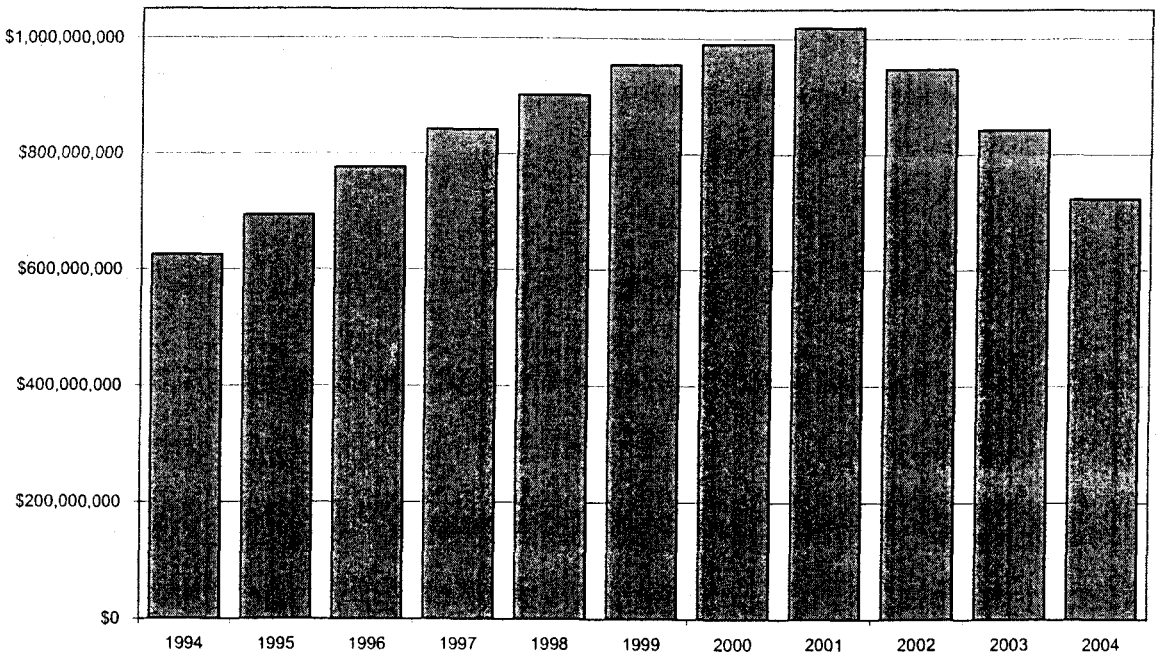
Conversely (and also not surprisingly) in the four years—1995 through 1998—that Qwest achieved a positive 6.1 percent annual output growth rate, revenues grew $273 million or 32 percent, which is an average annual growth rate of 7.2 percent. Following is a discussion of each of the four categories of revenues depicted in the graphs above.

Local service revenues

Q. PLEASE DESCRIBE THE CHANGE IN INTRASTATE LOCAL SERVICE REVENUES.

A. The following graph charts the first category, local service revenues, over the past eleven calendar years.

ARIZONA INTRASTATE
LOCAL SERVICE REVENUES



As depicted by the graph, Qwest's annual local service revenues grew steadily until they peaked at $1,019 million in 2001. Then they began a precipitous fall.

Q. HOW DOES LOCAL SERVICE REVENUE GROWTH DURING THE FOUR-YEAR PERIOD ENDING WITH 1998 COMPARE WITH THAT OF THE FOUR-YEAR PERIOD ENDING WITH 2004?

A. In the four year period ending with 1998, Qwest's Arizona local service revenues grew 44 percent. In the four year period ending with 2004, they declined 27 percent. The entire decline has occurred in the last three years. Since 2001 local service revenues have fallen over $295 million or 29 percent of the 2001 level. Over the

three years of 2002, 2003 and 2004, local service revenue has declined at an average annual rate of 8.9 percent.

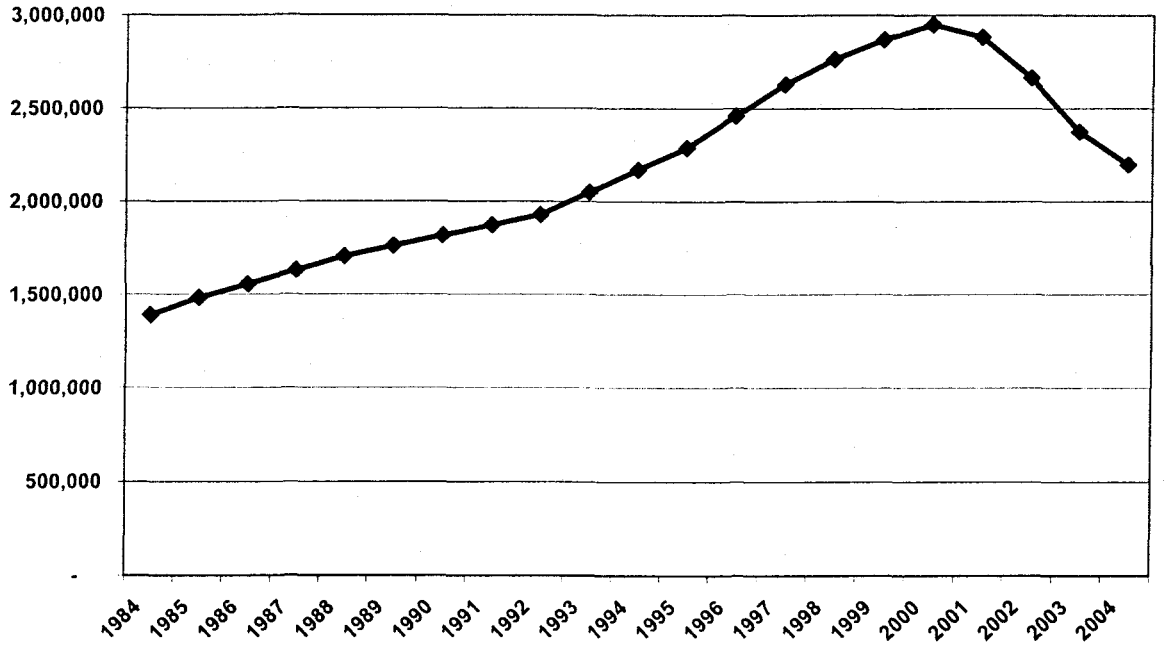
Q. WHAT CAUSED SUCH A SEVERE DECLINE IN JUST THREE YEARS?

A. Two major factors contributed to local service revenue losses: rate decreases required under the existing Price Plan and access line losses. The effect of the rate decreases was comparatively small; roughly $65 million of the $295 million decrease is attributable to Basket 1 and 2 price decreases under the current Price Plan. The other $230 million of the decrease is attributable to output decreases. In the four years between January 2001 and January 2005, Qwest's Arizona retail access line count fell 26 percent. In contrast, the four years between 1994 and 1998 saw Qwest's Arizona retail access line count climb 28 percent.

Q. IS IT UNUSUAL FOR QWEST'S ARIZONA RETAIL ACCESS LINE COUNT TO FALL 26 PERCENT IN FOUR YEARS?

A. Extraordinarily. It is my understanding that for well over a century, interrupted only by the Great Depression of the 1930's, the Company's access line count enjoyed relatively steady growth. Following is a graph of the Company's Arizona retail access line count over the most recent 20 years.

ARIZONA
RETAIL ACCESS LINES



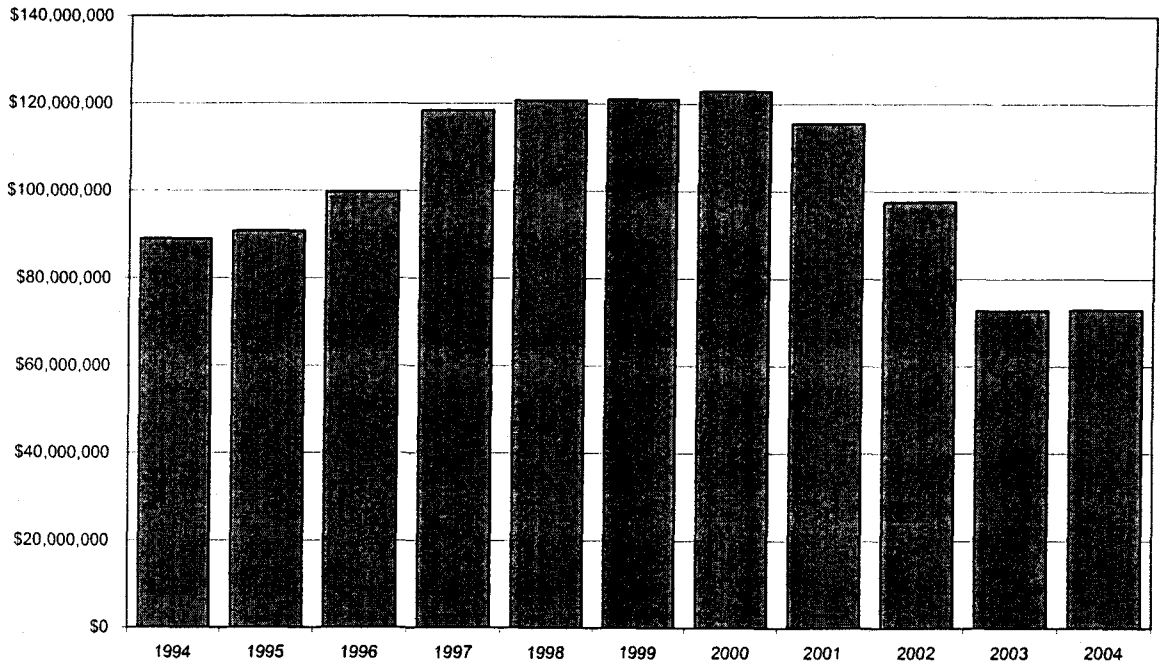
The graph shows continuous access line growth totaling 112 percent in the sixteen years between 1984 and 2000. Given the Company's century-long history of relatively steady access line growth, the loss of 26 percent of Qwest's retail access lines in the last four calendar years constitutes an unprecedented and fundamental change in the course of telephony in Arizona and the Company's financial performance.

Access service revenues

Q. PLEASE DESCRIBE THE CHANGE IN ACCESS SERVICE REVENUES.

A. The following graph charts access service revenues over the past eleven years.

ARIZONA INTRASTATE
ACCESS SERVICE REVENUES



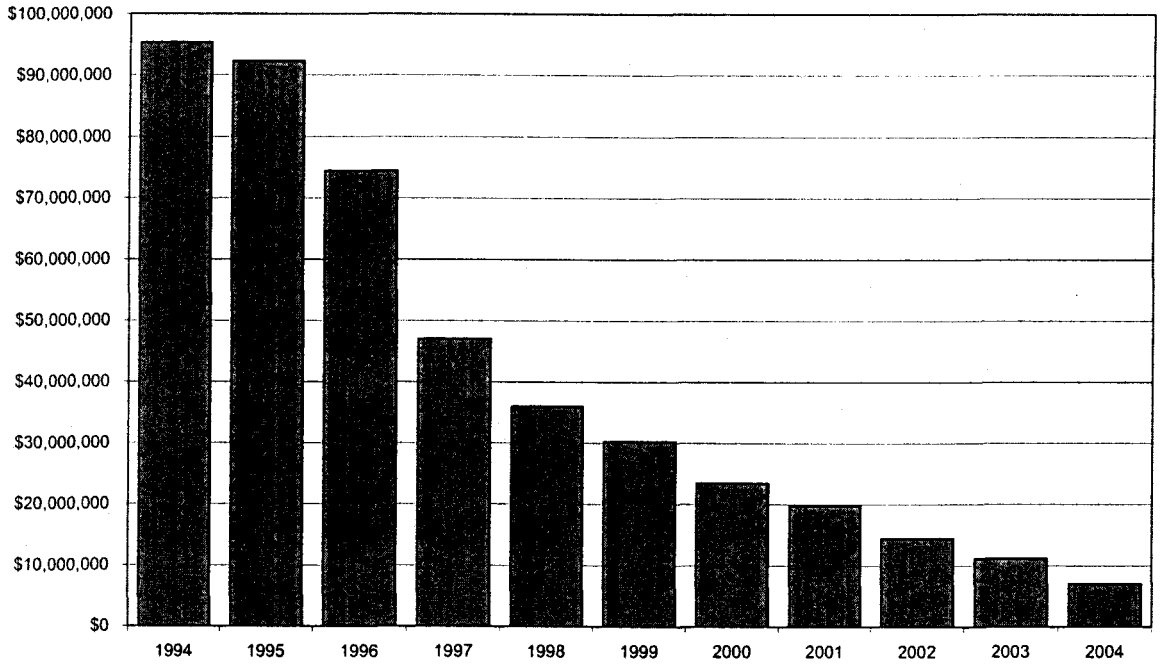
As depicted by the graph, Qwest's annual intrastate access service revenues peaked at $123 million in 2000 and fell to $73 million in 2004. Between 1994 and 1998, access revenues grew $32 million or 36 percent. Between 2000 and 2004 they declined $50 million or 41 percent. Roughly $15 million of that decline can be attributed to intrastate access rate reductions of $5 million each on April 1, of 2001, 2002 and 2003.

Intrastate long distance revenue

Q. PLEASE DESCRIBE THE CHANGE IN INTRASTATE LONG DISTANCE SERVICE REVENUES.

A. The following graph charts intrastate long distance service revenues over the past eleven calendar years.

ARIZONA INTRASTATE LONG DISTANCE SERVICE REVENUES



As depicted by the graph, Qwest's annual intrastate long distance service revenues declined 93% in ten years from $95 million in 1994 to $7 million in 2004. Rate decreases under the existing Price Plan had no effect on the decline.

Q. WHY DID LONG DISTANCE REVENUES FALL 93 PERCENT?

A. Federal law prohibits Qwest from offering interstate long distance service. Standalone intrastate long distance service is not fully competitive with the offerings other carriers can make in the highly competitive marketplace for long distance services. Consequently, as customers migrate to other providers, Qwest's sales of intrastate long distance have declined.

Q. HOW DOES QWEST'S ARIZONA LONG DISTANCE REVENUE GROWTH DURING THE FOUR-YEAR PERIOD ENDING WITH 1998 COMPARE WITH THAT OF THE FOUR-YEAR PERIOD ENDING WITH 2004?

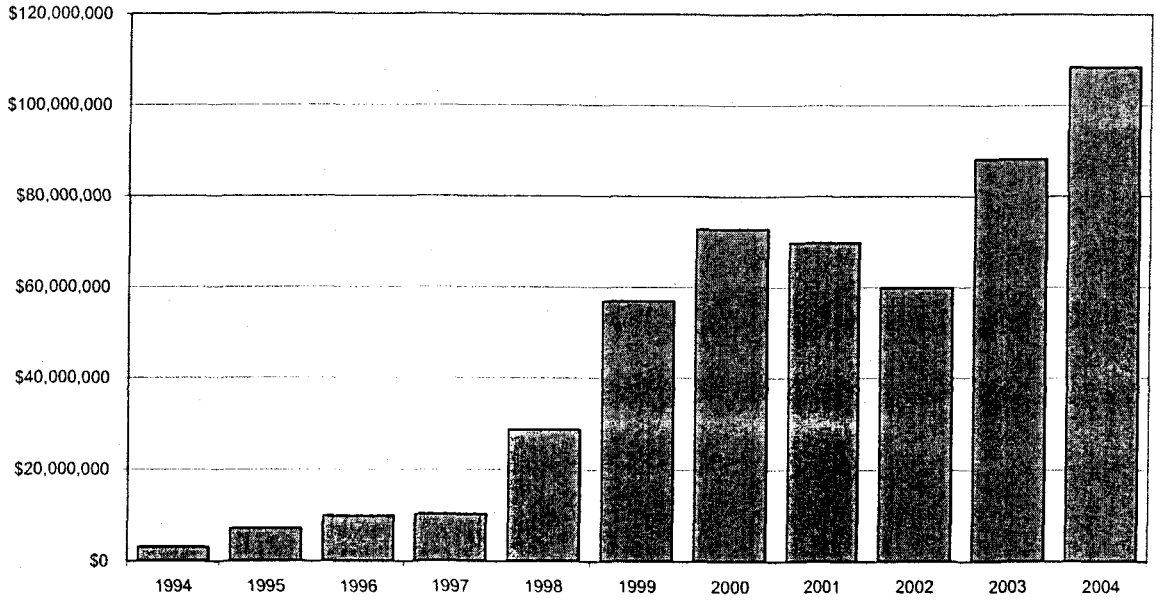
A. In the four-year period ending with 1998, Qwest's Arizona long distance service revenues declined $59 million or 62 percent of the amount generated in 1994. In the four-year period ending with 2004, they declined $16 million or 70 percent of the amount generated in 2000.

Miscellaneous revenues

Q. PLEASE DESCRIBE THE CHANGE IN MISCELLANEOUS REVENUES.

A. The following graph charts miscellaneous revenues over the past eleven years.

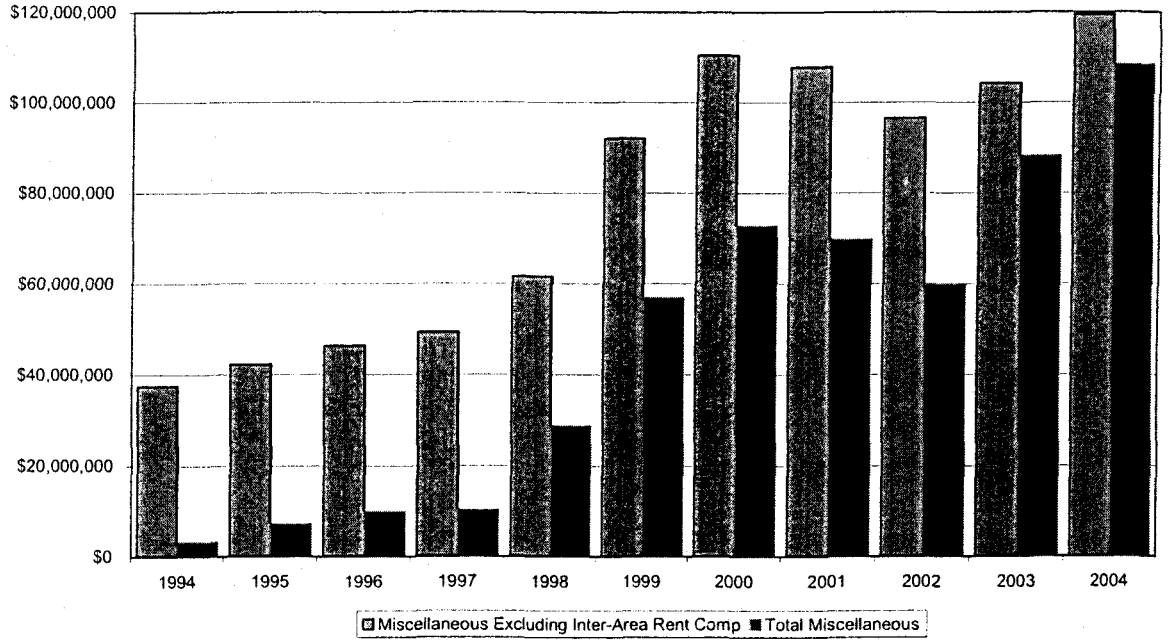
ARIZONA INTRASTATE
MISCELLANEOUS REVENUES



As depicted by the graph, Qwest's annual miscellaneous revenues increased from $3 million in 1994 to $108 million in 2004, an increase of $105 million. However, this graph misstates actual growth in miscellaneous revenues because it includes inter-area rent compensation. Inter-area rent compensation involves the assignment of costs among the states that Qwest serves. These costs are principally for buildings and computers located in one state that are used to provide service in other states. Hence, inter-area rent compensation is not an output of the business. It is the assignment of business inputs to the correct jurisdiction. Consequently, the data points on the following graph that exclude inter-area rent compensation from

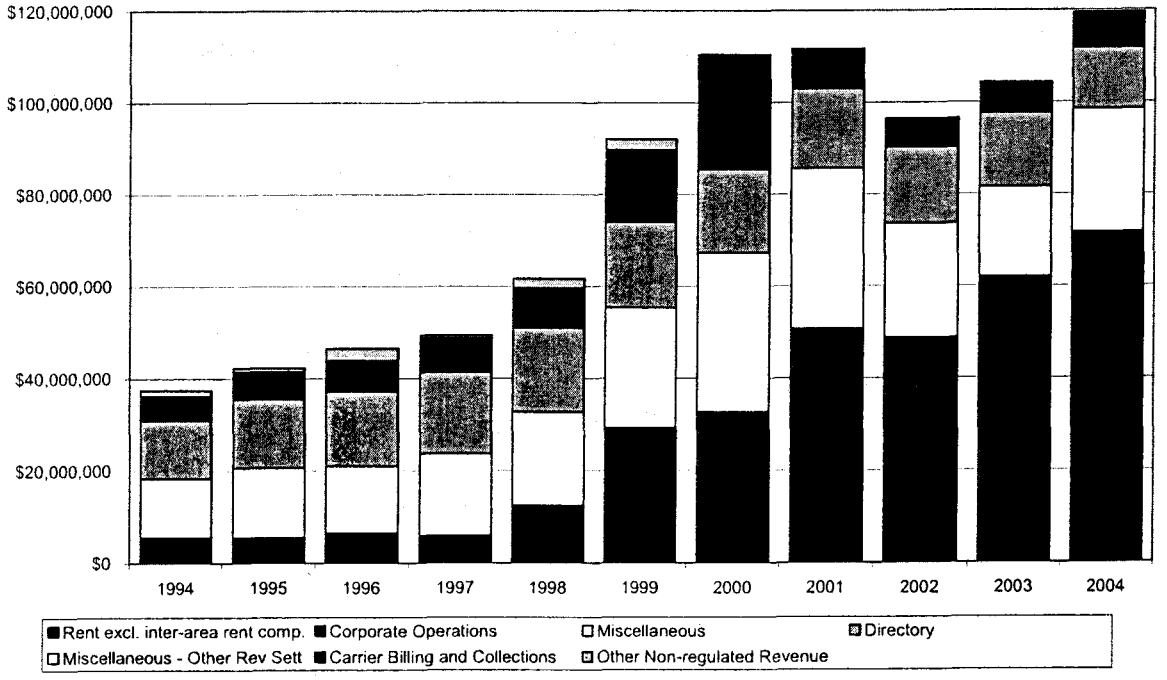
miscellaneous revenues more accurately reflect miscellaneous revenues growth attributable to output growth.

Arizona Intrastate
Miscellaneous Revenues
With and Without Inter-Area Rent Compensation



As depicted by the graph, miscellaneous revenues excluding inter-area rent compensation peaked in 2004 at $119 million. During the four years ending in 1998 they grew $24 million or 64% percent. During the four years ending 2004 they grew $9 million or 8%. The following graph provides a breakdown of the components of miscellaneous revenues excluding inter-area rent compensation.

Arizon Intrastate
Miscellaneous Revenue Excluding Inter-area Rent Compensation



The graph shows that the most significant change has been an increase in rent excluding inter-area rent compensation. This category reflects the growth in wholesale revenues from sales of unbundled loops, unbundled switching, unbundled transport, re-bundled services, and local interconnection.

Wholesale service revenues

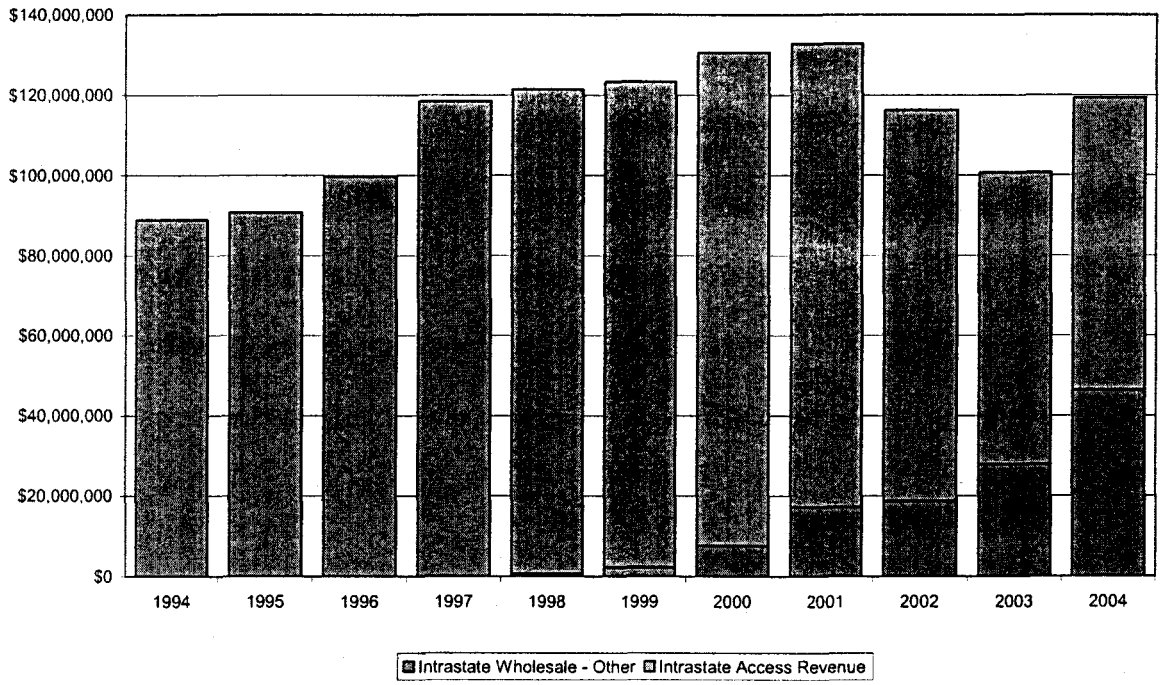
Q. HAVE INCREASES IN WHOLESALE SERVICE REVENUES COMPENSATED FOR QWEST'S LOSS OF RETAIL BUSINESS REVENUES?

A. No. In 2004, wholesale services generated roughly 13 percent of Qwest's Arizona intrastate revenues. The graph of total Arizona intrastate revenues above includes

both wholesale and retail revenues. Despite including wholesale revenues, total intrastate Arizona revenues have declined $339 million or 27 percent since 2001.

Wholesale revenues include intrastate access revenues (which were graphed and explained under the heading "access revenues") and other intrastate wholesale revenues recorded to the rent account (which was graphed and explained under the heading "miscellaneous revenue"). The following graph combines these two sources of wholesale revenue.

Arizona Intrastate
Wholesale Revenue



As the graph shows, total wholesale revenues have not increased substantially over the eleven years depicted. In 1994, they totaled $89 million. In 2004 they totaled

$119 million, an increase of $30 million or 34 percent in ten years. Between 1994 and 1998, wholesale revenues grew 37 percent. Between 2000 and 2004 they declined 9 percent. Since 2001 they have declined 12 percent. Thus, wholesale revenue growth has provided no offset to the decline in retail revenues since 2001.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	)	**DOCKET NO. T-01051B-03-0454**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)	**DOCKET NO. T-00000D-00-0672**
STATE OF WASHINGTON COUNTY OF KING	) :	**AFFIDAVIT OF PHILIP E. GRATE** **SS**

Philip E. Grate, of lawful age being first duly sworn, deposes and states:

1. My name is Philip E. Grate. I am State Finance Director for Qwest Corporation in Seattle, Washington. I have caused to be filed written rebuttal testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Philip E. Grate

Philip E. Grate

SUBSCRIBED AND SWORN to before me this 25th day of October, 2005.

LORI L. WHITE
COMMISSION EXPIRES
NOTARY
PUBLIC
STATE OF WASHINGTON

Lori L. White

Notary Public

My Commission Expires: 7/10/07

1 BEFORE THE ARIZONA CORPORATION COMMISSION

2

3 IN THE MATTER OF QWEST)DOCKET NO.
CORPORATIONS' FILING OF RENEWED)T-01051B-03-0454
4 PRICE REGULATION PLAN)
)
5 IN THE MATTER OF THE INVESTIGATION)T-00000D-00-0672
OF THE COST OF TELECOMMUNICATIONS)SPECIAL OPEN MEETING
6 ACCESS.)
)EMERGENCY MOTION

7

8

9

10

11

12 At: Phoenix, Arizona

13 Date: March 30, 2005

14 Filed:

15

16 REPORTER'S TRANSCRIPT OF PROCEEDINGS

17

18

19

ARIZONA REPORTING SERVICES, INC.
20 Court Reporting
Suite Three
21 2627 North Third Street
Phoenix, Arizona 85004-1103

22

By: MICHELE E. BALMER, RPR
23 Certified Court Reporter
Certificate No. 50489

24

25

EXHIBIT
Q-38
admitted

BE IT REMEMBERED that a Special Open Meeting was held at the Arizona Corporation Commission, Hearing Room 1, 1200 West Washington, Phoenix, Arizona, commencing at 1:05 p.m. on the 30th day of March, 2005.

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

APPEARANCES:

For the Arizona Corporation Commission:

LYN FARMER, Chief Administrative Law Judge
CHRISTOPHER KEMPLEY, Chief Counsel
MAUREEN SCOTT, Staff Attorney
TIMOTHY J. SABO, Staff Attorney
Legal Division
1200 West Washington Street
Phoenix, Arizona 85007

For Qwest:

QWEST CORPORATION
By: Mr. Norman Curtright
4041 North Central Avenue, 11th Floor
Phoenix, Arizona 85012

For RUCO:
Residential Utility Consumer Office
By: Mr. Scott S. Wakefield
Suite 200
1110 West Washington Street
Phoenix, Arizona 85007

MICHELE E. BALMER
Certified Court Reporter
Certificate No. 50489

CHMN. HATCH-MILLER: The Special Open Meeting of the Arizona Corporation Commission for Wednesday, March 30th in regard to Qwest Corporation is called to order.

Judge Farmer.

CALJ FARMER: Thank you, Mr. Chairman, Commissioners. Lyn Farmer on behalf of the Hearing Division for Jane Rodda.

The Commission approved a settlement agreement that adopted a Price Cap Plan for Qwest in Decision No. 63487 in March of 2001. Part of the Price Cap Plan included an annual rate adjustment determined by an inflation minus productivity indexing mechanism for services that -- in the noncompetitive services in Basket 1.

In Decision No. 66882 in February of 2004, the Commission clarified that the Price Cap Plan terms and conditions continued until the Commission approved a new plan or otherwise ordered its termination. The Commission ordered Qwest to make the productivity adjustment on April 1, 2004.

In Decision No. 67047, the Commission affirmed Decision 66772 and found that further adjustments after April 1, 2004 would be governed by the continuation clause and continue in effect until the Commission

approves a new or revised plan. Qwest appealed both decisions, and those appeals are pending at the Court of Appeals.

The matter before you today addresses a motion. On February 3rd of this year, Qwest filed what it captioned an emergency motion to suspend the productivity adjustment that is scheduled for April 1, 2005. Qwest argued that suspending the adjustment is supported by the evidence in the case, and that yo-yoing rates would be confusing for consumers, unnecessarily increase the customers' -- the company's administrative costs, and be bad public policy.

Staff supported the request as long as Qwest agreed to suspend the procedural schedule in the appeal of Decision No. 66772 and 67047. Both Staff and Qwest argued that a suspension of the adjustment would preserve the status quo and, thus, facilitate settlement discussions currently underway in the renewed Price Cap Plan docket.

Staff believed that a temporary suspension of the April 1, 2005 adjustment could be considered and addressed in the settlement discussions and subsequent agreement that may result.

RUCO opposed the motion, arguing that the Commission has already rejected Qwest's argument for

not making the April 1st adjustment. RUCO argued that the Commission cannot modify rates without making a finding of fair value, and that if the adjustment is not made and the ratepayers are not fully compensated for the value of the adjustment in a true-up, the Commission would be engaging in retroactive ratemaking.

The recommended opinion and order finds that pursuant to the terms of the current price cap plan approved in Decision 63487, and clarified in Decision 66772 and 67047, the productivity adjustment must be made effective on April 1, 2005.

The ROO finds that there may be some customer confusion if Qwest is required to lower certain rates as a result of the productivity adjustment, and then several months later increase those rates as a result of the renewed price cap plan. Thus, the ROO provides Qwest the option of making the productivity adjustment effective April 1st, or deferring the implementation of the adjustment until final rates are set in the renewed price plan docket, and depositing the equivalent of the revenues associated with the adjustment in an interest-bearing account.

The intent of the escrow account is to protect ratepayers. If Qwest elects the deferment, the ROO specifies that Qwest bears the burden of demonstrating

Page 6

1 that ratepayers receive the full benefit of the
2 adjustment.
3 Both Qwest and Staff filed exceptions, and
4 Staff continues to support a suspension, but for the
5 first time, I believe, clearly articulates that if a
6 suspension is granted, a liability accrues on April 1st
7 until the Commission enters an order terminating the
8 plan or approving a new or modified plan.
9 Staff's language to modify the ROO, which was
10 attached to their exceptions with the incorporation of
11 language in the discussion concerning that liability
12 and putting those into findings of fact and conclusions
13 of law in the ordering paragraph, I believe would
14 comport with the intent of the recommended order. And
15 we have prepared an amendment to reflect that.
16 Basically, you'll see that it's very similar to
17 Commissioner Gleason's proposed amendment, and we've
18 bolded the sections that we've added. It just carries
19 forward into the findings of fact, conclusion of law,
20 and ordering paragraphs the language that was included
21 in the amendment in the discussion part.
22 Qwest's exceptions also make it clear, I
23 believe, that it actually wants the adjustment
24 terminated. It proposes two new ways to handle this
25 issue. One would be by staying Decision 66772 and

Page 7

1 Decision 67047. That's one way. Another way would be
2 to declare that an emergency exists and that the rates
3 are interim.
4 Neither of these suggestions were proposed,
5 discussed, argued or briefed. And if the Commission
6 wants to consider those options, then I believe we need
7 to go back before the ALJ and hear arguments on them.
8 CHMN. HATCH-MILLER: Thank you, Judge Farmer.
9 Questions of Judge Farmer?
10 (No response.)
11 CHMN. HATCH-MILLER: Hearing none, appearance
12 of counsel.
13 MS. SCOTT: Chairman, Commissioners, Maureen
14 Scott, Chris Kempley and Tim Sabo on behalf of
15 Commission Staff.
16 CHMN. HATCH-MILLER: Thank you very much.
17 MR. CURTRIGHT: Chairman Hatch-Miller,
18 Commissioners, Norman Curtright on behalf of Qwest.
19 MR. WAKEFIELD: Good afternoon, Commissioners.
20 Scott Wakefield on behalf of the Residential Utility
21 Consumer Office.
22 CHMN. HATCH-MILLER: Thank you all for being
23 here today.
24 Mr. Johnson, do you have anything further to
25 add to what the Judge just said.

Page 8

1 MR. JOHNSON: Mr. Chairman, I don't have
2 anything to add to what the Judge stated, other than at
3 the time you take up the amendments, we would have a
4 comment or two that we would like to make.
5 CHMN. HATCH-MILLER: Thank you very much.
6 Mr. Curtright.
7 MR. CURTRIGHT: Chairman and Commissioners,
8 first, let me express our gratitude to you for taking
9 your Wednesday afternoon to hear us again on this
10 matter.
11 You probably have sort of a somewhat sickening
12 sense of deja vu. I know I do. I was not in this
13 chair, but I was in the gallery on June 9th when you
14 last heard this issue. We believe that the door was
15 left open after that hearing for us to come back before
16 you if we found ourselves in this set of circumstances.
17 This is the problem. If we were here today to
18 approve a new price cap plan, then, obviously, this
19 reduction as defined by the April 1st in the old case,
20 then the April 1st reduction would be off the table,
21 and whether rates then would go sideways or up or down
22 would be decided by the new case and not by an
23 outdated, four-year-old formula.
24 Unfortunately, we're not here today to approve
25 a new price cap plan. That case is not ready yet. But

Page 9

1 we submit that should not change what we all set out to
2 do. What I believe we all set out to do and what we
3 are asking for is the opportunity to argue our rate
4 structure in the new case, and not have our new rate
5 structure decided or heavily influenced by an outdated,
6 four-year-old formula. And that's an outdated,
7 four-year-old formula which does not take into account
8 the new data which has been presented by all of the
9 parties.
10 Commissioners, frankly, we believe that the old
11 formula has become an unguided missile and is not
12 appropriate to apply any longer. As I said,
13 unfortunately, we're not here today to approve a new
14 price cap plan because that case isn't ready.
15 And I think it's worth noting that that case
16 isn't ready because of any -- you know, it's not
17 because of any fault of Qwest, and it's not ready
18 because of any fault of Staff or RUCO or anyone else.
19 It's just the nature of the job that we had before us.
20 It was a lot of work, and we weren't able to fit it all
21 into a very small space of time. We're all continuing
22 to work hard to get it done.
23 But we think we should still have the ability
24 to reach a decision on our rate structure in the new
25 case without the interference of this adjustment. We

Page 10

1 don't believe that our new rate structure should be
2 based on anything other than the facts in the current
3 case.
4 And as we have noted in our pleadings and
5 before Judge Rodda, the facts are that every party has
6 submitted testimony that Qwest is underearning based on
7 a 2003 test year. So if Qwest has been underearning
8 since at least 2003, the appropriateness of yet another
9 annual rate reduction pursuant to a four-year-old,
10 outdated formula, we submit is so doubtful that the
11 Commission must intervene.
12 We believe that granting our original motion
13 would be the best way to do that. We have submitted
14 two other alternative ways, which Judge Farmer believes
15 should go back before a hearing examiner if that was
16 your desire. And we would not object to going back
17 before the hearing examiner to test those theories, but
18 we still think granting our motion is the best answer,
19 or the two options that we've submitted.
20 We've taken a look at the amendments which have
21 been proffered, and when it's appropriate we would be
22 glad, Mr. Chairman, to comment on those. I'm not sure
23 if you want that argument at this point in time.
24 CHMN. HATCH-MILLER: Not yet.
25 Questions of Mr. Curtright?

Page 11

1 Commissioner Mayes.
2 COM. MAYES: Thank you, Mr. Chairman.
3 Mr. Curtright, I was here for the hearing on
4 this matter in front of the ALJ. And as Judge Farmer
5 stated, I don't recall you bringing up the idea of
6 staying Decision 66772 and 67047, or this notion of
7 simply not requiring a further reduction at this point.
8 You never brought those two matters up.
9 And while I'm inclined to support the Hearing
10 Division amendment, I guess I'm a little bemused. Why
11 would you bring this up at this point when your
12 original motion was simply to suspend the reduction?
13 MR. CURTRIGHT: Chairman Hatch-Miller,
14 Commissioner Mayes, we believe that there are several
15 ways to skin this cat, if I could use that --
16 COM. MAYES: Then why didn't you raise that
17 during the hearing, Mr. Curtright? It seems to me that
18 that would be the appropriate time to do that when all
19 of the parties, including RUCO, had an opportunity to
20 cross-examine that.
21 MR. CURTRIGHT: We believe that the use of the
22 word "stay" to describe what we're asking for, while it
23 is a different vocabulary than suspension, is an
24 approach which probably is a more apt description of
25 what we are asking for. And so I think in a sense that

Page 12

1 was argued, if I could characterize it that way.
2 I would willingly agree with you that we did
3 not speak at all to the idea of emergency motions -- or
4 excuse me -- declaring an emergency and setting interim
5 rates because of the emergency.
6 If I may, though, suggest that this is an
7 emergency from our perspective, and we don't believe
8 that the Commission intended to take this -- to let
9 this matter be out of its hands when we came to this
10 particular set of circumstances. And we are simply
11 trying to present to you different ways to think about
12 it so that you could approach it in a way that does
13 justice.
14 COM. MAYES: And one more question,
15 Mr. Curtright, and then I'll alternately ask the other
16 parties in the matter this question as well.
17 But it seems to me that if we were to adopt the
18 Hearing Division amendment that describes accrual of
19 the liability from April 1st, that we would want to
20 make sure ratepayers were getting the full-time value
21 of their money, which is something that I raised during
22 hearing.
23 What is your proposal for an interest rate?
24 MR. CURTRIGHT: Frankly, we haven't thought
25 about it, Commissioner.

Page 13

1 COM. MAYES: But you agree that certainly
2 ratepayers should receive the full value of their money
3 if down the road this adjustment is ultimately made,
4 wouldn't you?
5 MR. CURTRIGHT: If that was the decision, it
6 would seem like a logical consequence. We don't think
7 that it's the right decision though.
8 COM. MAYES: Okay.
9 CHMN. HATCH-MILLER: Commissioner Mundell.
10 COM. MUNDELL: Thank you, Mr. Chairman. I have
11 a question for Mr. Kempley or counsel. There was an
12 argument made -- and let me just say, I think there's a
13 lot of good arguments for why we should adopt the
14 Hearing Division amendment and why we should, you know,
15 grant the request of Qwest as modified.
16 But one of the problems I'm having is the
17 argument that somehow this is an emergency. And they
18 cited a case from 1998, and I think there's some -- in
19 their exceptions, and I think there's been case law
20 since then. And I just want to make sure we're not
21 going to come back at some future time, whenever a
22 company may believe that they're in some financial
23 distress, and have that be used -- this case be used
24 from a precedent standpoint to somehow suggest that as
25 an emergency.

Page 14

1 I'll cite the page in the exception. Like I
2 said, I think there's some good arguments to be made to
3 grant their request as modified by the Hearing
4 Division, but what I'm concerned about is somehow --
5 because this thing is entitled emergency, and they
6 allude to it and they actually cite it as an argument.
7 MR. KEMPLEY: Mr. Chairman, Commissioner
8 Mundell, let me respond. And we can talk about the
9 specific language if that's still necessary, but I
10 don't believe that this is being treated either by the
11 Staff or by the Hearing Division in the recommended
12 opinion and order with the amendment as an emergency in
13 the sense of an emergency that justifies interim rates.
14 And even Qwest's use of the term emergency in their
15 motion, I don't think, is used in the same sense that
16 is used in the interim rate proceeding.
17 And I guess I think that's why Judge Farmer
18 suggested that if that theory that emerged in the
19 exceptions were to be applied, it would be necessary to
20 have an evidentiary basis for the finding of an
21 emergency to justify a finding that these were interim
22 rates. At this juncture, as I said, I don't believe
23 that that's Staff's theory of the case, and I don't
24 believe that that's the theory of the case under which
25 you would be deciding it if you issued the recommended

Page 15

1 opinion and order with the Hearing Division's
2 amendment.
3 I think that the Attorney General's opinion --
4 I think it's 71-15 or 71-17 -- talks about emergencies
5 in the context of interim rates, and it means a
6 financial emergency that brings into question the
7 financial viability of the utility. And I don't see
8 anything about this situation that suggests that
9 Qwest's financial viability is at risk.
10 I do think that Qwest makes a good point that
11 the yo-yoing effect that may occur with respect to
12 rates if the rate adjustment -- the productivity
13 adjustment occurred and it were followed shortly by
14 increased rates based on the current case, yields a bad
15 result for customers. It also yields potentially, you
16 know, a result that would be a bad one for the company.
17 But, again, I think that all that is going on
18 in terms of the Staff's position and the recommended
19 opinion and order is to attempt to avoid that yo-yo
20 effect and not to find an emergency of the sort that
21 would justify interim rates.
22 COM. MUNDELL: Well, okay. I appreciate that
23 explanation. And as long as you think the order as
24 written is clear enough, that's fine. I'm just saying
25 their argument -- they continue to argue -- and they

Page 16

1 don't talk about their -- maybe it's implicit in this
2 statement that they're concerned about their financial
3 wherewithal. But on page 3, Line 23 of their
4 exception, they say: In the past, the Commission has
5 treated a delay in the ability to fix and implement
6 proper rates as an emergency justifying interim rate
7 relief.
8 A delay as opposed to a delay causing
9 financial, you know, distress. That's the distinction
10 I'm trying to make. So as long as you think the
11 language is sufficient and we're not going to be back
12 here. They cite a Commission decision in 1998. That's
13 why I'm raising it.
14 So I just wanted to make it clear that you
15 believe the wording -- and maybe I'll ask Ms. Farmer --
16 the wording in the order is sufficient so we're not
17 going to be having, you know, concern when I'm no
18 longer here.
19 Their exceptions, Page 3, Line 23, and right at
20 the end of the sentence, "In the past..."
21 MR. KEMPLEY: Maybe Qwest could tell us who
22 the subject of that decision number is. I don't have
23 the decision in front of me.
24 In a general manner --
25 COM. MUNDELL: Well, I read the transcripts of

Page 17

1 the previous Open Meetings. I didn't have a chance to
2 grab that decision.
3 MR. KEMPLEY: Do you know who the subject of
4 the decision was?
5 CHMN. HATCH-MILLER: Mr. Curtright?
6 MR. KEMPLEY: Mr. Wakefield knows.
7 CHMN. HATCH-MILLER: Mr. Wakefield.
8 MR. WAKEFIELD: I decided it might be prudent
9 to go find the decision before I appeared today. It's
10 a decision from late 1998 involving Qwest and several
11 of the Citizens Telecommunications companies, and it
12 involves their PAL rates that were set. In the
13 decision, the Commission adopts a settlement of a PAL
14 rate issue that was negotiated by Staff and the Arizona
15 Payphone Association.
16 I didn't really see how it cited or implicated
17 the idea of emergencies or interim rates.
18 COM. MUNDELL: Thank you for that. That's sort
19 of what I was trying to ascertain.
20 MR. KEMPLEY: Thanks, Mr. Wakefield.
21 And Commissioner Mundell, having been advised
22 as to what case that decision was in, I do remember
23 that case, and I don't think it was a matter of a
24 finding of emergency interim rates.
25 But without regard to that question, the truth

Page 18

1 of the matter is -- and I'll say this again. I've said
2 it before. -- Commission decisions do not have a
3 precedential effect in the stare decisis sense. And
4 so --
5 COM. MUNDELL: Mr. Kempley, let me interrupt
6 for a second. For non-lawyers, though, when you cite
7 it in a pleading and you reference it, whether it has
8 stare decisis effect or not, it is trying to influence
9 a decision and implying that that was a prior decision
10 of the Commission.
11 So whether from a technically legal perspective
12 it's stare decisis, I agree with you and I've heard
13 that argument for six years. But from the perspective
14 of making the argument and trying to influence the
15 Commissioners, I believe it needs to be discussed and
16 clarified and distinguished.
17 MR. KEMPLEY: And Commissioner Mundell, I
18 absolutely agree with that. I think that it's
19 important, though, in the course of that discussion to
20 make the point that what you're talking about is
21 whether a particular prior Commission decision is
22 persuasive to you, not whether you're somehow bound by
23 it. And that's why, you know, maybe to excess, I point
24 out that the effect here is not a stare decisis or
25 binding, legal precedent-type effect, and that the

Page 19

1 Commission decides matters based on the facts of the
2 case that are presented to them.
3 And it's my view that the recommended opinion
4 and order that's in front of you with the proposed
5 Hearing Division amendment, if that order were
6 approved, I don't believe that that order would create
7 some new impetus towards a finding of an emergency that
8 would justify interim rates in circumstances that I
9 could envision coming in front of you in the future.
10 COM. MUNDELL: Thank you.
11 Mr. Chairman, whenever you want me to --
12 CHMN. HATCH-MILLER: Well, Commissioner Spitzer
13 has something he would like to add to this.
14 COM. SPITZER: Thank you, Mr. Chairman.
15 When I first reviewed the pleadings -- and I
16 appreciate Commissioner Mundell bringing this issue
17 up -- I was less than impressed with the emergency
18 argument.
19 And then last night, going through it again in
20 the context of evaluating my position on Commissioner
21 Gleason's amendment, which at the time was the only
22 amendment before us, I again took another look at the
23 emergency argument. And I didn't see anything in the
24 record justifying the emergency, and I reached the
25 conclusion that it was not the basis to support the

Page 20

1 Gleason amendment.
2 On the other hand, I think what we have here,
3 it's not an emergency case. We're not setting interim
4 rates. We've got a pending rate case, we've got
5 several prior decisions, and we've got a case that
6 needs to be decided based on the equities. And I think
7 it's fair to consider the equities that are in the
8 record and the equities which are known.
9 The emergency is not one of them, I wouldn't
10 base -- although, I will tell you, I ultimately became
11 disposed in favor of the Gleason amendment, and we'll
12 obviously hear whether there's a material distinction
13 between the Hearing Division amendment and the Gleason
14 amendment.
15 I became disposed for the Gleason amendment
16 based on the equities of whether a reduction, given the
17 facts and circumstances, is justified by the equities.
18 And I think we certainly can consider, in addition to
19 the fact that we've got a pending case and there have
20 been pleadings filed in that docket, we need to
21 acknowledge that there are parties that are not here
22 today, and there's a reason they're not here. They've
23 been acquired, and that's something that has affected
24 this case.
25 And, again, I don't think we have the financial

Page 21

1 circumstances in the record sufficient to justify an
2 emergency, but we can't ignore the fact that you've got
3 a company with $17 million of debt with negative net
4 equity. With net cash flow from operations, it would
5 take 150 years under the best circumstances to pay off
6 the debt. And that fits into the mix as to whether the
7 Commission mandates a further reduction or adopts
8 mandatory language that says, let's wait before we take
9 any further action on the reduction until we have a
10 full and fair case.
11 So I agree. I don't think an emergency is
12 justified. But the way I analyze it, the equities of
13 this particular case could cause the Commission to go
14 either way. And I think the equities support Qwest's
15 -- favorable action to some respect of Qwest's motion.
16 CHMN. HATCH-MILLER: Thank you, Mr. Spitzer.
17 You have the floor, Commissioner Mundell.
18 COM. MUNDELL: Thank you, Mr. Chairman. I
19 appreciate Commissioner Spitzer's comments, putting
20 those in the record.
21 And as I said, I think before I started asking
22 my questions, I was inclined to support the Hearing
23 Division amendment before I even asked any questions of
24 Mr. Kempley.
25 In analyzing the equities, I just have one

Page 22

1 quick question for the Hearing Officer, for the
2 Administrative Law Judge. Do you agree with the
3 statements that were made by Qwest that none of the
4 delay can be attributed to them or very minimal part of
5 the delay? Because one of the reasons last time
6 around, as I recall, we had insufficient financials, if
7 my recollection is correct. That was a long time ago.
8 So I agree with Commissioner Spitzer we ought
9 to balance the equities, and I just want to make sure
10 that that is a correct statement of how this matter has
11 proceeded in the docket.
12 CALJ FARMER: Mr. Chairman, Commissioner
13 Mundell, once you get past that delay that came at the
14 front end of it, I don't believe that there has been a
15 delay by any party. And I believe that all of the
16 parties have agreed to the delay that has happened in
17 this case in order to allow settlement discussions to
18 go forward.
19 COM. MUNDELL: Okay. That's what I needed to
20 know. Thank you.
21 CHMN. HATCH-MILLER: Thank you.
22 Mr. Wakefield, let's move on to you.
23 MR. WAKEFIELD: Thank you, Chairman,
24 Commissioners.
25 As you're aware, RUCO did oppose the motion

Page 23

1 that Qwest had filed. And the reason that we did that
2 is despite any suggestion that the rate formula that's
3 currently in place that provides for a productivity
4 adjustor on April 1st being out-of-date or
5 inappropriate on a going-forward basis under new rates,
6 the Commission can't make a change to the rate
7 structure that provides for such an adjustment without
8 making a concurrent finding of fair value.
9 And we believe that the recommended order
10 recognized that until such time as the Commission puts
11 in place a new rate structure based on a new fair value
12 finding, the adjustment is required to be made.
13 The recommended order also made a provision for
14 essentially not implementing that adjustment at this
15 time, but also provided that there would be a guarantee
16 that the dollars associated with the implementation of
17 the adjustment would, in fact, be reflected at the
18 conclusion of this proceeding.
19 RUCO didn't file any exceptions to the
20 recommended order. We felt that that was a fair
21 resolution to provide a way for Qwest to not actually
22 implement the adjustor today, and we could look later
23 at exactly how that adjustment should be implemented.
24 What we found comforting about it was that
25 there was an assurance that it would be implemented.

Page 24

1 Somehow there would be some recognition for the value
2 of the adjustment mechanism.
3 The amendments reflect a similar concern that
4 there be some degree of assurance that the adjustment
5 ultimately be recognized, but a recognition that maybe
6 we don't need to do that today and we can put that off
7 to tomorrow to figure out exactly how to recognize that
8 adjustment. And we can support that kind of a
9 resolution.
10 There's a few very minor language matters in
11 the amendments that I would like to address when it's
12 the appropriate time.
13 CHMN. HATCH-MILLER: Well, and I think --
14 questions of Mr. Wakefield?
15 Commissioner Mayes.
16 COM. MAYES: Thank you, Mr. Chairman.
17 Mr. Wakefield, so do I take your comments to
18 mean that you are amenable to the Hearing Division
19 amendment, or to the Gleason amendment, or to both?
20 Because I saw a material difference between the two.
21 MR. WAKEFIELD: I see a difference, and my
22 preference is definitely for the Hearing amendment.
23 There is a matter with respect to maybe what appears to
24 be an internal inconsistency, actually, in both of the
25 amendments that I would like to have cleared up before

Page 25

1 I take a definite position. And that comes down to the
2 fact that both of the amendments omit or delete the
3 existing Finding of Fact Number 20, but leave in place
4 the final ordering paragraph that appears on page 10
5 that says essentially the same thing.
6 And I understand from speaking with Ms. Scott
7 this morning -- and she was the drafter of the proposal
8 that ultimately Commissioner Gleason has put forward in
9 his amendment and we also see in the Hearing Division
10 amendment -- that that was an oversight on her part to
11 also not strike the final ordering paragraph.
12 So I'm not sure what Commissioner Gleason and
13 Ms. Farmer intend in their amendments as to whether the
14 final ordering paragraph is or is not struck, but I do
15 see the final ordering paragraph language as being
16 important and would feel most comfortable with an
17 amendment that either includes it, or includes
18 something very close to it.
19 COM. MAYES: Mr. Wakefield, what you're saying
20 is you want to see -- you're talking about: It is
21 further ordered that Qwest Corporation may defer the
22 adjustment pending the approval of new rates. That
23 ordering paragraph?
24 MR. WAKEFIELD: No. On the next page, Page 10.
25 COM. MAYES: I apologize.

Page 26

1 CHMN. HATCH-MILLER: Are you on the amendment
2 now?
3 COM. MAYES: No. He's talking about -- I see.
4 I'm sorry. Page 10, the first paragraph?
5 MR. WAKEFIELD: That's correct.
6 COM. MAYES: Okay. I just needed to clarify.
7 And then your thoughts on the issue of accrual
8 and whether that should contain the time value of
9 money, or some specific wording that recognizes
10 interest.
11 MR. WAKEFIELD: I think it is appropriate to
12 recognize that there is a time value of money that
13 customers would be forgoing if we deferred the
14 implementation of this. And a statement that such time
15 value of money should also be recognized in the
16 ultimate order in this case, I think, is appropriate.
17 I don't know whether it's necessary to define
18 what the value of that time value of money is, or if
19 that's a matter that perhaps the parties could
20 negotiate. And if they are unable to negotiate, then
21 would ultimately be brought back before the Commission
22 to either adopt whatever the parties negotiate or
23 impose whatever time value of money equivalent that
24 they feel is appropriate.
25 CHMN. HATCH-MILLER: Okay. And before

Page 27

1 Commissioner Mayes asks a question, it's time to move
2 on to the amendments. Let's do that, because I think
3 we can probably take up all of these issues within the
4 context of the amendments. I believe that the
5 amendments are very similar, although there are
6 substantial differences.
7 Commissioner Gleason, your amendment was the
8 first out of the chute, and I think we ought to discuss
9 it first and your preference in regard to this matter,
10 but I want to think of it as discussing both yours and
11 the Hearing Division's simultaneously.
12 COM. GLEASON: At this time, I don't plan to
13 offer mine. In other words, this was the -- not mine.
14 It's Staff, and I think there was a Hearing Division
15 had some improvements in it, so let's discuss Hearing
16 Division.
17 CHMN. HATCH-MILLER: Okay. That clarifies
18 everything. Commissioner Spitzer, will you move the
19 item?
20 COM. SPITZER: Thank you, Mr. Chairman. I
21 would move the item be approved.
22 And I do have a question before Mr. Gleason is
23 so quick to not move his amendment, if I may?
24 CHMN. HATCH-MILLER: Absolutely. And we're on
25 to the amendment now, and evidently the Hearing

Page 28

1 Division Proposed Amendment No. 1 is the one we have
2 before us.
3 COM. SPITZER: The Hearing Division amendment
4 provides for accrual of a liability expressly, and the
5 Gleason amendment does not.
6 Lord knows, I'm not a whiz at accounting, at
7 financial accounting, particularly when we get into
8 public utilities. But it seems to me that an express
9 provision for accrual would require accounting
10 treatment as a direct liability on the Qwest financial
11 statements.
12 Is that not the case, Mr. Curtright?
13 MR. CURTRIGHT: That's my understanding,
14 Commissioner.
15 COM. SPITZER: And under the Gleason amendment,
16 would that same accounting treatment be mandated?
17 MR. CURTRIGHT: Commissioner, we, frankly, read
18 the incremental change that the Hearing Division
19 offered over Commissioner Gleason's amendment as that
20 only incremental and more by way of clarification,
21 perhaps, than by way of change.
22 So we had a concern about Commissioner
23 Gleason's amendment as written, and for the other
24 amendment as well, which at the appropriate moment I
25 would like to address.

Page 29

1 COM. SPITZER: Okay.
2 CHMN. HATCH-MILLER: Okay. Where should we
3 start? We have the Hearing Division proposed
4 amendment. Let's start with the Hearing Division.
5 CALJ FARMER: Mr. Chairman, commissioners, Lyn
6 Farmer.
7 Although I wasn't the Hearing Officer that
8 wrote this recommended order, but knowing that I would
9 be covering this today, I took all of the transcripts
10 and the pleadings and I read through them.
11 And I believe that the critical issue is the
12 part that's in bold in the Hearing Division amendment.
13 And that is that the motion that was filed by Qwest in
14 February, it was termed emergency. I think that that
15 has been interpreted as urgency as opposed to any kind
16 of connotation with what's happening with the rate
17 structure. And that means that: Please act quickly on
18 this motion because we're coming up to this April 1st
19 deadline. That's just my first point. It's more of
20 the timing of resolving the motion as to the underlying
21 facts about the case.
22 And in that motion, Qwest requested a
23 suspension of the productivity factor. I think that
24 the parties and Staff have been kind of missing each
25 other in the semantics of this. I believe that what

Page 30

1 Qwest requested as a suspension was actually the
2 ability to terminate it at some point later in time.
3 And I believe that Staff's interpretation of suspension
4 is just purely a suspension, and that the rates that go
5 into effect are still a liability and a responsibility
6 that the company has under existing Commission orders.
7 So although it seemed like they agreed to
8 suspend, I don't think that they were necessarily
9 agreeing to the same kind of suspension.
10 What the recommended opinion and order tried to
11 do was not push that issue off to the future, and to
12 make sure that the Commission is clear today that the
13 issue is: Is Qwest going to have to reduce these rates
14 by this amount or not?
15 And if you push it off to a later point in
16 time, I think that Qwest would argue that they never
17 had to make this adjustment, and on a going-forward
18 basis the rates should be lowered. And whatever
19 happens with those rates in the future, I think that's
20 completely separate from whether the adjustment should
21 be terminated here. I think it may be relevant to
22 whether or not they should be suspended, but not to
23 whether the adjustment should be terminated.
24 So the way the recommended order was written
25 was to try to be clear that -- to give Qwest the

Page 31

1 option, basically, well, you can either implement the
2 adjustment now if you want, or if you don't want to
3 implement the adjustment now -- maybe they think
4 they're going to ultimately be successful in their
5 appeals -- they could defer putting that into effect.
6 Evidently, that didn't satisfy them, and I
7 believe that the reason is because they essentially
8 want the Commission to terminate the adjustment and not
9 just suspend it.
10 So what the amendment does is it takes the
11 language that Staff drafted, and in the discussion --
12 and, Commissioner Spitzer, going to your question about
13 the difference between the amendments, the first
14 paragraph of Staff's language that is adopted in these
15 amendments says that, quote, the liability associated
16 with the April 1, 2005 adjustment will continue to
17 accrue.
18 The only thing that the Hearing Division
19 amendment does differently than the Gleason proposed
20 amendment is it takes that language and it puts it in
21 findings of fact, conclusions of law, and ordering
22 paragraphs, so that it's clear that we're not creating
23 any new liability. We're just recognizing that the
24 liability exists today under the status quo, and that
25 it will continue until the Commission makes a fair

Page 32

1 value finding and adjusts rates.
2 CHMN. HATCH-MILLER: Commissioner Spitzer.
3 COM. SPITZER: Thank you. So then, Ms. Farmer,
4 under both amendments, the liability is suspended and
5 the accounting treatment would be the same, but under
6 the Hearing Division amendment it's more express?
7 CALJ FARMER: True. It actually requires Qwest
8 to move some funds and put them in an escrow account
9 and begin earning interest. And the Hearing Division
10 amendment leaves the issue of what's the appropriate
11 time value of money to a later proceeding that
12 potentially the parties would be able to negotiate and
13 resolve if there is a settlement.
14 CHMN. HATCH-MILLER: Commissioner Mayes.
15 COM. MAYES: Well, I appreciate that, Judge
16 Farmer. Where does it do that? Are you saying that
17 because it simply uses the word "accrual," or is it
18 explicitly stated that the time value of money will be
19 attached to the rates or the adjustment?
20 CALJ FARMER: The ordering paragraph that was
21 left in on Page 10 says: Result in the ratepayers
22 receiving the full value of the adjustment as if it had
23 been effected on April 1.
24 COM. MAYES: Okay.
25 CALJ FARMER: Frankly, when we were preparing

Page 33

1 this amendment, we noticed that Staff had not deleted
2 that amendment, and we consciously thought that that
3 was appropriate.
4 COM. MAYES: And you think it's appropriate not
5 to assign a specific value to that?
6 CALJ FARMER: I don't think it's necessary, but
7 maybe the parties would prefer it.
8 COM. MAYES: Okay.
9 CHMN. HATCH-MILLER: Other questions of Judge
10 Farmer?
11 (No response.)
12 CHMN. HATCH-MILLER: Ms. Scott.
13 MS. SCOTT: Chairman Hatch-Miller,
14 Commissioners, Staff has no objection to the Hearing
15 Division amendment. We believe that the language that
16 is added is actually consistent with the language which
17 we had attached to our exceptions.
18 I would like to address Judge Farmer's comments
19 of a few moments ago.
20 CHMN. HATCH-MILLER: Go ahead, Ms. Scott.
21 MS. SCOTT: What we envisioned the language
22 doing that was attached to our exceptions was to defer
23 certain issues until a later date. We felt that the
24 only issue that the Commission needed to address at
25 this point in time was whether or not this adjustment

Page 34

1 should be suspended given the procedural posture of the
2 case, and the customer confusion that could result if
3 the adjustment were made at this time and then somehow
4 reversed at a later date.
5 What we envisioned the process to be
6 ultimately, whether right or wrong, would be for the
7 Commission to make a determination after the parties
8 put forward a settlement agreement, if they're able to
9 come to agreement on all of the issues, to address the
10 issues as part of its order approving a settlement
11 agreement. If the parties are unsuccessful, the issue
12 in its present form would come back to the Commission,
13 and, again, the Commission would address at that time
14 the liability that's accrued, including the time value
15 of money.
16 As part of any settlement, it's Staff's
17 position that the value of this liability and the time
18 value of money would have to be considered. Whether or
19 not the parties agree that that should be in the form
20 of a reduction with interest, I think, remains to be
21 seen. We expect that that would be addressed as part
22 of a comprehensive settlement discussion.
23 So to clarify on what Judge Farmer said, I
24 think it would be our position that that adjustment may
25 or may not occur. It will be up to the Commission.

Page 35

1 And it will depend in part on whether you accept a
2 settlement agreement, if one is reached, which makes
3 provision for the reduction or which somehow includes
4 it in another form, but the full value of that
5 reduction would hopefully be there.
6 CHMN. HATCH-MILLER: Ms. Scott, what I'm
7 hearing from you is that until the full facts of the
8 rate case are available to us, it's difficult to make
9 the detailed decisions regarding the position of this
10 particular matter. It needs to be seen as a gestalt or
11 in totality.
12 MS. SCOTT: Chairman, I would agree with that.
13 CHMN. HATCH-MILLER: Mr. Johnson.
14 MR. JOHNSON: Mr. Chairman, I just want to
15 clarify something for the Commission and maybe offer
16 some insight.
17 As to the proposed amendment from the Hearing
18 Division, Staff is fully supportive of the amendment.
19 We think it's very consistent, as Ms. Scott indicated,
20 with our intent, which was to basically suspend this
21 issue, allowing settlement discussions to go forward.
22 Let me speak because there might be a question
23 regarding those settlement discussions. And I won't go
24 into any details, but I will just advise the Commission
25 or inform the Commission that from the Staff

Page 36

1 perspective, although those discussions are promising,
2 there is no agreement. And it's Staff's intent to
3 terminate those discussions as of April 15 if there is
4 no agreement.
5 And, therefore, in terms of assuring that
6 ratepayers receive the full benefit, that has been and
7 will continue to be Staff's goal, whether it's through
8 a settlement or through the ultimate litigation of this
9 matter upon the merits.
10 CHMN. HATCH-MILLER: So I guess you've given us
11 warning that very soon we'll know whether there's a
12 settlement being reached or whether you're going to be
13 working this.
14 Commissioner Mayes.
15 COM. MAYES: Thank you, Mr. Chairman.
16 Mr. Johnson, what happens if on April 15th you
17 pull the plug and there's no settlement in terms of the
18 adjustment here? Do we come back at it? Is that the
19 intention?
20 MR. JOHNSON: Mr. Chairman, Commissioner Mayes,
21 what we would envision is that the Administrative Law
22 Judge would convene a procedural conference wherein a
23 trial date would be established, this matter would be
24 set, and we would prepare to litigate it. And when
25 this matter ultimately came before the Commission, you

Page 37

1 would determine all of these issues in a final manner.
2 COM. MAYES: All of the issues --
3 MR. JOHNSON: Including the one we're
4 discussing today.
5 COM. MAYES: Okay. But wouldn't that one come
6 before the other issues because it's separate, the
7 issue, the adjustment, the automatic adjustment? In
8 other words, the adjustment was set to take place;
9 correct? We're suspending something that was set to
10 take place.
11 MR. JOHNSON: Commissioner Mayes -- excuse me.
12 Mr. Chairman, Commissioner Mayes, it is certainly
13 possible as a procedural matter for you to make a final
14 determination as to the April 1, '05 issue prior to
15 making your ultimate decision in the rate case. There
16 are pros and cons as to which approach you would take,
17 but you can do so.
18 COM. MAYES: Right. And in my mind, they are
19 separate. And I thought I heard Judge Farmer suggest
20 that in her mind the issues were somewhat distinct.
21 Mr. Johnson, could I ask you -- and maybe this
22 is too delicate a question, and I don't want to dive
23 too deeply into the settlement negotiations which are
24 ongoing, but wouldn't it make sense for the interest of
25 ratepayers for us to be clear that the time value of

Page 38

1 money is to attach, and that there's a certain time
2 value of money that should attach? I thought I heard
3 Ms. Scott suggest that that may or may not be part of
4 what comes out of the settlement negotiations.
5 MR. JOHNSON: And I would agree that in
6 discussion it may have been unclear as to where Staff
7 stood on that issue. Let me begin by saying ratepayers
8 ought to receive the full benefits associated with what
9 I believe is a previously established liability in
10 favor of the ratepayers.
11 An explicit statement through your order on
12 this issue as to the time value of money, I think that
13 is an option that you have, and that certainly would
14 clarify in the minds of all what your intent would be.
15 Could it be accomplished in the manner that
16 Ms. Scott was describing? I think it could as well.
17 But in terms of making it clear through your written
18 expression would be equally and maybe even move
19 appropriate.
20 COM. MAYES: Okay.
21 CHMN. HATCH-MILLER: Let me clarify in my own
22 mind what I thought was the case, though. I sense that
23 it was going to -- that the likelihood would be that
24 this element would be decided as an element of a larger
25 discussion, and that there may or may not be a finding

Page 39

1 that this should have continued past April 2005, and
2 that there may or may not be an adjustment in those
3 amounts. Am I incorrect in that?
4 MR. JOHNSON: Mr. Chairman, if I heard you
5 correctly, I don't necessarily think that I would agree
6 with what you just said. I think from a Staff
7 perspective -- and we've argued this -- that the
8 liability has been established and that there would be
9 an effectuation of that liability effective April 1,
10 2005, through some further reduction to the benefit of
11 ratepayers.
12 I think the issue becomes, whether this matter
13 comes before you ultimately through settlement or
14 through litigation, is what treatment should be
15 accorded to that liability in light of what you heard
16 in the written forum, and maybe heard through Qwest
17 counsel, that each of the parties have come to the
18 conclusion that there is some magnitude of revenue
19 deficiency as it relates to Qwest and its earnings.
20 And you will have to determine ultimately how do you
21 balance those issues. Are there appropriate offsets,
22 one against the other, or some against some, or how you
23 will ultimately deal with that issue.
24 I think the confusion was that if, in fact,
25 there is a liability of approximately $12 million in

Page 40

1 favor of ratepayers, but ultimately through the
2 settlement of litigation process it's determined that,
3 in fact, there is a revenue deficiency, what
4 specifically do you do in terms of balancing those
5 issues. And I don't think we're prepared, nor do we,
6 frankly, know, how we would address those issues at
7 this time, but they would have to be addressed.
8 CHMN. HATCH-MILLER: So I guess what I'm
9 hearing, then, and just checking out to make sure, that
10 the charges -- that the responsibility of Qwest to make
11 these adjustments is considered to still be there. The
12 amounts, the actual dollars, though, will not be given
13 out at this point in time. The adjustment won't be
14 made at this point in time. There will be a later
15 adjustment which might require other adjustments to
16 make up for the $12 million that this represents. I
17 didn't say that very well.
18 MR. JOHNSON: Mr. Chairman, Commissioners, I
19 would agree with that.
20 CHMN. HATCH-MILLER: Commissioner Spitzer.
21 COM. SPITZER: To maybe give some clarity, I
22 hope my colleagues will indulge me with a tax analogy.
23 I agree with Commissioner Mayes that I look at
24 these issues as distinct. But it may be in the
25 interest of justice and good ratemaking that discretion

Page 41

1 lie with the Hearing Division, and ultimately to the
2 Commission, to consolidate and combine for purposes of
3 giving the fairest treatment to the ratepayers.
4 An example is, there is a deficiency for taxes
5 for tax year 2001, and subsequently there's a refund
6 opportunity for the taxpayer for 2002. What the tax
7 court would do would be combine those two cases. So
8 instead of the IRS issuing a $10,000 check for 2001,
9 and then sending three days later a $10,000 bill for
10 2002, the tax court would combine '01 and '02, net them
11 out, and leave the taxpayer where they were.
12 And in the case of ratemaking, you're
13 particularly concerned about confusion of consumers and
14 ratepayers. And where we don't want to prejudge these
15 cases, maybe the right thing to do is to send a bill
16 for '01 and a refund for '02, maybe it's not. And
17 let's see -- let's not prejudge the process.
18 And, ultimately, the items could be distinct,
19 or it could be combined depending on how the interests
20 of justice lie.
21 CHMN. HATCH-MILLER: For me that's a helpful
22 analogy. Thank you.
23 MR. CURTRIGHT: Mr. Chairman.
24 CHMN. HATCH-MILLER: Yes, Mr. Curtright.
25 MR. CURTRIGHT: Thank you for that colloquy. I

Page 42

1 think it's important to note that as this amendment is
2 structured, it is prejudging the issue as to the
3 April 1st adjustment. It's deciding that this is an
4 accrued liability, and we are suggesting that that's
5 what should be postponed. That decision as to whether
6 or not there is an actual liability should be postponed
7 for the case that's before us.
8 And I wanted to point out that it's our concern
9 that our job in closing the current case is going to be
10 made a lot harder if we have to consider this rate
11 reduction now as an accrued liability. I mean, we'll
12 have to take that into account somehow in the case.
13 Much as Commissioner Spitzer was analogizing to
14 the tax circumstance, if I can make an analogy, the
15 April 1st reduction is going to be like the old, ugly
16 sofa in the living room that is going to have to sit
17 there even though we're remodeling everything around
18 it.
19 And to your earlier question or comment,
20 Chairman, because of that, there's going to have to be
21 some compensating adjustments somewhere, which may be
22 appropriate and may be somewhat artificial, but
23 adjustments that will have to be taken into account
24 because we've decided to keep this ugly sofa.
25 And it's Qwest's hope that we could avoid

Page 43

1 having our hands -- all of our collective hands tied in
2 that manner as we go into the resolution of this case,
3 and it's my belief particularly that the Commissioners
4 would not want to have their hands tied.
5 CHMN. HATCH-MILLER: If I remember correctly
6 from the earlier discussions, the ability to decide
7 this matter rests upon a much broader analysis of the
8 financial wherewithal of the company to provide
9 services, what it's costing you to provide those
10 services, your income and your expenses and the like.
11 And we don't have that before us now, and until we do
12 we can't make final determinations.
13 Commissioner Mayes.
14 COM. MAYES. Well, Mr. Curtright, I think your
15 comments belie what is really going on here, or maybe
16 they simply demonstrate what's really going on here,
17 which I think was what -- I can't remember if it was
18 Judge Farmer said --
19 COM. MUNDELL: Judge Farmer.
20 COM. MAYES: Yeah. Which is that essentially
21 you view this as terminating, or you want to be able to
22 view this as terminating the adjustment. And Staff's
23 view is that it is a suspension of the adjustment until
24 such time as it is addressed in the course of the
25 negotiations. So I think in my mind, for me to be able

Page 44

1 to vote for this, I need to know what is really going
2 on here. And so let me ask you this.
3 If we were to eliminate -- and I certainly
4 wouldn't vote in favor of this if we did, but if we
5 were to eliminate the language talking about accrual,
6 would you then believe that this was a termination
7 rather than a suspension?
8 MR. CURTRIGHT: Commissioner, at oral argument,
9 Judge Rodda asked the same question of me: So what's
10 the difference of whether you're asking for a
11 termination or a suspension?
12 And my response was what we're trying to get to
13 is to not have this issue prejudged as we go into the
14 critical decision-making phases of this case.
15 COM. MAYES: Well, Mr. Curtright, in a sense it
16 already has been judged. The Commission made a
17 decision to have an adjustment. It's done. It's a
18 done deal.
19 What we're doing here is essentially -- I mean,
20 we're bending over backwards here for you, and now you
21 want us to do a flip-flop. Okay? You know, or go just
22 sort of belly up for you. And I'm not sure that's
23 really what was envisioned or is envisioned by any of
24 the parties.
25 So you want a termination. Staff has bent over

Page 45

1 backwards and said, okay, we'll do a suspension in the
2 interest of doing this in the gestalt, as the Chairman
3 said, and trying to get all of these issued resolved.
4 You know, I guess maybe it doesn't matter what
5 you think if all of the other parties are in agreement
6 that what we're doing is a simple suspension, but I
7 would just like to hear it from you and out of your
8 mouth that this is a suspension and not a termination.
9 But what I'm hearing from you, I think I heard
10 an implied threat that you may sue us even if we do
11 pass this with the accrual. So is that your thought
12 now that you may still not back off of the appeal?
13 What is going on here? What were those comments really
14 meant to say? Can you just tell us straight up?
15 MR. CURTRIGHT: I'm sorry, Commissioner. The
16 comments that we feel that this should be decided later
17 and not now?
18 COM. MAYES: No.
19 MR. CURTRIGHT: That's all that I intended to
20 say.
21 COM. MAYES: If we include the accrual -- and I
22 can ask the court reporter to read it back to us -- but
23 I think you said something along the lines that if we
24 include the accrual, you would have to reexamine your
25 options. I think those were your words. I didn't

Page 46

1 write it down.
2 MR. CURTRIGHT: What I believe I said,
3 Commissioner, is if this accrual is written as an
4 accrual, then that is a fact that we have to deal with
5 as we go forward in this case before this Commission
6 and arrange everything around that, and there will have
7 to be compensating efforts taken to make up for that.
8 That's all I'm suggesting.
9 To make a very simple example, if our rates go
10 down $12 million on an annualized basis, we would
11 argue, then, that we need to recover that $12 million
12 somewhere else. And that's all I intended to say,
13 Commissioner.
14 CHMN. HATCH-MILLER: I don't think that's
15 different than what Ms. Scott said. I think that, you
16 know, the concept is if I owe you 5 bucks and I owe
17 Ms. Scott 10 bucks, and I say why don't you give
18 Ms. Scott 5 bucks and I'll give her 5 bucks, I mean,
19 we're adjusting for it in some way.
20 But eventually we have to look at this matter
21 of these roughly $12 million, with or without interest,
22 with or without an adjustment for the time value of
23 money, and see what that does to the overall rate case
24 at a future date, either through the settlement or
25 through a hearing and trial process here before the

Page 47

1 Commission.
2 Mr. Wakefield.
3 MR. WAKEFIELD: Thank you. I think the
4 discussion is hitting the nail on the head, although
5 I'm not sure that we're all understanding each other as
6 clearly as we would hope to.
7 I did believe that I heard Ms. Farmer indicate
8 that it is her intention that Hearing Division
9 Amendment No. 1 not strike the final ordering paragraph
10 on Page 10. We would support an amendment that
11 included -- that left in the ordering paragraph on
12 Page 10.
13 We think that the issue that the Commission --
14 well, the question really comes down to what is the
15 Commission putting off to a later period? Are they
16 putting off the decision whether to recognize the
17 liability, or are they putting off merely a decision as
18 to what would be the manner in which that liability
19 would ultimately be flowed through the customers.
20 And with the inclusion of -- with the retention
21 of the final ordering paragraph, we believe that the
22 Commission would be ordering only that the manner of
23 recovery is what is left open for decision later on,
24 and they would be reaffirming that they have previously
25 decided that there is an accrued liability on April 1st

Page 48

1 for the productivity adjustment, and we would support
2 such a conclusion.
3 CHMN. HATCH-MILLER: Ms. Scott.
4 MS. SCOTT: Yes, Chairman Hatch-Miller,
5 Commissioners. I apologize, first of all, if my
6 comments were not clear earlier, because it is Staff's
7 position that a liability has accrued as of April 1,
8 2005, and continues to accrue until the Commission
9 makes a determination.
10 We also agree with Mr. Wakefield that it really
11 comes down to the manner in which this happens in the
12 end and the form it takes.
13 We also believe that Judge Farmer's amendment
14 already leaves in ordering paragraph 3. And if the
15 Commission wanted to leave in the Finding of Fact,
16 which is almost identical to it, on Page 2 of Judge
17 Farmer's amendment, you would simply strike Page 8,
18 delete old Finding of Fact 20.
19 (Cell phone ringing.)
20 CHMN. HATCH-MILLER: You want to say that
21 again? My mind was jarred by -- I wish we were in
22 Rotary. Boy, we would walk out with a lot of fines
23 today.
24 COM. MUNDELL: Because the phone rang? Yeah.
25 MS. SCOTT: Chairman, Commissioners, with

Page 49

1 respect to Mr. Wakefield's comments about the third
2 ordering paragraph, Staff does not oppose retention of
3 that ordering paragraph, and we believe that Judge
4 Farmer's amendment as currently crafted would leave
5 that ordering paragraph in.
6 If you wanted also to leave the old Finding of
7 Fact that mirrors it in the order, then on Page 2 of
8 Judge Farmer's amendment you would simply strike
9 Page 8, delete old of Finding of Fact 20.
10 CHMN. HATCH-MILLER: All right. Are we all on
11 the same page here?
12 Mr. Curtright, I don't know that it could be
13 said any clearer what the intention of this body is
14 with this order and with this amendment. And I think
15 you were on the same page, but I need, I guess, you to
16 say you understand that this means that the amount is
17 accruing and it's not being eliminated.
18 MR. CURTRIGHT: We understand that's certainly
19 the effect of this order when you vote it in.
20 CHMN. HATCH-MILLER: Okay.
21 COM. MUNDELL: I have a couple of questions.
22 CHMN. HATCH-MILLER: Absolutely. Commissioner
23 Mundell.
24 COM. MUNDELL: Thank you.
25 Mr. Kempley, in the Staff's pleadings, there

Page 50

1 was a concern that if we adopted the ROO as originally
2 drafted, that might have the unintended consequence of
3 forcing Qwest to lift the stay on the appeal and move
4 forward.
5 What is the perspective or have there been
6 discussions on what would happen if, in fact -- and
7 I'll ask counsel for Qwest the same thing because it
8 may make a difference from my perspective whether we
9 even pass this today.
10 I mean, we're trying to compromise here. We're
11 trying to, in my opinion, weigh the equities, as
12 Commissioner Spitzer said. And one of the things that
13 I understood was that, you know, the appeal would not
14 go forward.
15 But now I want to make sure I'm clear if we
16 adopt the Hearing Division amendment, which is
17 different than what your concern was when you filed
18 your exceptions.
19 MR. KEMPLEY: Mr. Chairman, Commissioner
20 Mundell, I suppose that at this point I would like to
21 hear Qwest's response to that question, because it
22 seems from the way this matter has developed that there
23 may have been some misunderstanding of the relative
24 positions. And that while Staff always supported a
25 suspension of the adjustment, we always recognized that

Page 51

1 the liability would accrue on April 1st and that
2 suspension was not termination.
3 So to the extent Qwest misunderstood Staff's
4 position when they agreed to a stay of the appeals,
5 perhaps it would be best to hear what they have to say
6 now that I think the whole matter is pretty clear. I
7 would hope that they would believe that those appeals
8 should be stayed pending resolution of the whole case,
9 but I would like to hear --
10 COM. MUNDELL: Well, I would, too, and that's
11 why I asked you the question and I said I would ask
12 Qwest. Because, again, balancing the equities, one of
13 the equities here was, okay, let's have this emergency
14 Open Meeting. Let's deal with Qwest's request.
15 And the Commission, if we're balancing the equities, is
16 getting the benefit of not having to litigate that
17 appeal.
18 So I want to be clear, you know, what we're
19 doing here today and what your position is. And it's
20 been my experience that we need to get it on the record
21 with the court reporter here, yes or no, you know, what
22 the position is.
23 CHMN. HATCH-MILLER: Mr. Curtright.
24 MR. CURTRIGHT: Chairman Hatch-Miller,
25 Commissioner Mundell. When we suspended the appeal,

Page 52

1 our understanding was that we would do that while the
2 settlement discussions were proceeding, and that will
3 continue to be our position.
4 COM. MUNDELL: So let me be direct. If we, in
5 fact, pass this order today -- because the settlement
6 discussions are going to continue anyway whatever we do
7 here today. So I heard what you said, but I want to be
8 clear about it. Because, again, I've learned my
9 lesson. I've got to ask the question directly. I know
10 you guys think I'm beating a dead horse.
11 If we pass this recommended order with the
12 Hearing Division amendment, is Qwest going to continue
13 to stay the appeal?
14 MR. CURTRIGHT: Commissioner, I think the
15 answer is yes, but I think it's a matter of
16 indifference to us. Whether this is passed as an
17 amendment or not, we're going to suspend the appeal
18 while we're in settlement discussions.
19 COM. MUNDELL: Well, I guess, Mr. Kempley, is
20 that clear enough? Because I heard, "I think the
21 answer is."
22 MR. KEMPLEY: Chairman, Commissioner Mundell, I
23 believe that is clear enough. It is true that we've
24 previously filed a stipulation suspending the appeal.
25 What Staff was concerned about was that if the

Page 53

1 recommended opinion and order as originally drafted had
2 passed, that Qwest might view that as a reason to
3 reinstate the appeal.
4 COM. MUNDELL: No. I understand that. That's
5 why I asked you.
6 MR. KEMPLEY: It's clear from Mr. Curtright's
7 comments that if you do the recommended opinion and
8 order with the Hearing Division amendment, that Qwest
9 does not intend to reinstate the appeal. It will
10 remain stayed.
11 COM. MUNDELL: Thank you.
12 CHMN. HATCH-MILLER: Okay. Thank you for
13 following up on that.
14 Judge Farmer.
15 CALJ FARMER: Mr. Chairman, Commissioners, I
16 would note on Page 2 of the Hearing Division amendment,
17 oh, about the middle of it where it says: Page 8,
18 delete old Finding of Fact and insert in its place
19 Finding of Fact 19.
20 There is a sentence that says -- that makes the
21 suspension contingent upon the appeals being suspended
22 for a similar period of time. And I would note that
23 it's tied to until final rates are set in this docket.
24 CHMN. HATCH-MILLER: So what are you telling us
25 about Page 8?

Page 54

1 CALJ FARMER: It's on the second page of the
2 amendment. There's a new Finding of Fact that says
3 that the suspension is in place as long as the
4 consolidated appeals are suspended for a similar period
5 of time.
6 CHMN. HATCH-MILLER: Okay.
7 CALJ FARMER: And that is tied to when final
8 rates are set in the docket.
9 CHMN. HATCH-MILLER: Okay. Anything further on
10 this matter? We have before us the amendment to the
11 order.
12 MR. CURTRIGHT: Mr. Chairman, may I ask one
13 question for clarification, please?
14 CHMN. HATCH-MILLER: Mr. Curtright.
15 MR. CURTRIGHT: Judge Farmer in earlier
16 discussion mentioned the words escrow account. It
17 would be our hope that we could simply deal with this
18 as a matter of internal accounting and not have to set
19 up a third-party account.
20 CALJ FARMER: Mr. Chairman, Commissioners, yes.
21 I believe that the intent of this amendment is just a
22 recognition of the responsibility or liability that
23 these funds are owed to ratepayers that's important.
24 And also, if you are getting to the point of
25 doing something on the amendment, I would probably

Page 55

1 agree with Ms. Scott's earlier comment about putting in
2 that old Finding of Fact again, too. I would probably
3 strike that.
4 CHMN. HATCH-MILLER: That one is Page 8, old
5 Finding of Fact 20.
6 CALJ FARMER: Yeah. If you just mark through
7 that and delete that, then that would keep that Finding
8 of Fact in the order and it will be consistent with the
9 ordering paragraph.
10 CHMN. HATCH-MILLER: Anything further about the
11 amendment?
12 (No response.)
13 CHMN. HATCH-MILLER: You want to move the
14 amendment, Commissioner Spitzer?
15 COM. SPITZER: Mr. Chairman, I would move the
16 Hearing Division Proposed Amendment 1, and I would
17 further move the verbal amendment deleting the
18 deletion, Page 8, delete old Finding of fact 20, so
19 that it would be reinstated.
20 CHMN. HATCH-MILLER: So there's an amendment to
21 the amendment proposed, and that has just been
22 stipulated by Commissioner Spitzer to take out of this
23 amendment, the amendment before us, page 8, delete old
24 Finding of Fact 20.
25

Page 56

1 All those in favor signify by saying aye.
2 (A chorus of ayes.)
3 CHMN. HATCH-MILLER: All opposed, nay.
4 (No response.)
5 CHMN. HATCH-MILLER: The ayes have it.
6 Back to the amendment as amended.
7 COM. SPITZER: Mr. Chairman, I would move
8 Hearing Division Proposed Amendment No. 1 as amended be
9 adopted.
10 CHMN. HATCH-MILLER: Anything further?
11 (No response.)
12 CHMN. HATCH-MILLER: All those in favor of the
13 Hearing Division Proposed Amendment No. 1, say aye.
14 (A chorus of ayes.)
15 CHMN. HATCH-MILLER: All opposed, nay.
16 (No response.)
17 CHMN. HATCH-MILLER: The ayes have it.
18 Back to the order as amended.
19 COM. SPITZER: Chairman, I would move the
20 agenda item, Qwest Corporation motion as amended, be
21 adopted.
22 CHMN. HATCH-MILLER: Anything further?
23 (No response.)
24 CHMN. HATCH-MILLER: Hearing and seeing none,
25 Madam Secretary, please call the role.

Page 57

1 SECRETARY HOGAN: Commissioner Mayes.
2 COM. MAYES: Aye.
3 SECRETARY HOGAN: Commissioner Gleason.
4 COM. GLEASON: Aye.
5 SECRETARY HOGAN: Commissioner Mundell.
6 COM. MUNDELL: Aye.
7 SECRETARY HOGAN: Commissioner Spitzer.
8 COM. SPITZER: Aye.
9 SECRETARY HOGAN: Chairman Hatch-Miller.
10 CHMN. HATCH-MILLER: Aye.
11 And by a vote of five ayes and zero nays, we
12 have approved the order in regards to Qwest
13 Corporation.
14 Is there anything further before the Commission
15 in regards to this session?
16 (No response.)
17 CHMN. HATCH-MILLER: Seeing none, we're
18 adjourned.
19 (The Special Open Meeting concluded at
20 2:20 p.m.)
21
22
23
24
25

1 STATE OF ARIZONA)
) ss.
2 COUNTY OF MARICOPA)
3
4
5
6 I, MICHELE E. BALMER, Certified Court Reporter
7 No. 50489 for the State of Arizona, do hereby certify
8 that the foregoing printed pages constitute a full,
9 true and accurate transcript of the proceedings had in
10 the foregoing matter, all done to the best of my skill
11 and ability.
12
13 WITNESS my hand this 11th day of April, 2005.
14
15
16
MICHELE E. BALMER
17 Certified Court Reporter
Certificate No. 50489
18
19
20
21
22
23
24
25