OPEN MEETING AGENDA ITEM

ORIGINAL

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BEFORE THE ARIZONA CORPORATION

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AZ CORP COMMISSION
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IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

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

DOCKET NO. T-00000D-00-0672

EXCEPTIONS OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

The Residential Utility Consumer Office ("RUCO") submits these Exceptions in support of its position that the Arizona Corporation Commission ("ACC" or "Commission") should not approve the Recommended Opinion and Order ("ROO") and should reject the Settlement ("Settlement") entered into on April 23, 2005, between Qwest Corporation ("Qwest") the Commission's Utilities Division ("Staff"), MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Utility Investors Association, Cox Arizona Telecom, LLC, and XO Communications Services, Inc., (collectively "the Parties"). The Settlement is not in the public interest and its approval would result in a lost opportunity for the Commission to address directly the issues that face the telecommunications industry in Arizona as it continues its transition to a truly dynamic, competitive marketplace.

The Commission should take advantage of this docket as an opportunity to analyze the actual state of competition in Arizona, and formulate a strategy that addresses the telecommunications market issues that face the industry and the state, now and in the future. No party disputes that competition has intensified in Arizona since the current price cap plan ("Current Plan") went into effect in 2001. Yet the ROO's answer and the Settlement's approach to the increasing competition that Qwest is experiencing in its wire centers throughout Arizona is to ignore it. In lieu of allowing and encouraging market forces to bear on the demonstrably competitive elements of the Company's business, the Settlement opts for a convenient and admittedly easier solution that is not truly the alternative form of regulation it purports to be. Given the current state of industry competition, it is no longer wise or even appropriate to ignore and/or compromise on the issues that face the telecommunications industry in Arizona. In business areas where Qwest is facing real competition, the Commission should loosen the shackles of regulation, and force the Company to compete like a real business in the real competitive environment in which it now operates.

1) THE SETTLEMENT AGREEMENT IS A LOST OPPORTUNITY FOR THE COMMISSION TO ADDRESS COMPETITION.

RUCO believes that a Commission telecom strategy should provide Qwest with sufficient pricing flexibility to encourage it to behave competitively *in those geographic areas that are now demonstrably competitive.* Instead, the Settlement ignores geographic pricing and adopts a "one price fits all" strategy. Stated another way, irrespective of any consideration by the Commission of the differing levels of competition Qwest faces for any given service in downtown Phoenix, Sunnyslope, Flagstaff, or Sierra Vista, under the Settlement the service is priced the same. The Settlement simply ignores the varying levels of competition Qwest faces in these different service areas.

At the very least, this approach stifles, if not thwarts competition. In its urban service areas, Qwest has no incentive to lower prices if it means having to consequently lower prices in areas where it faces little or no competition. Further, because of the hard cap the Settlement shields the company from competitive pressures to lower its 1FR and 1FB rates in urban areas where it faces the most competition. Ratepayers in urban areas miss the opportunity to benefit from competition, which after all is the subject of this application. Denying Qwest the opportunity to compete and possibly lower its 1FR and 1FB rates is not a benefit to ratepayers. It is precisely this flaw that makes the Settlement counter to the best interests of ratepayers.

RUCO emphasizes that there currently exists significant competition to provide certain telecommunication services in particular geographic areas. RUCO explicitly recognizes the increased level of competition that Qwest faces and agrees with the originally filed cases of both the Company and the ACC Staff that the Commission should carefully, selectively and flexibly modify the existing regulatory model to recognize the changing competitive environment Qwest faces and to encourage the Company to compete in those geographic areas where demonstrable competition exists. A price cap plan which recognizes and responds to geographic and competitive disparities appropriately addresses competition in Arizona and encourages Qwest to behave competitively without being able to exert market power (placing a greater burden on the Company itself to devise effective, non-discriminatory strategies that will return it to financial health). A regulatory system that at once protects consumers from the exercise of monopoly power and encourages Qwest to behave competitively where it faces real competition is in the best interest of ratepayers. The Commission should approve a price cap plan which provides for geographic pricing.

There is no question that the implementation and administration of a geographic pricing model would not be a simple task. The Company, Staff, [1] and RUCO each proposed different geographic pricing models initially. Each party recognized the virtues and need for a geographic pricing model. Staff said the following regarding the "idea of Competitive Zones":

> "Allowing Qwest to have the ability to respond to its competitors does seem fair on its face." S-4 at 20.

Apparently because of the complexity of the proposal, however, the settling parties decided and the ROO endorses the elimination of a geographic pricing model. ROO at 26. The Commission should embrace opportunities to explore ways of enabling this or any other Company to respond nimbly to competitors *where demonstrable and real competition exists*. Moreover, this Commission should never opt for sub-optimal solutions simply because of administrative difficulty. The Commission should take the opportunity presented in this Docket to pro-actively explore ways to encourage Qwest to respond to the level of competition it faces in each of the Company's service areas throughout Arizona.

The notion that geographic pricing in Arizona can and should be examined in another docket on an industry-wide basis (ROO at 26) is misguided. The Commission is considering Qwest's rates **in this docket**. A generic docket designed to discuss the general state of competition in Arizona will not change filed tariffs for any telecom provider. Once the Commission renders its decision **in this docket**, Qwest's pricing structure will be locked in. It

[1] Staff did not oppose the idea of Competitive Zones; however, before Staff could support it Staff set forth several criteria which would have to be addressed. Staff's main requirement was the use of zip codes to define zones and not specific wire centers as the Company proposed. S-4 at pp. 20-44. References to testimony at the hearing are made by identifying the Transcript, followed by the volume number, followed by the page number. References are made to exhibits as they appear in the Transcript of Proceedings.

is absurd and ignorant of reality to suggest that geographic pricing can be meaningfully addressed outside the context of this docket.

2) THE SETTLEMENT AGREEMENT IS A LOST OPPORTUNITY TO ADDRESS THE ARIZONA UNIVERSAL SERVICE FUND (AUSF)

The ROO recommends that the AUSF issue, like the geographic pricing issue, should be addressed in a generic docket. ROO at 26. RUCO has the same concern expressed above regarding the deferral of geographic pricing to another generic docket. Now is the time to consider the Company's proposal to draw from the AUSF to subsidize the high costs of providing residential service to rural areas, not after rates are set and it is too late.

It is appropriate to discuss the AUSF in this docket to the extent it can help foster competition in areas around Arizona where there is little or no competition and address pricing disparities where market forces are insufficient to protect consumers. Qwest was the party that originally advocated its relevance in this docket when it proposed to withdraw $64 million from the AUSF. Transcript at 199. Qwest argued that approval of its request would encourage competition in its high cost centers and promote competitive choices for these consumers. Transcript at 199. Rather than propose an alternative, the settling parties, as with geographic pricing, simply eliminated it from consideration leaving no proposal to help defray the high cost of rural service in this docket. The failure to consider the AUSF in the context of this proceeding is another example of why this Settlement represents a lost opportunity for the Commission to consider and resolve competitive issues that are increasingly the reality of the telecommunications industry in Arizona today. Other states have used Universal Service Funds to help defray the high costs of serving rural areas. RUCO-14 at 20. In fact, the Settlement reduces the amount of cost support provided by access charges, thereby making it even less profitable for competitive local exchange carriers to serve rural areas. Id. The Commission should examine mechanisms to support the high costs of rural lines and encourage competition in rural areas.

3) THE SETTLEMENT FAILS TO PROVIDE ADEQUATE CREDIT TO RATEPAYERS FOR THE 2005 PRODUCTIVITY ADJUSTMENT

In Decision No. 67734 the Commission found that Qwest had the burden of demonstrating by the terms of a renewed plan that ratepayers would be given full credit for the value of the April 1, 2005 productivity adjustment. Decision No. 67734 at page 8. Qwest has failed to meet its burden. The Settlement provides, and the ROO endorses satisfaction of Qwest's obligation by a $12 million reduction in Qwest's allowable net increase in revenues for the first year of the renewed Plan. S -1 at 5, ROO at 26. However, in the absence of Decision No. 67734, ratepayers would have enjoyed real rate cuts of approximately $8 million. RUCO - 8 at 6. By April 1, 2006, ratepayers would have enjoyed rate decreases of the full $12 million under the Current Plan. The $12 million offset to Qwest's year one revenues does not put money back in ratepayer's pockets and/or provide a dollar for dollar benefit in lieu of the 2005 adjustment. An unprovable hint of two birds in the bush is not superior to one bird clearly demonstrated—even ordered—to be in the hand. The Commission should reject the ROO and the Settlement as neither provides ratepayers with adequate "credit" for the 2005 productivity adjustment.

CONCLUSION

The Settlement fails to address the major issues that face the telecommunications industry in Arizona--geographic pricing and competition in both Qwest's urban and rural service areas. The Settlement is nothing more than a convenient, easy and quick temporary fix for a financially ailing company experiencing revenue erosion. The Settlement is not a substitute for a comprehensive and strategic long-term plan designed to effectively facilitate Arizona's transition towards competition and it ignores the existing and increasing dynamism of the competitive telecommunications marketplace.

The Commission should not approve the ROO, and should reject the Settlement and take the opportunity to examine industry competition and to develop a strategic telecommunications regulatory plan for the state of Arizona.

RESPECTFULLY SUBMITTED this 8th day of March, 2006.

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