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BEFORE THE ARIZONA CORPORATION COMMISSION

2003 AUG 29 P 3:08

1
2 MARC SPITZER
CHAIRMAN
3 WILLIAM A. MUNDELL
COMMISSIONER
4 JIM IRVIN
COMMISSIONER
5 JEFF HATCH-MILLER
COMMISSIONER
6 MIKE GLEASON
COMMISSIONER

Arizona Corporation Commission

DOCKETED

AUG 29 2003

DOCKETED BY	
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ARIZONA CORPORATION COMMISSION

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8 IN THE MATTER OF QWEST
CORPORATION'S COMPLIANCE WITH
9 SECTION 252(e) OF THE
TELECOMMUNICATIONS ACT OF 1996.

Docket No. RT-00000F-02-0271

10 IN THE MATTER OF U S WEST
11 COMMUNICATIONS, INC.'S
12 COMPLIANCE WITH SECTION 271 OF
THE TELECOMMUNICATIONS ACT OF
1996.

Docket No. T-00000A-97-0238

13 ARIZONA CORPORATION COMMISSION

Docket No. T-01051B-02-0871

14 Complainant.

15 v.

16 QWEST CORPORATION,

17 Respondent.

18
19 **NOTICE OF FILING**

20 The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing
21 the Testimony of Stephen Ahearn in the above-referenced matter.

22 RESPECTFULLY SUBMITTED this 29th day of August, 2003.

23
Daniel W. Pozersky
24 Attorney

1 AN ORIGINAL AND SEVENTEEN COPIES
of the foregoing filed this 29th day
2 of August, 2003 with:

3 Docket Control
Arizona Corporation Commission
1200 West Washington
4 Phoenix, Arizona 85007

5 COPIES of the foregoing hand delivered/
mailed this 29th day of August, 2003 to:

6 Jane L. Rodda
Administrative Law Judge
7 Hearing Division
Arizona Corporation Commission
400 West Congress Street, Room 222
8 Tucson, Arizona 85701

Mark Dioguardi
Tiffany and Bosco, P.A.
500 Dial Tower
1850 North Central Avenue
Phoenix, Arizona 85004

9 Maureen Scott
Legal Division
Arizona Corporation Commission
10 1200 West Washington
Phoenix, Arizona 85007

Curt Huttzell
Electric Lightwave, Inc.
4 Triad Center, Suite 200
Salt Lake City, UT 84180

11 Ernest Johnson, Director
Utilities Division
Arizona Corporation Commission
12 1200 West Washington
Phoenix, Arizona 85007

Jeffrey W. Crockett
Snell & Wilmer
One Arizona Center
Phoenix, Arizona 85004-0001

14 Timothy Berg
Theresa Dwyer
Fennemore Craig, P.C.
15 3003 North Central Ave., Suite 2600
Phoenix, Arizona 85012

Darren S. Weingard
Stephen H. Kukta
Sprint Communications Company L.P.
1850 Gateway Drive, 7th Floor
San Mateo, California 94404-2467

16 Maureen Arnold
Qwest Corporation
17 3033 North Third Street, Room 1010
Phoenix, Arizona 85012

Andrew O. Isar
TRI
4312 92nd Ave., N.W.
Gig Harbor, Washington 98335

18 Andrew Cain
Qwest Corporation
19 1801 California Street, 4900
Denver, Colorado 80202

Mark DiNunzio
Cox Communications
Cox Arizona Telecom LLC
20 20401 North 29th Ave.
Phoenix, Arizona 85027

21 Michael M. Grant
Todd C. Wiley
Gallagher & Kennedy, P.A.
22 2575 East Camelback Road
Phoenix, Arizona 85016-9225

Richard M. Rindler
Morton J. Posner
Swidler, Berlin, Shereff, Friedman, LLP
3000 K Street, NW, Suite 300
Washington, DC 20007-5116

23

24

1	Raymond S. Heyman Roshka Heyman & DeWulf, PLC One Arizona Center 400 East Van Buren Street, Suite 800 Phoenix, Arizona 85004	Traci Grundon Mark Trincherro Davis Wright Tremaine, LLP 1300 S.W. Fifth Ave., Suite 2300 Portland, Oregon 97201
2		
3	Thomas F. Dixon Worldcom, Inc. 707 17th Street, Suite 3900 Denver, Colorado 80202	M. Andrew Andrade 5261 S. Quebec Street, Suite 150 Greenwood Village, Colorado 80111
4		
5	Richard S. Wolters AT&T & TCG 1875 Lawrence Street, Suite 1500 Denver, Colorado 80202	Al Sterman Arizona Consumers Council 2849 East 8th Street Tucson, Arizona 85716
6		
7	Joyce Hundley U.S. Department of Justice Antitrust Division 1401 H St., NW, Suite 8000 Washington, DC 20530	Brian Thomas Time Warner Telecom, Inc. 223 Taylor Avenue North Seattle, WA 98109
8		
9	Joan Burke Osborn Maledon 2929 North Central Ave., 21st Fl. P.O. Box 36379 Phoenix, Arizona 85067-6379	Jon Poston Arizonans for Competition in Telephone Service 6733 East Dale Lane Cave Creek, Arizona 85331-6561
10		
11	Daniel Waggoner Davis Wright Tremaine 2600 Century Square 1501 Fourth Ave. Seattle, Washington 98101-1688	Eric S. Heath Sprint Communications Company L.P. 100 Spear Street, Suite 930 San Francisco, CA 94105
12		
13	Douglas Hsiao Jim Scheltema Blumenfeld & Cohen 1625 Massachusetts Ave., N.W. Suite 300 Washington, DC 20036	Philip Doherty 545 S. Prospect St., Suite 22 Burlington, VA 05401
14		
15	Diane Bacon, Legislative Director Communications Workers of America 5818 North 7th Street, Suite 206 Phoenix, Arizona 85014-5811	Michael Morris Allegiance Telecom of Arizona, Inc. 505 Sansome Street, 20 th Floor San Francisco, CA 94111
16		
17	Mark N. Rogers Excell Agent Services, L.L.C. PO Box 52092 Phoenix, Arizona 85072-2092	Kevin Chapman SBC Telecom 1010 N. St. Mary's, Room 13K San Antonio, TX 78215-2109
18		
19		
20		
21		
22		
23		
24		

1 Richard Sampson
Z-Tel Communications
2 601 S. Harbour Island, Suite 220
Tampa, FL 33602

3 Gary L. Lane
4 6902 E. First St., Suite 201
Scottsdale, AZ 85251

5 Steven Strickland
SBC Advanced Solutions, Inc.
6 1010 North St. Mary's, Room 13-I
San Antonio, TX 78215

7 Richard Kolb
One Point Communications
8 150 Field Dr., Suite 300
Lake Forest, IL 60045

9 Steven Duffy
Ridge & Isaacson
10 3101 N. Central Ave., Suite 1090
Phoenix, AZ 85012

11 Dennis Ahlers
Eschelon Telecom
12 730 Second Ave South, Suite 1200
Minneapolis, MN 55402

13 Dennis Doyle
Arch Communications Group
14 1800 West Park Dr., Suite 250
Westborough, MA 01581-3912

15 David Conn
McLeod USA
16 P.O. Box 3177
17 Cedar Rapids, IA 52406-3177

18 Frederick Joyce
Alston & Bird, LLP
19 601 Pennsylvania Ave., NW
Washington, DC 20004-2601

20 John Munger
Munger Chadwick
21 333 North Wilmot, Suite 300
Tucson, AZ 85711

22 Deborah Harwood
Integra Telecom of Arizona
23 19545 NW Von Newman Dr., Suite 200
Beaverton, OR 97006

24

Bob McCoy
William Local Network
4100 One Williams Center
Tulsa, OK 74172

Teresa Tan
Worldcom, Inc.
201 Spear St., 9th Floor
San Francisco, CA 94105

Rodney Joyce
Shook Hardy & Bacon, LLP
600 14th St., NW, Suite 800
Washington, DC 20005-2004

Diane Peters
Global Crossing
180 South Clinton Ave
Rochester, NY 14646

Gerry Morrison
Map Mobile Communications
840 Greenbrier Circle
Chesapeake, VA 23320

Metrocall, Inc.
6677 Richmond Highway
Alexandria, VA 22306

Paul Masters
Ernest Communications
6475 Jimmy Carter Blvd, Suite 300
Norcross, GA 30071

Rex Knowles
XO
111 E. Broadway, Suite 100
Salt Lake City, UT 84111

Teresa Ono
AT&T
795 Folsom St., Room 2159
San Francisco, CA 94107-1243

Penny Bewick
New Edge Networks
P.O. Box 5159
Vancouver, WA 98668

David Kaufman
E.Spire Communications
343 W. Manhattan St.
Santa Fe, NM 87501

1 Bob Edgerly
Nextel West Corporation
2001 Edmund Halley Dr.
Reston, VA 20131

3 McLeodUSA Telecommunications Services
Attention: Law Group
P.O. Box 3177
Cedar Rapids, IA 52406-3177

5 Steven Sager
McLeodUSA Telecommunications Services
215 S. State St.
Salt Lake City, UT 84111

7 Gary Kopta
Mary E. Steele
8 Davis Wright Tremaine LLP
1501 Fourth Avenue
Seattle, WA 98101

10 Thomas H. Campbell
Lewis & Roca
40 North Central Avenue
Suite 1900
Phoenix, AZ 85004

12 Harry Pliskin
Senior Counsel
13 Covad Communications Company
7901 Lowry Blvd.
Denver, CO 80230

15 Jacqueline Manogian
Mountain Telecommunications, Inc.
1430 W. Broadway Road, Suite A200
Tempe, AZ 85282

17 Martin A. Aronson
Morrill & Aronson PLC
One E. Camelback Road
Suite 340
Phoenix, AZ 85012

19 Jon Loehman
Managing Director – Regulatory
20 SBC Telecom, Inc.
5800 Northwest Parkway
Suite 135 Room 1.S.40
San Antonio, TX 78249

22 Cynthia A. Mitchell
1470 Walnut Street
Suite 200
Boulder, CO 80302

24

Peter S. Spivack
Martha Russo
Douglas R.M. Nizarian
Hogan & Hartson, LLP
555 13th Street, N.W.
Washington, DC 20004

Mitchell F. Brecher
Greenberg Traurig, LLP
800 Connecticut Avenue N.W.
Washington, DC 20006

Marti Allbright
MPower Communications
5711 South Benton Circle
Littleton, CO 80123

By 
Jennifer Rumph

TESTIMONY
OF
STEPHEN AHEARN

ON BEHALF OF
THE
RESIDENTIAL UTILITY CONSUMER OFFICE

AUGUST 29, 2003

1 Q. Please state your name for the record.

2 A. My name is Stephen Ahearn. My business address is 1110 West Washington,
3 Suite 220, Phoenix, AZ 85007.

4
5 Q. Please state your educational background and qualifications in the utility regulation
6 field.

7 A. I have been employed by the State of Arizona as the Director of the Residential
8 Utility Consumer Office ("RUCO") since January 2003. From 1998 through 1999, I
9 was employed by the Arizona Corporation Commission in the capacity of Executive
10 Consultant. From 1990 to 1998, I was closely involved with utility regulation at the
11 Commission and utility policy-making at the Legislature in my role as the Manager
12 of Planning and Policy at the Department of Commerce Energy Office. Additionally,
13 I have had training in utility ratemaking and telecommunications policy conducted by
14 NARUC and New Mexico State University, respectively. Finally, I have an MBA in
15 Finance from UCLA.

16
17 Q. From what perspective do you offer this testimony?

18 A. I offer my testimony from a public policy orientation, and its emphasis is meant to go
19 directly to issues affecting the integrity of the institution of the Arizona Corporation
20 Commission. I do not offer this testimony as a technical expert; RUCO's technical
21 record in this matter has previously been established in the relevant dockets.

22

23

24

1 Q. Please summarize your testimony.

2 A. My testimony presents RUCO's position regarding the proposed Settlement
3 Agreement reached between Staff and Qwest. RUCO believes that the Settlement
4 Agreement is insufficient and therefore not in the public interest. Most importantly,
5 RUCO believes that Qwest needs to be held accountable and responsible for
6 clearly demonstrated wrongdoing, and that a finding of wrongdoing by the
7 Commission needs to be made in the 252 docket and 271 sub-docket. The reasons
8 why this is of utmost importance will be elaborated upon and developed further in
9 my testimony, and suggestions to address the deficiencies will be provided in the
10 sections of this testimony that follow.

11
12 With regard to the financial elements of the Settlement Agreement, RUCO
13 acknowledges that the Settlement Agreement goes a long way to redress many of
14 the grievances against the company in these combined cases. However, RUCO
15 believes that the Settlement Agreement can be improved in the following ways:

- 16 • Settlement Agreement - §3, p. 6 - RUCO recommends a three year period be
17 considered for the one-time credit (Settlement Agreement provides for a 1 ½
18 year period) and should be applied to all types of services (i.e. not limited to
19 just 252 services). These modifications make the Settlement Agreement
20 conform more closely to the deal Eschelon and McLeod received;
- 21 • Settlement Agreement - §2, pp. 3-6 – regarding “underserved areas”- RUCO
22 recommends a commitment from Qwest of a timetable acceptable to the
23 Commission when broadband services will be available in the underserved
24 areas;

- 1 • Settlement Agreement - § 2, p. 3-6 – The Settlement Agreement should
2 specifically direct that Qwest will not be able to earn a return on any of the
3 so-called “voluntary contributions” investments.
4

5 Q. Was RUCO a party to all the proceedings that are the subject of the Settlement
6 Agreement?

7 A. No. RUCO was not a party to the OSC Docket regarding Qwest’s implementation
8 of wholesale rates. Therefore, RUCO has evaluated the Settlement Agreement
9 only as it relates to the 252 proceeding and the 271 proceeding.
10

11 Q. What was the status of the proceedings prior to the negotiation of the Settlement
12 Agreement?

13 A. The Commission held a hearing in the 252 docket on March 17-20, 2003. Post-
14 Hearing Briefs were filed and the matter has since been under advisement. On May
15 6, 2003, Staff filed its Report and Recommendation in the 271 Sub-Docket. On May
16 19, 2003, Qwest filed exceptions to the Staff Report and requested a hearing.
17 Qwest has since conditionally withdrawn its request for a hearing and has filed with
18 Staff a request for a joint procedural schedule. That request was granted and a
19 hearing to consider the Settlement Agreement is scheduled to commence on
20 September 16, 2003.
21

22 Q. Does RUCO find the Settlement Agreement to be a satisfactory resolution of the
23 252 Docket and the 271 Sub-Docket?

24 A. By itself, no.

1 Q. Why not?

2 A. Essentially, Qwest's conduct was so egregious that the company should be subject
3 to a penalty that goes beyond merely paying money. Qwest not only interfered with
4 the development of the competitive market by discriminating in favor of some
5 competitors and against others, but it also undermined the integrity of the
6 Commission's process to evaluate whether Qwest should be granted authority to
7 enter the interLATA market. In addition, Qwest has demonstrated a history of
8 inaccurately predicting its own performance, resulting in favorable treatment by the
9 Commission. In consideration of this history, the Commission should exercise great
10 caution and specificity in how it orders Qwest to act (or not act).

11
12 Q. What evidence was presented that Qwest interfered with the development of
13 competition?

14 A. The record clearly established that Qwest engaged in discriminatory conduct that
15 favored two CLECs, Eschelon and McLeod, over others. These CLECs were
16 provided pricing discounts unavailable to other CLECs, giving them a competitive
17 advantage.

18
19 Q. What evidence was presented that Qwest undermined the integrity of the
20 Commission's process?

21 A. The record establishes that Qwest entered into, and failed to file, non-participation
22 agreements with two of its largest wholesale customers, McLeod and Eschelon. It
23 is clear from the record that these companies were experiencing significant service-
24 related issues with Qwest. Because of the secret agreements, the Commission

1 was unaware of the service related issues during the course of its 271 process. In
2 the case of Eschelon, relations turned so bad that at one point Qwest attempted to
3 solicit compliance with the non-participation agreement by requesting that Eschelon
4 destroy certain records and file supporting testimony and testify when requested by
5 Qwest and in a manner suitable to Qwest. Throughout this time, Qwest was making
6 its 271 case and assuring this Commission that it was in compliance with the
7 various checklist items required by the Act.

8
9 In addition, it is clear from the record that Qwest deliberately and intentionally failed
10 to file interconnection agreements that, by law, this Commission is required to
11 approve. Those agreements decided such things as rates and services between
12 Qwest and the CLEC. In effect, Qwest, through its actions, assumed the role and
13 carried out the function of the Commissioners.

14
15 Q. What historical events suggest that the Commission should use the utmost care in
16 how it formulates and words its Orders regarding Qwest?

17 A. Historically, Qwest may comply with the letter of this Commission's Orders, but
18 does not always comply with the spirit of the Commission's Orders.

19
20 For example, in Decision No. 62672 (Qwest merger with US West – June 30, 2000)
21 the Commission ordered Qwest, because of the compelling need to upgrade
22 Arizona's rural telephone services, to invest roughly \$48.24 million annually to
23 upgrade or extend services in rural exchanges in "central offices of 50,000 or less
24 access lines." The Commission's obvious intent was to require Qwest to invest in

1 rural service areas. In fact, as the Commission later found out, exchange areas of
2 50,000 access lines include larger metropolitan areas — which were clearly not
3 what the Commission intended in its Decision.

4
5 Q. What other historical events suggest that the Commission should pay very close
6 attention to the positions advocated by Qwest?

7 A. As I previously stated, the Company has a record of predicting highly inaccurate
8 future business scenarios, resulting in undeservedly favorable treatment by the
9 Commission. The 1999 merger docket (T-01051B-99-0497) provides a rich
10 illustration of this corporate shortcoming. Qwest persuaded the Commission to
11 approve the merger, because, according to Qwest, the merger would result in
12 approximately \$18.5 billion of pro-forma year-2000 revenue; during the period from
13 2000 through 2005 the merger would enable Qwest to achieve gross revenue
14 synergies of more than \$12 billion and net financial and operational synergies of
15 approximately \$10.5 to \$11 billion; the merger would result in the acceleration of the
16 deployment of broadband communications; the merger would allow for the
17 redeployment of approximately \$7.5 billion toward new investment in Internet
18 applications and out-of-region broadband access and Internet services; and the
19 merger would actually increase Qwest's incentives to meet consumer demands.

20
21 In fact, what has actually happened to Qwest since the merger has been the subject
22 of newspaper headlines throughout Qwest's fourteen-state region. Since the
23 merger Qwest's credit line has been cut to junk, it's stock price has hit all-time lows,
24 it has been the subject of numerous federal investigations including the SEC's

1 investigation into Qwest's accounting, the US Attorney's investigation of criminal
2 wrongdoing, a congressional investigation in conjunction with Global Crossing, and
3 a US General Service Administration announcement that it would review all
4 governmental contracts that it had with Qwest. Qwest has experienced substantial
5 quarterly revenue losses and announced that it made \$1.5 billion in accounting
6 errors in 2002, creating the scenario that a bankruptcy filing was impending. It was
7 only a short time after the merger that it was clear the merger would not result in the
8 benefits that Qwest claimed.

9
10 Q. Historically, has the imposition of fines/penalties been successful in deterring Qwest
11 from wrongdoing?

12 A. No. In the past, the payment of substantial penalties has not deterred Qwest from
13 wrongdoing. Since 1996, Qwest has paid this Commission over \$4.5 million in
14 penalties regarding the Quality of Service Tariff. Qwest has also paid substantial
15 penalties in other states. In Florida, Qwest paid \$3.25 million to settle slamming
16 complaints, in California Qwest paid \$20 million in penalties for slamming violations,
17 and in Arizona, Qwest settled for over \$3 million to resolve similar type complaints.
18 One can reasonably conclude that Qwest considers fines as a cost of doing
19 business and is not deterred by having to pay them.

20
21 Q. From a policy perspective why do you believe Qwest needs to be held accountable
22 beyond the monetary provisions set forth in the Settlement Agreement?

23 A. Qwest's conduct was egregious and possibly criminal. Qwest's conduct did more
24 than just discriminate against non-party CLECs. Qwest participated in fraudulent

1 schemes that undermined the integrity of this Commission's regulatory process and
2 has jeopardized the credibility of this and future Commissions. There is no discrete
3 dollar value that the Commission can place on the integrity of the process or its own
4 credibility.

5
6 Q. Do you believe that the integrity of the Commission will be restored by the approval
7 of the Settlement Agreement?

8 A. No.

9
10 Q. Why not?

11 A. The public will question the integrity of the process as well as this Commission if the
12 Commission does not act swiftly and appropriately to address Qwest's conduct that
13 undermines the integrity of the Commission's process. A purely financial penalty—
14 one that represents significantly less than one percent of Qwest's reported 2001
15 gross revenues¹ -- will do little to restore the integrity of the process or the
16 Commission, or to seriously give pause to other would-be bad actors. On the
17 contrary, it is likely to further imperil the Commission's integrity and tarnish future
18 regulatory processes by encouraging tolerance of Qwest-like conduct.

19
20 Q. Do you believe that approval of the Settlement Agreement will send the wrong
21 message to utilities contemplating wrongdoing before this Commission?

22 A. Yes.

¹ Using the \$21.317 million settlement maximum set forth in the proposed terms of settlement and dividing that by Qwest's annual Gross 2001 reported revenues (attached as Exhibit SA - 1) the settlement maximum represents .00108 of Qwest's total 2001 revenue (Qwest has not reported it's restated annual 2002 gross revenues).

1 Q. Why?

2 A. Approval of the Settlement Agreement will send the message that companies can
3 engage in wrongdoing without the fear of a finding of wrongdoing. Instead, they will
4 conclude the checkbook solution is available to them, and will plan and scheme
5 accordingly. The decision to engage in wrongdoing will become less an ethical
6 consideration and less a consideration of respect for regulatory authority and
7 regulatory institutions. Instead, it will become an actuarial exercise—a financial
8 calculation of the risk of being caught and the likely penalty if discovered.

9
10 The payment of a large fine in this case will not in itself send the message this
11 Commission should send to Qwest or potential future bad actors. Unfortunately,
12 there is nothing that this Commission can do that will guarantee that Qwest will not
13 engage in similar conduct in the future. However, the Commission does have and
14 should exploit this opportunity to do everything in its power to send a message to
15 Qwest and future companies considering similar illegal conduct that it will not be
16 tolerated in Arizona.

17
18 Q. Why would a finding of wrongdoing by this Commission be a stronger deterrent to
19 Qwest from engaging in wrongdoing in the future?

20 A. First, it will allow the Commission to invoke its contempt powers when Qwest
21 engages in wrongdoing in the future. Second, it will send the message to Qwest as
22 well as other regulated utilities that if they are to engage in future wrongdoing in
23 Arizona, they will not be able simply to buy their way out of it. Third, it will send a

1 message that a decision to engage in wrongdoing will be more than just a financial
2 decision.

3
4 Q. Would a finding of wrongdoing be necessary for the Commission to consider
5 Eschelon and McLeod's participation in the scheme also improper?

6 A. Yes. Qwest was not the only participant guilty of wrongdoing. Eschelon and
7 McLeod were also involved in the scheme. Should the Commission consider
8 holding Eschelon and McLeod accountable, a finding against Qwest is necessary
9 since the scheme involved Qwest. Not finding Qwest responsible for wrongdoing
10 and clearing Eschelon and McLeod of any wrongdoing will compound the
11 consequences of their acts—it will send the message to CLECs contemplating
12 illegal behavior that at least under some circumstance they will not have to fear any
13 consequences from this Commission.

14
15 Q. Would a finding of wrongdoing promote the integrity of the Commission in this
16 case?

17 A. Yes. Allowing Qwest to escape without a Finding offends the notion of justice and
18 would make the Commission appear as though it is more interested in accepting
19 money than in defending the integrity of its processes.

20
21 Q. How do you recommend the Commission proceed to address RUCO's concerns?

22 A. RUCO would not object to the Commission approving the Settlement Agreement as
23 long as the Order granting approval includes a specific Finding of Fact and a
24 corresponding Conclusion of Law that Qwest engaged in practices that were

1 discriminatory and illegal, as well as an ordering paragraph ordering Qwest to cease
2 engaging in discriminatory and illegal conduct.

3
4 Q. How would such terms in the Order assure that Qwest would not behave in the
5 future as it has in the past?

6 A. As I stated above, there is no way to guarantee Qwest's future behavior. At best,
7 the Commission can enter an Order that sufficiently limits Qwest's conduct such
8 that, if Qwest did violate that Order, the Commission can take action pursuant to its
9 contempt powers.

10
11 Q. Doesn't the Settlement Agreement already provide that Qwest failure to comply can
12 be enforced through the Commission's contempt powers?

13 A. Yes, but because an Order that merely adopts the Settlement Agreement would
14 only order Qwest to do certain things, the Commission could not find Qwest in
15 contempt if it did those specific things but engaged in other forms of discriminatory
16 or illegal conduct. By drafting the Order to proscribe a broad category of conduct
17 (discriminatory and illegal conduct), the Commission could find Qwest in contempt
18 for any act of discriminatory or illegal conduct, not just for failing to comply with the
19 narrow requirements of the Settlement Agreement.

20
21 Q. What other provisions of the Settlement Agreement do you feel need to be
22 improved?

23 A. Following is a list of the other components of the Settlement Agreement that I feel
24 can be improved and the reasons why:

1 1) Settlement Agreement - § 3, p. 6 - this section of the Settlement Agreement
2 provides that Qwest will issue a one-time credit to eligible CLECs, equal to a
3 10% of the total amount of services purchased under sections 251 (b) and (c)
4 of the Act. The credit applies to those purchases made during the period of
5 January 1, 2001 through June 30, 2001. *RUCO recommends that this term*
6 *be changed to allow a one-time credit for purchases made during a three*
7 *year period and should be applied to all types of purchases (i.e. not limited to*
8 *just §252 services). The basis for RUCO's recommendation is that the*
9 minimum time period for the Eschelon deal was 5 years and the McLeod
10 agreement had a minimum period of 3 ½ years, and both applied to all
11 purchases. The Settlement Agreement should provide for a discount period
12 that approaches the minimum of what was agreed to in the secret
13 agreements and applies to the same services that were purchased.

14
15 2) Settlement Agreement - §2, pp. 3-6-a - the Settlement Agreement provides
16 that Qwest will make voluntary contributions towards infrastructure
17 investment in unserved and underserved areas throughout Arizona. *RUCO*
18 *recommends a commitment from Qwest of an acceptable timetable when*
19 *broadband services will be available in the underserved areas. RUCO*
20 makes this recommendation because of Qwest's previous promises and the
21 lack of any future timetable for Qwest to comply (See Qwest's statements
22 regarding the deployment of broadband referred to earlier in my testimony
23 and in the merger docket).

1 Moreover, RUCO would also note that Qwest's contributions to implement
2 infrastructure in underserved areas is nothing more than what Qwest has
3 promised before and is responsible for doing. If Qwest is going to be able to
4 use penalty money toward something it has already committed to do, the
5 Commission should at minimum prescribe a timetable and hold Qwest to its
6 word.

7
8 3) Settlement Agreement - § 2, pp. 3-6 – the Settlement Agreement is silent as
9 to whether Qwest will be able to earn a return on its voluntary contributions.
10 *So that there is no misunderstanding, the Commission should include in its*
11 *Order an explicit provision that Qwest will not be able to earn a return on its*
12 *“voluntary contributions.”* Qwest should not be able to earn a return on any
13 of the investments that it makes via the voluntary contributions, any recovery
14 of which would also violate the spirit of the Settlement Agreement. Here, the
15 Commission's intent should be to use the voluntary contributions to improve
16 telecommunication services throughout this state. Were Qwest permitted to
17 earn a return on any of this portion of the Settlement Agreement, it would
18 offset the true amount of dollars being contributed so that less than the full
19 amount that the Commission intended would really be “contributed.”

20
21 Q. Does this conclude your testimony?

22 A. Yes.

23

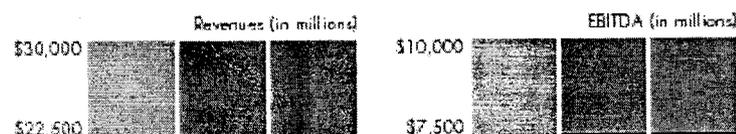
EXHIBIT
SA - 1

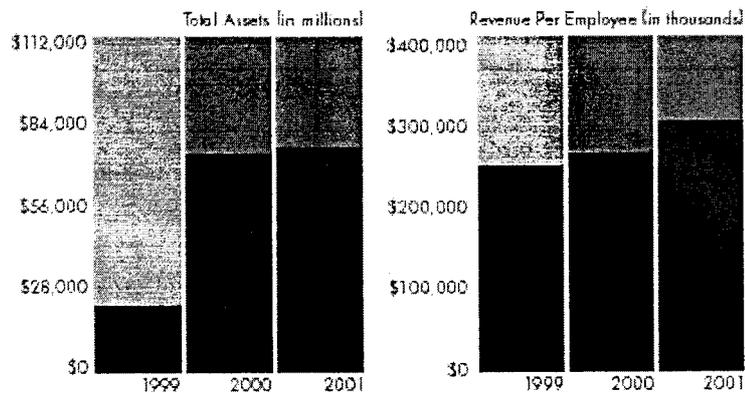
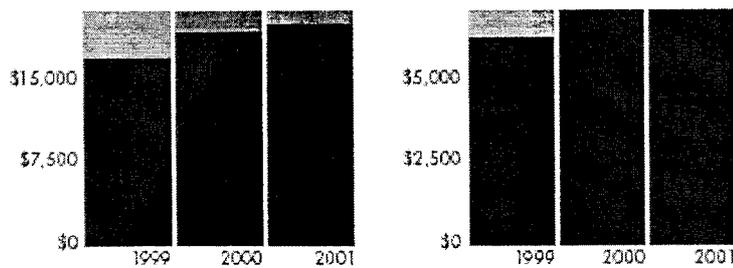


Financial Highlights

Years ended December 31, (in millions, except per share and revenue per employee data)	2001	2000	1999
Revenue⁽¹⁾			
Commercial services	\$ 11,118	\$ 10,466	\$ 8,297
Consumer services	5,900	5,674	5,375
Directory services	1,604	1,530	1,436
Switched access services	1,073	1,284	1,486
	\$ 19,695	\$ 18,954	\$ 16,594
EBITDA⁽²⁾⁽³⁾	7,353	7,369	6,282
Total assets⁽⁴⁾	73,781	73,501	23,272
Pro forma operating income⁽⁵⁾	2,266	3,303	2,475
Revenue per employee	\$305,000	\$265,000	\$250,000
EPS-reported⁽⁶⁾⁽⁷⁾			
Basic	\$ (2.42)	\$ (0.06)	\$ 1.54
Diluted	(2.42)	(0.06)	1.52
EPS-pro forma⁽⁸⁾⁽⁹⁾			
Basic	\$ 0.04	\$ 0.60	\$ 0.41
Diluted	0.04	0.59	0.39
Diluted cash EPS⁽¹⁰⁾⁽¹¹⁾	0.75	1.25	1.08

(1) 2001 amounts represent actual reported results prepared in accordance with generally accepted accounting principles. Unaudited pro forma results for 2000 and 1999 reflect the impact of the Qwest-U S WEST merger as though the merger had occurred as of the beginning of the periods presented. Certain reclassifications have been made to prior year balances to conform to the current year presentation. (2) The 1999 figure reflects U S WEST results only. (3) Results for all years presented have been adjusted for certain non-recurring and non-operating items. See Management's Discussion and Analysis of Financial Condition and Results of Operation on page 43 for a discussion of these non-recurring and non-operating items. (4) Earnings per share calculations for 2000 and 1999 reflect the conversion of each share of U S WEST common stock into 1.72932 shares of Qwest common stock. (5) Earnings before interest, income taxes, depreciation and amortization ("EBITDA") does not include non-recurring and non-operating items such as restructuring charges, Merger-related and other charges, asset write-offs and impairments, gains/losses on the sale of investments and fixed assets, gains/losses on sales of rural exchanges, changes in the market values of investments, one-time legal charges, Separation charges, certain regulatory rate refunds and sales of local telephone exchanges. EBITDA does not represent cash flow for the periods presented and should not be considered as an alternative to net earnings (loss) as an indicator of the Company's operating performance or as an alternative to cash flows as a source of liquidity, and is not necessarily comparable with EBITDA as defined by other companies. (6) Pro forma diluted cash earnings per share represent diluted earnings per share adjusted to add back the after-tax amortization of goodwill and other intangible assets.





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