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BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
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COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

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| IN THE MATTER OF THE PETITION OF AMERICAN COMMUNICATIONS SERVICES, INC. AND AMERICAN COMMUNICATIONS SERVICES OF PIMA COUNTY, INC. FOR ARBITRATION WITH U S WEST COMMUNICATIONS, INC. OF INTERCONNECTION RATES, TERMS, AND CONDITIONS PURSUANT TO 47 U.S.C. § 252(b) OF THE TELECOMMUNICATIONS ACT OF 1996. | DOCKET NO. U-3021-96-448<br>DOCKET NO. U-3245-96-448<br>DOCKET NO. E-3245-96-448 |
| IN THE MATTER OF THE PETITION OF AT&T COMMUNICATIONS OF THE MOUNTAIN STATES, INC. FOR ARBITRATION WITH U S WEST COMMUNICATIONS, INC. OF INTERCONNECTION RATES, TERMS AND CONDITIONS PURSUANT TO 47 U.S.C. § 252(b) OF THE TELECOMMUNICATIONS ACT OF 1996. | DOCKET NO. U-2428-96-417<br>DOCKET NO. E-1051-96-417 |
| IN THE MATTER OF THE PETITION OF MFS COMMUNICATIONS COMPANY, INC. FOR ARBITRATION WITH U S WEST COMMUNICATIONS, INC. OF INTERCONNECTION RATES, TERMS, AND CONDITIONS PURSUANT TO 47 U.S.C. § 252(b) OF THE TELECOMMUNICATIONS ACT OF 1996. | DOCKET NO. U-2752-96-362<br>DOCKET NO. E-1051-96-362 |
| IN THE MATTER OF THE PETITION OF TCG PHOENIX FOR ARBITRATION WITH U S WEST COMMUNICATIONS, INC. OF INTERCONNECTION RATES, TERMS, AND CONDITIONS PURSUANT TO 47 U.S.C. § 252(b) OF THE TELECOMMUNICATIONS ACT OF 1996. | DOCKET NO. U-3016-96-402<br>DOCKET NO. E-1051-96-402 |

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| IN THE MATTER OF THE PETITION OF GST TUCSON LIGHTWAVE, INC. FOR ARBITRATION OF THE RATES, TERMS, AND CONDITIONS OF INTERCONNECTION WITH U S WEST COMMUNICATIONS, INC. PURSUANT TO § 252(b) OF THE TELECOMMUNICATIONS ACT OF 1996. | DOCKET NO. U-3155-96-527<br>DOCKET NO. E-1051-96-527 |

**INITIAL POST HEARING BRIEF**

**OF TCG PHOENIX**

Dated: January 3, 1997.

Michael Morris
Vice President, Regulatory and External Affairs

Deborah S. Waldbaum
Senior Regulatory Counsel, Western Region
TELEPORT COMMUNICATIONS GROUP, INC.
201 North Civic Drive, Suite 201
Walnut Creek, California 94596
(510) 949-0600

BROWN & BAIN, P.A.
2901 North Central Avenue
Phoenix, Arizona 85012
(602) 351-8000

Attorneys for Petitioner TCG Phoenix

By Lex Smith
Lex J. Smith
Michael W. Patten

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## Introduction

The above captioned proceedings arise out of various petitions for arbitration filed by competitive local exchange carriers under 47 U.S.C. § 252 of the Telecommunications Act of 1996 (hereafter the "Act") and under Arizona law pursuant to A.A.C. R.14-3-109H and R14-2-1505.F.3. Public hearings were held in Phoenix commencing on November 18, 1996 and concluding on November 27, 1996. Additional hearings have been scheduled commencing February 27, 1996 on other issues common to the petitions, including quality of service measurement/liquidated damages and the cost apportionment of U S West's electronic interfaces. See Procedural Order dated December 13, 1996. At the conclusion of the consolidated cost proceedings, briefs were ordered and TCG Phoenix ("TCG") hereby submits its initial post hearing brief.

TCG's petition for arbitration was previously heard by the arbitrators and resulted in Decision No. 59873 issued October 29, 1996. U S West filed an application for rehearing of such decision on November 18, 1996 and such application for rehearing was denied by operation of law. In Decision No. 59873, the parties were required to file an interconnection agreement and a preliminary unsigned agreement was filed on November 19, 1996. Although U S West made separate "reservation of rights" filings requesting that the agreement be rejected, final revisions to the agreement were jointly filed by the parties on December 13, 1996. The agreement was approved by the Commission on December 18, 1996 in Decision No. 59937.

On August 8, 1996, the FCC issued its First Report and Order in CC Docket No. 96-96 (hereafter the "Order") and offered guidelines under which local exchange competition would be implemented in accordance with the Act. Various parties, including U S West, challenged the FCC's Order and on October 15, 1996, the United States Court

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of Appeals for the Eighth Circuit stayed part but not all of the Order pending full judicial review.[1]

In issuing the preliminary stay, the court stated that it was concerned that the FCC Order may have undermined the jurisdiction of the states over the pricing of intrastate telecommunications services. It is important to note that the stay does not affect the pricing provisions of the Act in any way and that even if the Order is stayed, state regulatory commissions, in the exercise of their statutory jurisdiction under the Act, can consider the extensive analysis provided by the FCC Order as a guideline for their own action. In Arizona, this is particularly true in view of the Commission's Interconnection and Unbundling Rules, A.A.C. R14-2-1301 through 1311, which were actually adopted before issuance of the FCC's Order in order to "take another step on the road toward a fully competitive telecommunications environment." Decision No. 59761 (issued July 22, 1996) at page 3, lines 11-12. In these rules, the Commission has approved total service long run incremental cost ("TSLRIC") as the "cost standard to be employed by the incumbent local exchange carrier in conducting the cost studies that establish the underlying cost of local exchange carrier services including unbundled essential facilities and services." A.A.C. R14-2-1309. TSLRIC is similar to the total element long run incremental cost standard ("TELRIC") adopted in the FCC's Order. See Order at ¶ 672, ¶ 681 n. 1687. Thus in interpreting Arizona's TSLRIC standards for costing and pricing, this Commission is independently and concurrently exercising its exclusive rate making authority under Article XV Section 3 of the Arizona Constitution and is entitled to examine the FCC's extensive analysis of the subject for guidance if it so elects.

In general, TCG is aligned with other competitive local exchange carriers ("CLECs"), including AT&T, concerning the consolidated common issues of cost and pricing for U S

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[1] Iowa Utilities Board, et al. v. FCC, Case No. 96-3321, 1996 WL 5892 04 (8th Cir. Oct. 15, 1996).

West's unbundled network elements. Accordingly, TCG incorporates by reference the positions set forth by AT&T in its initial post-hearing brief herein concerning the underlying principles to be used in the development of network element pricing. TCG submits that U S West has failed to carry its burden of proof to establish a proper cost basis under the Act for setting the prices needed to bring competition in local exchange telecommunications in Arizona. In this initial filing, TCG will not address all issues raised during the proceeding, but rather will focus on some of the more important matters providing appropriate references to the testimony and exhibits of witnesses. TCG specifically reserves the right to respond to any party's positions concerning any issue in TCG's post-hearing reply brief. Throughout this brief, the various parties will be referred to as follows: AT&T Communications of the Mountain States, Inc. ("AT&T"); MCI Metro Access ("MCI"); Sprint Communications Company, L.P. ("Sprint"); American Communications Services, Inc. ("ACSI"); MFS Communications Company ("MFS"); GST Tucson Lightwave, Inc. ("GST") and Brooks Fiber Communications of Tucson, Inc. ("Brooks"). References to particular pages of the hearing transcript will appear as "TR" and the parties' exhibits will be identified with a prefix (e.g. AT&T, U S West, etc.) denoting the sponsoring party.

I.

U S WEST COST STUDIES

A. U S West's Cost Studies Are Overstated, Unreliable and Should Not be Used as the Basis for Setting Prices Under § 252 of the Act or Under the Commission Rules.

In the pre-filed submissions of the various parties, there was much discussion questioning the many U S West cost studies that were offered in support of the prices proposed by U S West. U S West sought unsuccessfully to explain the differences in the studies by referring to "further analyses" or "reexamination" of assumptions of prior cost studies submitted using similar costing principles such as TSLRIC. In the final analysis, U S West's version of a cost model--the so-called RLCAP model--produced a price scheme that was completely at odds with the cost submissions of the other parties and was approximately 2½ times the guideline rate established in the FCC's Order. It was revealed during the hearings that years earlier U S West itself had sponsored TSLRIC and related studies that produced costs for the local loop that were at or below the costs being submitted by AT&T and others in this proceeding. One of AT&T's experts, Dr. Thomas M. Zepp, concisely summarized this anomaly as follows:

> In all the various states that I've worked in over the last 10 or 12 years, the loop cost estimates made by U S West were very close to the estimates that we now see being produced with the Hatfield model. Maybe actually the U S West numbers were a little lower, and that's just the fact. It's only the recent changes and assumptions that have been made by U S West in their models that have jacked these costs up to the $30 range. TR 980, lines 8-16.

In fact, in U S West's most recent rate case in Arizona, long run incremental cost studies were submitted by U S West to justify its requested residential rates. See Re U S West Communications, Inc., Decision No. 59827 (January 3, 1995) (Commission adopts $13.18 residential one party rate).

In TCG's earlier arbitration, heard months before U S West witnesses filed their "latest" cost studies in this consolidated case, TCG's consultant, William Page Montgomery, accurately observed that U S West's changing cost studies were "not facially credible."[2] TCG Exhibit 2, direct testimony at 42. Other witnesses described the results and aspects of the studies to be "suspect." TR 1428, line 18 (Mr. Zubkus); TR 1246, lines

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[2] Its appears that U S West's continuing barrage of cost studies has not abated even though the record in this case is now closed. On December 23, 1996, U S West submitted to the Chief Arbitrator eight "updated" or "revised" cost studies and one entirely new study that had never been submitted before. None of these studies are appropriate for consideration in this proceeding. In the event that this "notice of filing" is deemed by the Arbitrators as an "offer" of exhibits into evidence, TCG respectfully objects. These new studies are untimely, prejudicial, in violation of the procedural orders herein and should not be any part of this case.

8-9 (Mr. Artman). Most of the witnesses that tried to examine RLCAP came away scratching their heads wondering how to validate the inputs asserted by U S West. The inputs were secret; they were confidential. Even when the U S West model was installed in a dated software program--Symphony--the basic inputs could not be evaluated properly. TR 916-17 (Dr. Zepp); TR 1123-24 (Mr. Solomon); TR 1372-74 (Dr. Cabe). It was just one week before the hearings that RLCAP became able to be reviewed in Excel on a compact disk (TR 71-72; TR 420). These factors and others led various witnesses to refer to the model as a "black box." MCI Exhibit 1, pages 26-27 (Dr. Cabe); TR 1120-21 (Mr. Solomon); AT&T Exhibit 9, pp. 15-18 (Dr. Zepp). Moreover, the RLCAP cost proposal is used only by U S West and not by any other regional Bell operating company (TR 41, lines 5-9) and similar U S West "incremental cost" studies have been severely criticized by other state regulatory commissions. TR 244-45 (Ms. Santos-Rach). See, e.g., Re U S West Communications, Inc., Docket No. 95-049-05, Report and Order (Utah Pub. Serv. Comm'n Nov. 6, 1996); Washington Utilities and Transportation Commission v. U S West Communications, Inc., Docket No. UT-94-1464, 1995 WL 735315, *72, Fourth Supplemental Order Reporting Tariff Filings and Order Refiling and Granting Complaints in Part, (Wash. Util. Trans. Comm'n. Oct 31, 1995) (commenting about U S West's "protracted inability to produce respectable, auditable and 'checkable' cost studies . . . ."); Washington Utilities and Transportation Commission v. U S West Communications, Inc., Docket No. UT-950200 15th Supplemental Order (Wash. Util. Transp. Comm'n. April 11, 1996), 169 P.U.R. 4th 417 (1996) (U S West's cost studies rejected).

In a recent state arbitration under the Act, the Iowa Utilities Board criticized the U S West cost studies for being unverifiable and not using publicly available information Preliminary Decision of the Iowa Utilities Board, Docket Nos. ARB-96-1, ARB-96-2, issued October 18, 1996. The Iowa Board approved use of the Hatfield Model as the "most credible" cost study in the proceeding. Id.

TCG submits that for the reasons set forth in the testimony of AT&T witnesses and the brief of AT&T, the principles encompassed in the Hatfield Model should be the preferred basis for setting TELRIC prices. TCG's position concerning prices for resale services is set forth at Section III, below.

In the pages that follow, TCG will examine particular deficiencies of RLCAP to demonstrate that there is significant upward bias and unreliability in the prices proposed by U S West.

B. <u>Alleged "Depreciation Reserve Deficiency"</u>.

After the filing of direct testimony, U S West claimed it should be entitled to levy a theoretical depreciation reserve deficiency ("DRD") surcharge as part of the CLEC's price for access to U S West's local loop facilities. Although U S West witness Susanne Mason claimed that the DRD surcharge was appropriate under the Commission's Interconnection and Unbundling Rules, A.A.C. R14-2-1310 as a "verifiable indirect cost," this claim was not a part of U S West's initial presentation. TR 674, lines 9-25; TR 675, line 1 (Ms. Mason). This post-hoc rationalization seems specious at best. There are many reasons why the late filed depreciation surcharge concept should be rejected:

(1) First, U S West's claim is an attempt to recover embedded costs, TR 706, lines 6-8 (Ms. Mason), and is improper. Embedded cost recovery is not a proper element of a forward looking and efficient TELRIC or TSLRIC methodology. It is prohibited by the Act in Section 252(d)(1)(A)(i) and it has been rejected by the FCC Order, at paragraphs 704-06. Moreover, U S West itself has <u>agreed</u> that TSLRIC should not reflect embedded costs. See Principle No. 7, Consensus Principles Report submitted by Susanne Mason to Gary Yaquinto October 11, 1995 (U S West Exhibit 1, Attachment 2, Direct Testimony of Ms. Santos-Rach) ("TSLRIC studies shall be 'forward looking,' i.e. they shall not reflect a company's embedded base of facilities.") (hereafter "Consensus Principles"). U S West's DRD surcharge assertion flies in the face of this imposing array

of authorities and is in complete defiance of its <u>own</u> <u>commitment</u> to adhere to the Consensus Principles.

(2) Second, U S West's claim in this proceeding interferes with a separate application initiated before this Commission by U S West in October, 1995 in which accelerated depreciation lives for certain U S West plant are in issue. <u>See</u> U S West Exhibit 28. U S West now improperly asks the Commission to leapfrog over this separate application submitted over a year ago, accept its results as established without analysis--since Commission staff has not analyzed the claim in either proceeding--and take on blind faith that it is proper to assess the new entrants with an extra surcharge in order to obtain access to its essential facilities.

(3) Third, in a forward looking competitive environment, U S West's embedded costs are irrelevant. As concisely put in MCI's Exhibit 6, lines 8-13:

> Embedded costs do not reflect current efficient technology but rather have arisen from a mixture of vintages embodying different technologies, installed in an incremental fashion as each technology became available, in an environment of growing demand. Embedded costs of existing regulated monopolists probably do not reflect minimum cost of any of the changing environments in which investments were made because the regulated firm has not faced incentives for cost minimization.

U S West's assertion that it will be "hindered" as a competitor unless it can recover this depreciation surcharge is simply untrue. As MFS' witness Mr. Artman accurately stated, a perceived depreciation difference from prior times "has very little, if any, effect on pricing or competition decisions on a going forward basis." TR 1235, lines 5-7.

(4) Fourth, U S West's DRD claim is an improper attempt to collect depreciation twice. Since depreciation is one of the three components of the TELRIC of a network element (Order at ¶ 703), a second bite at allegedly unrecovered depreciation costs amounts to double-dipping. As GST's witness Mr. Zubkus observed:

> So if you include a reserve deficiency you are double counting. You are including it in the TELRIC, and then you are again including it in the reserve deficiency. TR 1423, lines 2-5.

Stated differently, this double-counting effect is in effect a ". . . tax intended to provide a subsidy to U S West which favors neither deregulation nor the development of competition." Rebuttal testimony of Dr. Cabe, MCI Exhibit 4, page 1. Moreover, from the economist's viewpoint, this "tax" "distorts prices at the margin [and] frustrates both what the act and this Commission's rules" are trying to accomplish. TR 1283, lines 5-8 (Mr. Hubbard).

(5) Fifth, "theoretical" differences between U S West's embedded costs and their present value must first be established, if ever, in appropriate proceedings before the Commission. Until such time as they are properly examined, analyzed and verified, they remain theoretical and should not be accepted on U S West's mere assertion.

(6) Finally, U S West offers no authority, other than its outstretched hand, to support the lawfulness or reasonableness of the depreciation surcharge concept. The Commission need not debate whether the proposed DRD surcharge really amounts to retroactive rate making (it may). Rather, since the focus in an TELRIC study is forward looking and the U S West proposal is backward looking, it is simply inappropriate and should be rejected.

C. <u>U S West's Proposed Capital Structure and Cost of Capital is Speculative and Unsupported.</u>

Under the FCC's Order (¶ 702), the company's existing approved cost of capital and capital structure is preferred unless the company demonstrates that a different cost of capital is justified. In <u>Re U S West Communications, Inc.</u>, Decision No. 58927, (January 3, 1995), the Commission approved U S West's capital structure and established an overall weighted average cost of capital and allowed return for ratemaking purposes. The currently approved capital structure for U S West is 61.7% equity and 38.3% debt. The currently approved cost of equity is 11.4% and the cost of debt is 7.09%. As authorized by Decision No. 58927, and as a fallout from the foregoing costs, the overall weighted average cost of capital is 9.75%.

As part of its RLCAP model, U S West proposed to throw these recent Commission approved determinations to the winds and offered a completely speculative and unsupported capital structure of 72% equity and 28% debt and a composite cost of capital of 11.4%--a full 165 basis points above the currently authorized levels. To place this amount in perspective, if an 11.4% cost of capital were to have been applied in U S West's last rate case (Decision No. 58927), the result would have been a rate increase for U S West of $67 million, more than double the $32 million amount authorized by the Commission.

The witness sponsoring this ledgermain was U S West's Mr. Cummings, the same witness who testified in the company's last rate case (TR 398; lines 24-25; TR 399, lines 1-2). The basis for Mr. Cummings' proposal is a "market value" version of cost of capital. The stock price of U S West is multiplied by the number of shares outstanding to yield an equity capitalization as of December 31, 1995. Then both long and short term debt as well as capital leases are figured in to arrive at a debt capitalization component. The debt and equity components are added together to obtain total capitalization and the respective percentages offered are 72% equity and 28% debt. See U S West Exhibit 1, Attachment 8 at pages 4-7 (Affidavit of Mr. Cummings attached as an exhibit to the direct testimony of Ms. Santos-Rach, U S West Exhibit 1). There are many problems with this approach which yields numbers and results that are at best counterintuitive.

1. U S West's Market Value Approach

Under Mr. Cummings' "market value" approach, the equity ratio increases as the stock price increases. If U S West's stock goes to $50 per share, under Mr. Cummings' approach, the Commission should immediately tack on another six percentage points to the equity ratio thus raising it to 78%. With each increase in U S West's stock price, the equity ratio increases and, correspondingly, U S West's calculated overall cost of capital also increases. Under RLCAP, as the weighted average cost of capital increases, the price of the network element <u>also</u> increases. So, according to Mr. Cummings, higher U S West stock prices and increased company market capitalization mean higher prices charged all CLECs for unbundled elements; and lower stock prices and decreased market capitalization mean lower unbundled element prices. We respectfully must ask what is wrong with this picture? Network element prices should not be dependent on the vagaries of U S West's stock price.

2. <u>U S West's Adjustments are Hypothetical and Inappropriate</u>

Under U S West's last rate order, Decision No. 58927, the company's approved (actual) capital structure was 61.7% equity and 38.3% debt. In Mr. Cummings' "market" proposal, the capital structure becomes 72% equity and 28% debt. Under Decision No. 58927, the cost of equity for the approved (actual) capital structure was determined to be 11.4% and the cost of debt was set at 7.09%. Mr. Cummings' proposed capital structure is claimed to be "actual" but it is unrelated to reality. The cost of equity is proposed at 12.85% and the cost of debt is set at 7.5%. The anomaly is obvious: although Mr. Cummings' "new" capital structure is more equity rich (by 10 percentage points), the asserted cost of equity, instead of being lower, is in fact higher by 145 basis points (12.85-11.40=1.45%). Similarly, although the "new" capital structure is less debt dependent (by about 10 percentage points), the asserted cost of debt, instead of being lower, is <u>higher</u> by 41 basis points.

The "going forward" capital structure of 72% equity and 28% should produce lower costs of both equity and debt under accepted finance theory:

> . . . it is a rudimentary tenet of basic finance that the greater the amount of financial risk borne by common shareholders, the greater the return required by shareholders in order to be compensated for

> the added financial risk imparted by the greater use of senior debt financing. In other words the greater the debt ratio, the greater is the return required by equity investors. Both the cost of incremental debt and the cost of equity must be adjusted to reflect the additional risk associated with the hypothetical capital structure. The arguments work in reverse if a hypothetical capital structure consisting of less debt than the actual were to be imputed.

R.A. Morin, Regulatory Finance at 439 (1994) (emphasis added).

Here, Mr. Cummings indeed made adjustments to the cost of debt and cost of equity for his proposed higher equity capital structure. Inexplicably, however, these adjustments go in the wrong direction--UP--and thus increase the costs for new entrants to compete.[3]

3. Adoption of Mr. Cummings' Proposed Higher Equity Ratio and Higher Costs of Capital Would Result in Pure Windfalls for U S West Shareholders

The counterintuitive increase in U S West's proposed cost of equity and debt under a higher equity ratio hypothetically and unnecessarily increases U S West's overall cost of capital. If TELRIC prices are established using these fictional increased costs there is an obvious resulting windfall to U S West shareholders.

First, it should be remembered that U S West's debt ratio is the result of actual contract commitments between the company and holders of its debt securities. These are fixed rate obligations established when the respective debt issues were sold to the public. U S West's actual debt costs are measurable and were found by the Commission to be 7.09 percent. Decision No. 58927 at p. 65. When a fictional debt cost is used (here a proposed 7.5 percent) in determining a cost of capital that is higher than U S West's actual fixed contract debt, there is a resulting overallowance for the cost of debt. If a "market" measure of cost of debt exceeds U S West's actual debt cost, the difference would not

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[3] Mr. Cummings' citation (U S West Exhibit 10, pp. 2-3) to Brealey and Meyers, Principles of Corporate Finance is erroneous. The quote cited appears in a footnote on a different page than the one cited and is taken out of context. However, the quotation is interesting because it supports the use of book value of debt in determining cost of capital, a point addressed in the next section.

accrue to the bondholders, but rather would be enjoyed by the stockholders because of the fixed nature of the contract debt obligation. Why should TELRIC prices be set to artificially overcompensate U S West? To prevent such windfalls, U S West's actual cost of debt--recently found by the Commission to be 7.09 percent--should be used in determining cost of capital.

Second, the Commission's recently approved capital structure of 61.7 percent equity and 38.3 percent debt was approved in order to compensate U S West for a degree of business risk associated with competition. Indeed, the Commission specifically stated: "However, with increasing competition we find a conservative capital structure is appropriate for the Company." Decision No. 58927, p. 64, lines 21-23. It should be noted that in adopting U S West's actual capital structure, the Commission specifically stated that it was "on the high end of a reasonable range." Id., lines 20-21. Surely, if 61.7 percent equity is on the "high-end," then U S West's proposed use of a 72 percent equity ratio is completely unjustified even in a so-called forward looking environment.

In sum, the natural outgrowths of U S West's proposed cost of capital and capital structure are higher costs for new entrants and windfalls for U S West shareholders. These should be avoided--not encouraged--by the Commission.

4. The Onset of Competition in Telecommunications Has Been Widely Expected and is Already Reflected in the Securities Markets

The coming of competition in telecommunications has been widely expected for many years in the industry as well as the securities markets. At least two years before the passage of the Act, Arizona was holding workshops with affected parties concerning competition. Proposed rules were developed by the Commission's Utilities Division Staff in December, 1994. Many states were considering competitive telecommunications initiatives by way of rulemakings or legislation. In fact, the Order contains many references to the states' prior efforts in promoting local exchange competition. See, e.g., Order at ¶ 53. These are matters of common knowledge that are already reflected in the capitalization ratios and costs of capital of the affected companies including U S West.

U S West's proposed ten percentage point increase in its equity ratio as a "going forward" adjustment is simply another example of apparent double counting. Assuming the company's existing capital structure contemplates the onset of competition (as the Commission duly noted in Decision No. 58927), the allowance of an additional--even higher--equity ratio is unnecessary and inappropriate.

5. <u>Value Line Investment Survey Forecasts an Increase--not a Decrease--in the Debt Ratio of U S West Communications Group</u>

Value Line Investment Survey ("Value Line") is a respected information tool used by investors and security analysts in evaluating potential investments. Value Line regularly makes forward looking estimates of various investment indicators including capital structure. TCG Exhibit 1. (Value Line Report Dated October 11, 1996.) Value Line projects that in three to five years, U S West Communications Group operations should have a capital structure consisting of 52 percent debt and 48 percent equity. The Value Line estimate represents a ten percent decrease in the equity ratio and a ten percent increase in the debt ratio of the company from that presented by Mr. Cummings in this proceeding. This projected capital structure change is exactly the <u>opposite</u> of Mr. Cummings' proposed <u>increase</u> in equity ratio and <u>decrease</u> in debt ratio for the communications group and results in a significantly lower overall cost of capital for U S West.

There is every reason to believe that the Value Line projection is reasonable. Mr. Cummings' proposed capital structure would lead to a <u>higher</u> overall cost of capital (11.4 percent versus 9.75 percent) and implies that U S West management will intentionally resort to financing of capital expansion in competitive markets using <u>higher</u>

. . .

(instead of lower) capital costs.[4] If U S West's actual weighted average cost of capital is 9.75 percent, would management seriously consider manipulating its equity ratio to result in higher costs of financing for the company's ongoing operations? This doesn't make sense but is plainly the thrust of Mr. Cummings' inappropriate proposal to use 11.4 percent as the weighted average cost of capital. As the Value Line projection reflects, it is far more likely that financing of new capital expansions will be through lower cost debt issues--not new equity, thus resulting in a somewhat more debt dependent capital structure.

### D. <u>The Revenue Loss Scare Tactic Should be Ignored by the Commission as Pure Speculation.</u>

U S West witness Mr. Thompson claims that when local exchange competition occurs, U S West will suffer "devastating affects [sic]" (U S West Exhibit 4, page 5, line 7). These speculative claims are unfounded.

#### 1. <u>Mr. Thompson's "Analysis" of Assumed Cash Flow Reduction is Flawed and Should be Rejected</u>

Mr. Thompson submitted an "analysis" that was really no analysis at all but rather an "assumed" cash flow scenario that teetered on incomplete assumptions. Mr. Thompson finally admitted that his cash flow exhibit was simply an "illustration" or a "what if" type of exercise and that he personally made no study to determine whether, <u>in fact</u>, U S West would suffer <u>any</u> loss of revenues with the introduction of competition into local exchange services. TR 332, lines 11-16; TR 334, lines 3-11.

The "gloom and doom" picture painted by Mr. Thompson is self-fulfilling because of the restricted assumptions made by the witness. Basically, Mr. Thompson hypothesized

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[4] Mr. Cummings answered a hypothetical stating: "An increase in the cost of capital of 200 basis points would increase the costs that U S West faces, yes." TR 390, lines 5-7.

that if U S West lost 30 percent of its customers, and if the FCC proxy rates for interconnection were substituted, there would be a 22 percent reduction in revenues. The self-fulfilling nature of Mr. Thompson's presentation was revealed in questions from the bench by Arbitrator Behun:

> Q: (BY ARBITRATOR BEHUN) So the entire whole of the service you considered was U S West's market within Arizona?
>
> A: Yes.
>
> Q: And with competition, you assumed that some of that would go away?
>
> A: Yes, that we would have that 30 percent loss of customers.
>
> Q: So based on your assumptions, U S West had to have lost money; isn't that correct?
>
> A: Yes.

TR 349, lines 19-25; TR 350, lines 1-4 (emphasis added).

The fallacy of Mr. Thompson's presentation lies in the fact that he failed to consider any of the myriad factors that would offset or even increase revenues for U S West in competitive markets.

First. Mr. Thompson took no account of the likelihood that the overall telecommunications market may grow as a result of competition (TR 311, line 25; TR 312, lines 1-2) as in fact occurred in the competitive interexchange market. He simply "took a picture at a point in time" (TR 312, line 2) although acknowledging that the market might in fact grow because of competition (TR 312, lines 16-18). Indeed, market growth is a real possibility because after the divestiture of AT&T, its market share declined but its overall revenues increased (TR 324, lines 3-10). Mr. Thompson, however, assumed no growth would occur at all.

Second, the witness took no account of the additional revenue to be enjoyed by U S West as a result of its expected entry into interLATA markets (TR 321, lines 21-24;

TR 349, lines 9-11). The revenues to be enjoyed from the interLATA toll business to come are certainly going to be significant. For example, a recent Wall Street Journal article described the results of GTE's entry into the competitive interLATA toll market. After only ten months' effort, GTE has signed up more than 750,000 long distance customers, surpassing its own projection by 10 percent. See article at Tab 1 of the Appendix. As Mr. Siwek observed, the expected revenues from entry into the interLATA market must be considered in order to evaluate the "overall picture" for future revenues (TR 856-57; TR 858, lines 1-8).

Third, the witness took no account of the cost savings to U S West from leasing unbundled network elements instead of operating them (TR 321, lines 13-17).

Fourth, he took no account of the savings to U S West of network investment as a result of provision of service by other facilities-based competitors (TR 322, lines 16-25).

Fifth, he took no account of the possibility of offsetting revenue allocations from the federal universal service fund (TR 329, lines 19-25; TR 330, lines 1-16) and he was unfamiliar with the operations of the Arizona Universal Service Fund (TR 341-343).

As Ms. Behun's questions indicated, Mr. Thompson's "analysis" was one-sided and its "devastating affects [sic]" were pre-destined to occur.

2. Contrary to Mr. Thompson's Speculation, Securities Analysts are Forecasting Positive--Not Negative--Revenue Growth for U S West and U S West is Currently Enjoying Robust Revenue and Access Line Growth

The Value Line report on U S West Communications Group (TCG Exhibit 1) tells a radically different story about the company's projected financial future. Value Line estimates that the communications group will enjoy a 6½ percent increase in 1996 revenues over 1995; a 5 percent increase in estimated 1997 revenues over estimated 1996; and a projected 3-5 year revenue growth of about 18 percent over the estimated experience for 1996. Value Line estimates annual revenue growth of 3.5 percent through the 3 to 5 year period ending in 2001. Similarly, the company's cash flow, earnings and book value are forecasted to increase annually on a going forward basis for 4 to 7.5 percent, respectively, over the same 3 to 5 year period. Id. The Value Line Report is attached hereto at Appendix Tab 2.

Meanwhile, U S West itself has proclaimed star billing for its recent financial performance: "U S West Communications Group Records Another Quarter of Strong Growth in Core Operations; Access Lines and Volumes at Record Levels" (ACSI Exhibit 7, October 23, 1996 News Release of Third Quarter, 1996 Performance). These results are asserted to be "among the best in the industry." Id. Further examples of U S West's robust financial condition are touted in the press release: "[A]ccess line growth, among the strongest in the nation, continues to accelerate in U S West Communications' 14-state region . . ."; ". . . strong local service revenue growth of 9.3 percent"; and "Increased volume due to unprecedented access line growth--resulting from the strong regional economy of the west . . .". Id. The quarterly earnings press release is attached hereto in its entirety at Appendix Tab 3.

The dichotomy is apparent and we are left to ask: who's kidding who? While Mr. Thompson is forecasting "devastating" financial losses, the investment community and U S West itself see stable growth at present and into the future. It should be noted that according to Value Line, U S West Communications Group enjoys the highest rating for "Safety" (1) and the second highest rating for "Financial Strength" (A+). These strong financial indicators seriously call into question Mr. Thompson's artificial revenue loss scenario as well as Mr. Cummings' plea for a higher risk-adjusted cost of equity.

3. U S West is not Legally Entitled to Protection from the Effects of Competition in Any Event

The implicit theme of Mr. Thompson's testimony (and indeed U S West's entire presentation) is that the Commission has a duty to insure U S West shareholders against all effects of competition. As U S West sees it, the Telecommunications Act of 1996 should be renamed as the "RBOC's Revenue Protection Act of 1996." The Commission's Competitive Service Rules and the Act announced changes in state and national policy in order to foster competition in telecommunications. Contrary to Mr. Thompson's implication, however, U S West is not legally entitled to demand "protection" (constitutional or otherwise) against the effects of competition. Tennessee Electric Power Company v. Tennessee Valley Authority, 306 U.S. 118, 139, 141 (1930); Law Motor Freight, Inc., et al. v. Civil Aeronautics Board, 364 F.2d 139, 144 (1st Cir. 1966); cf. Market Street Ry. Co. v. Railroad Comm'n, 325 U.S. 548, 567 (1945).

For the foregoing reasons, the arbitrators should ignore the speculative, unfounded and irrelevant "illustration" of alleged loss revenues offered by Mr. Thompson.

E. The Assumption of RLCAP that 82 Percent of Trenching Will be Under "Difficult" or "Developed" Conditions is Unreasonable and Unsupported.

1. The 82 Percent Developed Ratio

One of the assumptions used in RLCAP is that 82 percent of the trenching necessary to install communications cable will be performed in areas which are fully "developed" and that the construction conditions will be difficult, and in 18 percent of the conditions, trenching is in "undeveloped" areas with low trenching costs. Trenching costs form a large part of the TELRIC for cable and contribute significantly to the cost of the reconstructed local loop. The hypothetical task of reconstruction of the network using forward looking incremental costs under so called "scorched node" conditions has provided U S West with a unique opportunity to drive up the TELRIC of the local loop simply by using changes in assumptions concerning construction conditions. In fact, before passage of the Act, U S West used virtually the opposite developed/undeveloped ratio in its cost study presentation in Colorado. There, "80 percent" [of construction conditions] were easy/undeveloped, and 20 percent [were] hard/developed . . ." (TR 137, lines 11-18).

After U S West's consultants received their assignment to derive a post-Act TELRIC cost methodology, the developed/undeveloped assumptions were magically transformed into the costly 82/18 ratio used in RLCAP (TR 90, lines 16-23). Chief Arbitrator Rudibaugh cut to the chase on this matter when he asked Ms. Santos-Rach whether there have "been any significant changes in U S West's costs in the last several years" (TR 87, lines 24-25; TR 88, line 1). The witness responded by saying that the changes were in "cost methodology" rather than the costs themselves (TR 88, lines 13-15). The Arbitrators should therefore view this change as pure opportunism by U S West rather than a coincidental review and revision of dated assumptions used from prior cost studies.

2. The 82 Percent Developed Ratio Ignores the Commission's Rules and U S West's Tariffs

RLCAP's use of the 82 Percent Developed Ratio substantially increases the TELRIC of the local loop. However, since at least 1983, developers in Arizona have been required in new subdivisions to advance all costs of construction for underground communications infrastructure to the incumbent local exchange carrier. A.A.C. R14-5-506E.3. Regardless of whether trenching conditions were "easy" or "difficult" or whether the subdivision occurred in a "developed" or an "undeveloped" area, it was always the developer--not U S West-- that bore the entire cost of trenching and related earthwork construction:

> 2. The developer shall provide the trenching backfill (including any imported backfill required), compaction, repaving, and any earthwork required to install the underground communication system all in accordance with the reasonable specifications and schedules of other utilities in the same area when feasible. . . . [Alternatively] the utility may elect at the developer's expense to perform the activities necessary to fulfill the developer's responsibility hereunder.

Id. (emphasis added)

. . .

The Arbitrators can take administrative notice that significant new residential development has occurred in recent years in Arizona's metropolitan areas, especially Phoenix and Tucson. A recent article concerning United States Census Bureau data described Arizona as the "second fastest growing state" in the country. Wall Street Journal, December 31, 1996 at 2, appearing at Appendix, Tab 4. It is safe to say, therefore, that at least since 1983, a significant portion of U S West's current access lines have resulted from new residential subdivision development growth. Whether developed or undeveloped, these are areas in which U S West should have incurred no trenching costs whatsoever. The Commission's rule, R14-2-506E.3, makes no mention of "easy" or "difficult" trenching but rather states that anywhere there is new residential subdivision growth the developer must bear ALL costs of trenching and earthwork construction and in such areas U S West has no investment in trenching construction.

In spite of the Commission's regulation, and ignoring the reality of significant new residential subdivision growth in recent years, the company's RLCAP model includes significant "trenching" costs where none have in fact been incurred by U S West. TCG must respectfully ask why should new entrants pay any cost associated with trenching if none have been incurred by U S West?

It is no answer to say that in a "scorched node" environment we must hypothetically assume that such trenching would be required. It is far more reasonable to say that in a "scorched node" environment, by definition all residential connections are "new" and that no trenching costs are borne by U S West under applicable Arizona law.

None of the applicable U S West witnesses analyzed the specific Arizona requirements on trenching construction being required to be provided by developers for new construction. See TR 228, lines 19-25 (Ms. Santos-Rach); TR 650, lines 14-20 (Mr. Orrell). Ms. Figueroa, however, stated that there were currently working on "close

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to a thousand subdivisions" (TR 1625, lines 10-13), so the number of installations is clearly significant.[5]

### 3. The 82 Percent Developed Ratio Also Ignores Revenues Received From Developers

Not only are the trenching costs in RLCAP substantially overstated, U S West's cost model takes no account of the fact that the actual costs of the feeder and distribution facilities are advanced to U S West by the developer in new subdivisions. Up front "facility charges" are collected by U S West and, under its construction tariff, such advanced charges may be repaid over five years. If not repaid, the construction advances are retained by U S West as a gift. See Tariff attachment at Appendix, Tab 5. The RLCAP model then falsely assumes (1) that there will be actual construction outlays paid for by U S West (in new subdivisions) and (2) that there will be a financing or cost of money component associated with these outlays. The feeder and distribution facilities charges are totally advanced by developers and, even if some of the costs are actually refunded over time, U S West has enjoyed zero cost financing for all related facilities.

Ms. Santos-Rach confirmed that none of the revenues received from developers were taken into consideration in RLCAP (TR 268, lines 24-25; TR 269, lines 1-10).

## F. The Three Pair Distribution Assumption is Speculative and Overstated.

Another aspect of RLCAP that moves its TELRIC cost higher is the assumption that there will be three cable pairs installed per dwelling unit. U S West witness

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[5] The unsupported nature of the costs assumed by U S West for trenching illustrates again U S West's tendency to make assumptions in order to drive up the TELRIC result. In the instances of all costs--not just trenching costs--the Arbitrators and the Commission should reject assertions that have no cost basis. The Commission need not feel compelled to accept either the Hatfield Model or RLCAP in their entirety, but can eliminate non-cost based assumptions in developing appropriate TELRIC prices. As has been seen elsewhere in this proceeding, on balance, the Hatfield Model's assumptions enjoy a decidedly firmer and more provable cost basis than RLCAP.

Mr. Butler claimed that the three pair design is reasonable (TR 486-87). However, Mr. Butler's claims are completely at odds with U S West's actual experience with additional lines to residences. As Mr. Orrell testified, U S West has approximately 1.5 million "first lines" in Arizona. As of May, 1995, there were roughly 108,000 second lines, 2,500 third lines and 370 fourth lines (TR 549, lines 10-20). Assuming Mr. Orrell's numbers are correct, out of 1,610,870 access lines in Arizona, less than two one-thousandths of one percent are third lines. Despite this minuscule percentage of actual third lines in service, a three pair design for all services is claimed as reasonable. In light of U S West's actual experience with in service third lines, its claim is clearly unreasonable on its face and should be rejected. Moreover, in apparent contradiction to the claim that the three pair design has been in effect for some time, U S West used a two pair assumption in its last rate case. See Decision No. 58927 at p. 71, lines 6-10.

The two pair assumption used in the Hatfield Model is far more reasonable. In fact, considering that U S West's in service experience with second lines comprising only 6.7 percent of total access lines, the two pair assumption used in the Hatfield Model appears to be overly generous.

G. Collocation Charges Should be Established at the Rate Levels Sponsored by AT&T Witness Mr. Baker.

U S West maintains that costs for physical collocation cages or enclosures will be determined on an individual basis. See U S West Exhibit 22 (Ms. Mason), Exhibit A, page 3 of 4. As demonstrated by the concerns of AT&T witness Ms. Baker, allowing U S West to establish these charges on a case by case basis will allow U S West the perfect opportunity to try to exact exorbitant charges for space that is essentially equal to

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industrial warehousing.[6] The Commission should adopt the prices submitted by Ms. Baker in AT&T Exhibit 19, NJB Schedule 2, pages 3-4 in order to prevent U S West's "individual case basis" (ICB) charges from constituting a barrier to entry. See Exhibit 20, page 6. The adoption of an ICB pricing standard also invites the possibility of delay in initiating and completing specific interconnections with competitors since U S West could delay the process by claiming the need for a "study" to determine the particular case-by-case pricing. None of this is necessary and Ms. Baker's prices for physical collocation should be adopted.

H. The "Efficiency" of the Constructed Network; U S West's Unbundled Loop Costs are not Credible.

Because the construction of U S West's communications facilities occurred over time in the "cost plus" environment of regulated monopoly pricing, there is reason to assume that the costs of the constructed network are probably well in excess of what they would otherwise have been if constructed in a competitive market. Although Ms. Santos-Rach was evasive in responding to Mr. Rudibaugh's questions about whether the constructed network was "efficient" (TR 44, lines 12-25; TR 45, lines 1-9), U S West's consultant Mr. Fitzsimmons agreed with Mr. Rudibaugh that the existing system was not efficient (TR 1740, lines 12-16). This is a significant admission because it raises the anomaly that on a comparative basis, the embedded costs of the "inefficient" communications network should be considerably <u>higher</u> than the "incremental" "forward looking" "efficient" costs of a reconstructed TELRIC-priced network. However, in the case of U S West's cost models, these prices all tend to be the same. U S West's glib assertion that in a TELRIC cost

[6] As Dr. Zepp observed: "The type of service being purchased is not office space, but Class-C industrial space. Recurring charges should be based on rents for that type of space, not office space." AT&T Exhibit 9, p. 46, lines 19-20. See also TR 1004-1005 (Dr. Zepp).

study, some "going forward" prices are going to be higher than embedded costs (TR 1740-41) simply will not wash.

This Commission's rules (A.A.C. R14-2-1309), the Order (at ¶ 704-06) and the agreed upon consensus principles (U S West Exhibit 1, Attachment 2) all mandate that embedded costs are not to be recovered in a TSLRIC or TELRIC exercise. Here, however, when the dust settles over U S West's proposed pricing for the unbundled loop, the TELRIC loop price in effect recovers U S West's embedded costs since it is higher than U S West's embedded loop costs. Compare prices at U S West Exhibit 1, page 3; see also U S West Exhibit 15, DRE-3 at p. 1. These factors are compelling and show that the U S West pricing proposal is simply not credible and should be rejected.

## II.

## THE IMPORTANCE OF THE PRICING ISSUE: MARKET POWER AND COMPETITION

### A. Pricing Should Promote Competition.

As might be expected from the incumbent carrier, U S West's pricing proposals provide no economic incentives to CLECs who might seek to compete for local exchange customers. In fact, if adopted, the pricing proposed by U S West will create a very real barrier to entry in contravention of the Act and the Commission's Competitive Service Rules. Although U S West pays lip service to the guiding principles in establishing TELRIC prices for unbundled network elements, when its version of the cost exercise is over, the end result for local loop access is so inordinately high that no competitors are likely to pay the prices sought by U S West.

Here, the U S West proposal is two and one-half times the proxy rate established as a guideline by the FCC. The basic rate including non-recurring charges for CLECs competitive access to a single U S West business customer is so high as to be prohibitive. This fact was eloquently made in the testimony and exhibits of ACSI witness

Mr. Robertson. As demonstrated by his testimony and exhibits, if competitive service were to be provided at U S West's proposed rates for a 1 FB customer, it would take nearly five years for a CLEC to break even and would involve a loss of money each and every year until the fifth year. ACSI Exhibit 12; TR 1442-1447. The illustration conservatively assumes that the CLEC makes no capital investment (such as installing a switch) associated with instituting such competitive service. Id. Interestingly, U S West chose not to rebut this compelling example. Under such circumstances, no CLEC could afford to do any business in Arizona (TR 1447, lines 17-24). The invitation to lose money for many years has no allure. Competitors simply will not enter the market if U S West's proposed pricing is sustained--all of which would inure to the benefit of U S West. The Arbitrators and the Commission should reject the exorbitant pricing proposals of U S West in favor of TELRIC based prices that will stimulate--not retard--the development of facilities-based competition in Arizona.

B. The Establishment of TELRIC Costs Will Have Consequences for U S West's Other Retail Rates.

One matter that was not squarely addressed by U S West is the effect on other retail customer rates of the establishment of a TELRIC based local loop cost. Presently, U S West's approved residential one party monthly service rate is $13.18. Decision No. 58927 at p. 73. U S West's proposal in the rate proceeding was on the basis of a long run incremental cost ("LRIC") study submitted to the Commission. The residential rate requested by U S West as being cost justified in that proceeding was $17.50. Id. at p. 70. Although U S West will surely argue that the LRIC cost study is different from a TSLRIC or TELRIC study, the differences, if any, are not likely to make changes in the retail rates designed from such studies. Accordingly, if the Commission adopts U S West's proposal and determines that the TELRIC for the unbundled local loop is $30, it will in all likelihood be setting a precedent for U S West's next "rebalancing" case. That precedent would provide a potential cost basis for raising U S West's residential one party rate from $13.18 per month to over $30 per month! Therefore, the Arbitrators and the Commission should use only verifiable costs to fix the TELRIC rates for unbundled elements in this proceeding--it will surely have effects in other proceedings before the Commission.

## III.

## PRICING FOR RESALE SERVICES

The Act requires incumbent local exchange carriers to provide "for resale at wholesale rates any telecommunications service that the carrier provides at retail . . . ." 47 U.S.C. § 251(c)(4). Also under the Act, the State commission shall determine wholesale rates on the basis of retail rates charged to subscribers excluding all costs attributed to "marketing, billing, collection and other costs that will be avoided by the local exchange carrier." 47 U.S.C. § 252(d)(3).

TCG submits that rates for resale services of U S West should be carefully established by the Arbitrators and the Commission, balancing all appropriate factors so that facilities-based competition will in fact develop in local exchange telecommunications. This task requires a delicate balance. If resale discounts are set too high, then competitors will not invest in infrastructure needed to support the increased demands of competitive telecommunications but rather will overutilize and perhaps strain U S West's network. See, e.g., AT&T's Ms. Dodd's testimony at TR 1011, line 25; TR 1012, lines 1-13. On the other hand, if resale discounts are established at unduly low levels, the immediate entry of competitors that rely (at least in part) on resold services will be stifled because profit incentives will not be present and competition will be extremely slow to develop. Neither of these scenarios promotes the public interest.

TCG submits that the avoided cost discount proposed by AT&T is probably too high and that the discount proposed by U S West is probably too low. Wholesale prices should

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be set in this proceeding to promote both facilities-based and resale competition in local exchange telecommunications.

## Conclusion

The cost studies presented by U S West in this proceeding are inflated with inappropriate and unnecessary costs. U S West has not borne its burden of proof of establishing a proper cost basis for establishing rates for unbundled network elements either in accordance with the Act or as a part of a proper TSLRIC study as mandated by Arizona's Competitive Service and Interconnection and Unbundling Rules. Unbundled network element rates should be established using principles encompassed in the Hatfield Model for establishing costs with the careful recognition that the costs established may serve as precedent in other U S West retail rate proceedings. Avoided cost discounts should be established by carefully balancing the need for development of robust resale as well as facilities-based competition in the local exchange markets.

Dated: January 3, 1997.

Michael Morris
Vice President, Regulatory and External Affairs

Deborah S. Waldbaum
Senior Regulatory Counsel, Western Region
TELEPORT COMMUNICATIONS GROUP, INC.
201 North Civic Drive, Suite 201
Walnut Creek, California 94596
(510) 949-0600

BROWN & BAIN, P.A.
2901 North Central Avenue
Phoenix, Arizona 85012
(602) 351-8000

Attorneys for Petitioner TCG Phoenix

By Lex J. Smith
Lex J. Smith
Michael W. Patten

Original and four (4) copies
hand-delivered January 3, 1997 to:

Mr. Jerry L. Rudibaugh
Chief Hearing Officer and
Chief Arbitrator
Hearing Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Copy of the foregoing hand delivered
January 3, 1997 to:

Docket Control Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Copies of the foregoing mailed
January 3, 1997 to:

Norton Cutler, Esq.
U S WEST, INC.
Law Department
1801 California Street, Suite 5100
Denver, Colorado 80202

Timothy Berg, Esq.
FENNEMORE CRAIG
Two North Central Avenue, Suite 2200
Phoenix, Arizona 85004

*Counsel for U S West Communications, Inc.*

Thomas L. Mumaw, Esq.
SNELL & WILMER, L.L.P.
One Arizona Center
400 West Van Buren
Phoenix, Arizona 85004-0001
*Counsel for Brooks Fiber Communications of Tucson, Inc.*

Thomas H. Campbell, Esq.
LEWIS & ROCA
40 North Central Avenue
Phoenix, Arizona 85003
*Counsel for MCImetro Access Transmission Services, Inc.*

Thomas F. Dixon, Jr.
MCI TELECOMMUNICATIONS CORPORATION
707 Seventeenth Street
Denver, Colorado 80202

Greg Patterson
RESIDENTIAL UTILITY CONSUMER OFFICE
2828 North Central Avenue, Suite 1200
Phoenix, Arizona 85004

Russell M. Blau, Esq.
Douglas G. Bonner, Esq.
SWIDLER & BERLIN Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007-5116
*Counsel for MFS Communications Company, Inc. and GST Tucson Lightwave, Inc.*

Donald A. Low
SPRINT COMMUNICATIONS COMPANY, L.P.
8140 Ward Parkway 5E
Kansas City, Missouri 64114

Andrew D. Hurwitz, Esq.
Joan S. Burke, Esq.
OSBORN MALEDON, P.A.
2929 North Central Avenue, 21st Floor
Post Office Box 36379
Phoenix, Arizona 85067-6379

Daniel Waggoner, Esq.
Mary E. Steele, Esq.
DAVIS WRIGHT TREMAINE
2600 Century Square
1501 Fourth Avenue
Seattle, Washington 98101-1688

*Counsel for AT&T Communications of the Mountain States, Inc.*

Edward A. Yorkgitis, Jr., Esq.
KELLEY, DRYE & WARREN, L.L.P.
1200 19th Street Northwest, Suite 500
Washington, D.C. 20036

Michael W. Patten, Esq.
BROWN & BAIN, P.A.
Post Office Box 400
Phoenix, Arizona 85001-0400

*Attorneys for American Communications Services, Inc.*

DWatts
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# APPENDIX

# TO INITIAL POST HEARING BRIEF

# OF TCG PHOENIX

# APPENDIX

# GTE to Introduce Flat-Rate Toll Calls For Business Users

By GAUTAM NAIK
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK – GTE Corp. has signed up more than 750,000 long-distance customers just 10 months after entering the business, and now plans to aggressively pursue corporate users by launching three flat-rate calling plans.

The company is expected to announce today three calling plans that let business customers place long-distance calls for as little as 14 cents a minute, day or night. That price edges out the 14.5 cents a minute offered to small businesses by **MCI Communications** Corp. Neither AT&T Corp. nor **Sprint** Corp. offer a flat rate.

GTE, the largest U.S. carrier of local phone traffic, entered the long-distance market in March under a new telecommunications law that lets local providers compete with AT&T and others. GTE's success suggests the kind of damage the regional Bells could eventually do to the Big Three long-distance carriers, AT&T, MCI and Sprint. The Bells are equally eager to offer long-distance service, but first must open their local monopolies to competition. GTE was exempted from that rule.

Nonetheless, the costs are high. GTE, based in Stamford, Conn., said its long-distance business won't turn a profit until the fourth quarter of 1998.

GTE says it has signed up more than 750,000 long-distance subscribers, most of them residential, beating its own estimates by 10%. A big reason, GTE maintains, is that customers prefer buying several services, such as local and long-distance, on a single bill and with a single number for customer service. In Tampa, Fla., GTE also packages cellular, paging and Internet access with its telecom offerings – the beginnings of a bigger push toward "bundled services."

"The carrier who has the capability to provide a single bill has a strategic advantage" over others, said Rob McCoy, president of GTE's long-distance unit, which now serves all 50 states.

GTE hopes to win more business customers by simplifying its phone offerings. High-volume callers will pay a flat rate of 14 cents a minute for domestic long-distance calls, while low-volume users will pay 15 cents a minute. The company is also offering a flat-rate international plan whose rates depend upon the country called. The rates apply to direct-dialed, calling-card, toll-free and operator-assisted calls.

11-19-96 TCG 1

# U S WEST COMM. GRP. NYSE-USW

RECENT PRICE 31 | P/E RATIO 12.5 (Trailing: 12.7 Median: NMF) | RELATIVE P/E RATIO 0.81 | DIV'D YLD 6.9% | VALUE LINE 770

TIMELINESS —F (Relative Price Perform-ance Next 12 Mos.)

SAFETY 1 Highest (Scale: 1 Highest to 5 Lowest)

BETA NMF (1.00 = Market)

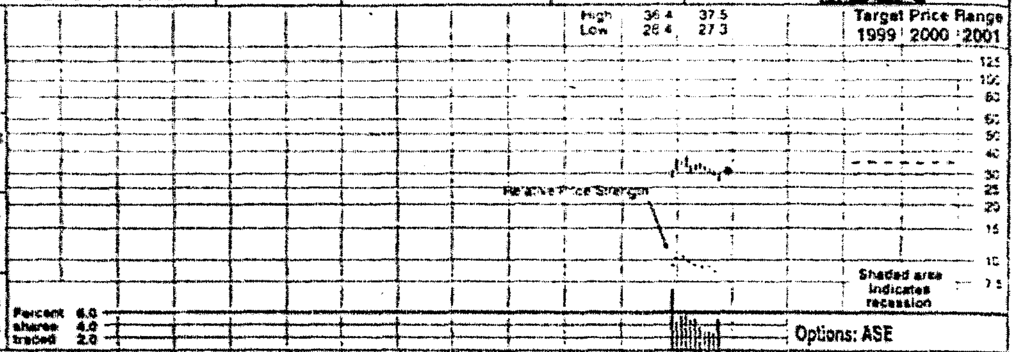
| 1999-01 PROJECTIONS | Price | Gain | Ann'l Total Return |
|---|---|---|---|
| High | 35 | (+15%) | 9% |
| Low | 30 | (-5%) | 6% |

Insider Decisions

| | N | D | J | F | M | A | M | J | J |
|---|---|---|---|---|---|---|---|---|---|
| to Buy | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Options | 0 | 2 | 1 | 0 | 0 | 0 | 0 | 1 | 1 |
| to Sell | 1 | 1 | 1 | 0 | 0 | 1 | 0 | 0 | 0 |

Institutional Decisions

| | 4Q95 | 1Q96 | 2Q96 |
|---|---|---|---|
| to Buy | 182 | 179 | 157 |
| to Sell | 241 | 232 | 218 |
| Hld's(000) | 204925 | 221934 | 212563 |




Options: ASE

On January 1, 1984, AT&T was broken up into the "new" AT&T and seven Regional Bell Operating Companies (RBOCs). Included among the RBOCs is U S West, Inc. On November 1, 1995, each share of U S West, Inc.'s stock was divided into one share of U S West Communications Group Common Stock and one share of U S West Media Group Common Stock (tkr. UMG). These two classes of stock were established in order to allow investors to "track" the performance of each group's operations.

| 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994E | 1995E | 1996 | 1997 | © VALUE LINE PUB., INC. | 99-01 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| -- | -- | -- | -- | -- | -- | -- | -- | 19.55 | 20.02 | 21.05 | 21.55 | Revenues per sh | 24.00 |
| -- | -- | -- | -- | -- | -- | -- | -- | 6.41 | 6.55 | 6.50 | 7.20 | "Cash Flow" per sh | 8.10 |
| -- | -- | -- | -- | -- | -- | -- | -- | 2.42 | 2.35 | 2.45 | 2.60 | Earnings per sh A | 3.00 |
| -- | -- | -- | -- | -- | -- | -- | -- | 2.14 | 2.14 | 2.14 | 2.14 | Div'ds Decl'd per sh B ■ | 2.14 |
| -- | -- | -- | -- | -- | -- | -- | -- | 4.80 | 5.20 | 5.40 | 5.35 | Cap'l Spending per sh | 5.20 |
| -- | -- | -- | -- | -- | -- | -- | -- | 6.77 | 7.34 | 7.70 | 8.25 | Book Value per sh | 10.60 |
| -- | -- | -- | -- | -- | -- | -- | -- | 469.34 | 473.64 | 480.00 | 485.00 | Common Shs Outst'g C | 500.00 |
| -- | -- | -- | -- | -- | -- | -- | -- | -- | 13.6 | Bold figures are | | Avg Ann'l P/E Ratio | 11.0 |
| -- | -- | -- | -- | -- | -- | -- | -- | -- | .93 | Value Line | | Relative P/E Ratio | .85 |
| -- | -- | -- | -- | -- | -- | -- | -- | -- | 6.7% | estimates | | Avg Ann'l Div'd Yield | 6.5% |
| -- | -- | -- | -- | -- | -- | -- | -- | 9176.0 | 9484.0 | 10100 | 10600 | Revenues ($mill) | 12000 |
| -- | -- | -- | -- | -- | -- | -- | -- | 1099.0 | 1107.0 | 1165 | 1245 | Net Profit ($mill) | 1500 |
| -- | -- | -- | -- | -- | -- | -- | -- | 36.1% | 35.7% | 37.5% | 37.5% | Income Tax Rate | 37.5% |
| -- | -- | -- | -- | -- | -- | -- | -- | 12.0% | 11.7% | 11.5% | 11.7% | Net Profit Margin | 12.5% |
| -- | -- | -- | -- | -- | -- | -- | -- | 58.7% | 62.1% | 60.5% | 59.0% | Long-Term Debt Ratio | 52.0% |
| -- | -- | -- | -- | -- | -- | -- | -- | 41.3% | 37.9% | 39.5% | 41.0% | Common Equity Ratio | 48.0% |
| -- | -- | -- | -- | -- | -- | -- | -- | 7695.0 | 9155.0 | 9400 | 9700 | Total Capital ($mill) | 11000 |
| -- | -- | -- | -- | -- | -- | -- | -- | 15041 | 13529 | 13300 | 13500 | Net Plant ($mill) | 13700 |
| -- | -- | -- | -- | -- | -- | -- | -- | 16.1% | 14.1% | 14.5% | 15.0% | % Earned Total Cap'l | 15.5% |
| -- | -- | -- | -- | -- | -- | -- | -- | 34.8% | 31.8% | 31.5% | 31.0% | % Earned Net Worth | 28.5% |
| -- | -- | -- | -- | -- | -- | -- | -- | 34.8% | 31.8% | 31.5% | 31.0% | % Earned Com Equity | 28.5% |
| -- | -- | -- | -- | -- | -- | -- | -- | 6.7% | 5.2% | 4.0% | 5.5% | % Retained to Com Eq | 8.0% |
| -- | -- | -- | -- | -- | -- | -- | -- | 81% | 84% | 88% | 83% | % All Div'ds to Net Prof | 71% |

CAPITAL STRUCTURE as of 6/30/96
Total Debt $5831 mill. Due in 5 Yrs $2354 mill.
LT Debt $5571 mill. LT Interest $373 mill.
(LT interest earned: 6.1x; total interest coverage: 5.2x)

Leases, Uncapitalized Annual rentals $113.0 mill.

Pension Liability None

Pfd Stock None

Common Stock 477,632,312 shs. as of 7/31/96

| CURRENT POSITION ($MILL.) | 1994E | 1995E | 6/30/96 |
|---|---|---|---|
| Cash Assets | 116.0 | 172.0 | 55.0 |
| Other | 2022.0 | 2120.0 | 2069.0 |
| Current Assets | 2138.0 | 2292.0 | 2124.0 |
| Accts Payable | 885.0 | 851.0 | 675.0 |
| Debt Due | 1606.0 | 1055.0 | 1160.0 |
| Other | 1712.0 | 1591.0 | 1689.0 |
| Current Liab. | 4206.0 | 3507.0 | 3524.0 |
| Fix. Chg. Cov. | 563% | 516% | 522% |

| ANNUAL RATES of change (per sh) | Past 10 Yrs. | Past 5 Yrs. | Est'd 1995E to '99-'01 |
|---|---|---|---|
| Revenues | -- | -- | 3.5% |
| "Cash Flow" | -- | -- | 4.0% |
| Earnings | -- | -- | 5.0% |
| Dividends | -- | -- | Nil |
| Book Value | -- | -- | 7.5% |

| Calendar | QUARTERLY REVENUES ($ mill.) Mar.31 | Jun.30 | Sep.30 | Dec.31 | Full Year |
|---|---|---|---|---|---|
| 1993 | -- | -- | -- | -- | -- |
| 1994 | 2253 | 2281 | 2316 | 2325 | E9176.0 |
| 1995 | 2318 | 2338 | 2383 | 2439 | E9484.0 |
| 1996 | 2465 | 2500 | 2600 | 2535 | 10100 |
| 1997 | 2650 | 2750 | 2650 | 2550 | 10600 |

| Calendar | EARNINGS PER SHARE A Mar.31 | Jun.30 | Sep.30 | Dec.31 | Full Year |
|---|---|---|---|---|---|
| 1993 | -- | -- | -- | -- | -- |
| 1994 | .63 | .60 | .59 | .61 | DE2.42 |
| 1995 | .59 | .60 | .59 | .57 | E2.35 |
| 1996 | .61 | .61 | .62 | .61 | 2.45 |
| 1997 | .64 | .67 | .65 | .64 | 2.60 |

| Calendar | QUARTERLY DIVIDENDS PAID B ■ Mar.31 | Jun.30 | Sep.30 | Dec.31 | Full Year |
|---|---|---|---|---|---|
| 1992 | .52 | .53 | .53 | .53 | 2.11 |
| 1993 | .53 | .535 | .535 | .535 | 2.14 |
| 1994 | .535 | .535 | .535 | .535 | 2.14 |
| 1995 | .535 | .535 | .535 | .535 | 2.14 |
| 1996 | .535 | .535 | .535 | | |

BUSINESS: U S West Communications Group stock tracks the performance of U S West, Inc.'s traditional domestic wireline telephone operations. U S West Communications serves customers in Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington, and Wyoming. Access lines in service: 15.1 million. Access lines per Telco employee: 313. '95 revenue breakdown: local service, 46%; toll, 12%; access charges, 33%; other, 9%. '95 depreciation rate: 6.8%. Estimated plant age: 9 yrs. Has about 51,150 employees, about 868,000 shareholders. President & Chief Executive Officer: Sol Trujillo. Inc.: Colorado. Address: 7800 East Orchard Road, Englewood, CO 80111-2526. Telephone: 303-793-6500.

**U S West Communications Group stock has not been assigned a Timeliness rank due to its brief trading history.** Our presentation reflects pro forma data (prior to 1996) and estimates and projections for the Communications Group only. Our report on the Media Group can be found on page 771. *(There is no legal separation between the assets and liabilities of the two groups, and it is possible for events affecting one to carry over to the other.)*

**We look for modest earnings growth in 1996.** The Communications Group's strong revenue advances are likely to be tempered by high operating and start-up costs. The top line is benefiting from a healthy economy and the region's brisk population growth. These factors are translating into strong demand for new and additional access lines in residences and businesses as well as greater minutes of use. Also, revenue per access line is being enhanced by value-added services, such as caller I.D. and call waiting. The elevated operating expense levels relate to the company's efforts to market its products and services and improve its customer service. These costs are being somewhat offset by a reduction in personnel and the consolidation of customer service centers. The start-up expenses are associated with USW's entry into the long-distance, video, and PCS (Personal Communication Service) markets and the expansion of existing data networking services. Separately, we expect the effective tax rate to be higher in 1996 than in previous years.

**Profit growth should accelerate in 1997.** The effects of a slowing economy on earnings will likely be more than offset by strong growth in data networking revenue and a decline in operating and start-up expenses (as a percentage of revenue). But interstate long-distance, video, and PCS services are unlikely to contribute significantly to the bottom line until 1998.

**U S West Communications Group shares are most appropriate for income-oriented accounts.** The current dividend yield is about 7%, and the stock carries our Highest Safety rank. However, a mid-single-digit earnings-growth rate and lofty payout ratio will likely preclude a dividend increase anytime soon.

*Marc H. Bettinger* *October 11, 1996*

(A) Based on the weighted average number of common shares outstanding. Excludes nonrecurring items: '94, 11¢; '95, 17¢; '96, 15¢. Next earnings report due late October. (B) Next div'd meeting about Dec. 6th. Goes ex-div'd Oct. 17th. Div'd payment dates: 1st of Feb., May, Aug., Nov. ■ Dividend reinvestment plan available. (C) In millions. (D) Quarterly earnings do not sum due to changes in the number of s/o. (E) Pro forma. (F) Trading history too short to assign a Timeliness rank.

| | |
|---|---|
| Company's Financial Strength | A+ |
| Stock's Price Stability | NMF |
| Price Growth Persistence | NMF |
| Earnings Predictability | NMF |

# U S WEST News Releases

October 23, 1996

For further information, contact: Dave Banks (303) 804-6752
dbanks@uswest.com

## U S WEST Communications Records Another Quarter Of Strong Growth In Core Operations; Access Lines And Volumes At Record Levels

ENGLEWOOD, Colo. - U S WEST Communications Group (NYSE:USW) today announcedrecord quarterly revenues and continued record access line growth -- among the best in theindustry -- as well as strong growth rates in new products and local services.

These results, tempered by higher -- but moderating -- operating expenses, led to normalizedquarterly net income of $ 282 million, up 2.2 percent over the same period in 1995. Furtheradjusting for certain one-time expenses associated with the company's Omaha videooperations, net income would have grown 6.2 percent.

Third quarter operating highlights include:

- Earnings per share (EPS) were unchanged from last year at $.59 on a normalized basis.Further adjusting for the one-time operating costs associated with the Omaha videooperations, EPS would have been $.61, a 3.4 percent increase.
- Access line growth, among the strongest in the nation, continues to accelerate in U SWEST Communications' 14-state region, increasing 5.1 percent (excluding the sale ofselected rural telephone exchanges) over the past 12 months. This includes 4.0 percentgrowth in residential lines, growth in business lines of 7.9 percent, and a growth rate of31.7 percent in residential additional lines.
- A 5.3 percent increase in operating revenues to $2.52 billion from $2.39 billion in thethird quarter, 1995. This quarter's revenue performance was driven by continued stronglocal service revenue growth of 9.3 percent. It was also bolstered by strong growth inhigh-capacity services provided to our large business customers, one of the mostcompetitive segments of the industry.
- Strong revenue growth in new products, such as Caller ID, Voice Messaging, and data networking services, up nearly 50 percent from the same period in 1995. Within thiscategory, revenues from CLASS services (which include Caller ID) were upapproximately 90 percent. !NTERPRISE®, the data networking services division of U S WEST Communications, reported a revenue increase of more than 100 percent compared to the same period a year ago.
- Continued strong penetration of custom calling features such as Call Waiting, CallForwarding, and 3-way Calling, driven by innovative marketing of tailored productbundles.
- The company intensified its efforts to control costs which led to a reduction ofapproximately 1,000 employee positions during the quarter, 500 of which will leave thecompany's payroll during the fourth quarter. This contributed to a productivity increaseof 4.6 percent as measured by employees per 10,000 access lines. That figure nowstands at 31.2 versus 32.7 last year.

Operating expenses were up over the same period in 1995 by 5.1 percent at $1.94 billion, animprovement over the 1996 second quarter increase of 8.0 percent. Expense increases weredriven by:

- Increased volume due to unprecedented access-line growth -- resulting from the strongregional economy of the west -- and continuing service-improvement initiatives. Thecompany had a net gain of 197,000 access lines in the third quarter, a 25 percentincrease compared with third quarter, 1995. A majority of this growth occurred outsidethe company's five major metro areas, and more than half of the residential gain was onprimary -- versus additional -- lines. While initial costs for provisioning this type ofgrowth are higher than if a greater percentage were on second lines or in metro areas, primary line growth spread more evenly across the 14-state territory is great for the future of the business.
- Increased costs associated with retail sales and marketing programs, which are helpingdrive unprecedented revenue growth and positioning U S WEST Communications ascompetitors enter new markets.

"I'm pleased with U S WEST Communications Group's improving service quality and strongrevenue growth," said Richard McCormick, chairman and chief executive officer of U SWEST, Inc. "Those are critical elements in being fit for an increasingly competitivemarketplace."

Sol Trujillo, president and chief executive officer of U S WEST Communications Group, saidU S WEST Communications' third quarter performance shows the company's commitment tocustomers is stronger than ever.

"We have kept our promises to our customers by improving service," Trujillo said. "That hasbeen our number one priority. At the same time, we're doing a great job stimulating growth inrevenues and new products. That shows our aggressive marketing efforts are paying off."

"Our challenge now is to flow more of the dollars from these successes in the core businessto the bottom line and generate cash for continued investme... in the business," Trujillo added. "We've begun to see the results of our initiatives to improve our cost structure, and I'mconfident that we'll continue to improve in the coming quarters. This will translate to improved shareowner value."

**Third Quarter Operating Highlights**

Operating highlights for the quarter include:

- On September 5, U S WEST Communications Group joined many of its industrycounterparts in appealing and asking for a stay of selected portions of the FCC's August8 interconnection order. Last week, the Federal 8th Circuit Court stayed essentially thesame parts of the order U S WEST had requested, pending the outcome of appeals, which are expected sometime in early 1997.
- Marked improvement in many service quality measures. For instance, orders "held"more than 30 days for primary service at the end of September, 1996 were 2,033, lessthan half of the 4,144 at the end of September, 1995 and were only 37 percent of the5,439 at the end of September, 1994. As well, 90 percent of the company's customersnow reach a customer service representative within three rings, compared to only about70 percent in 1994. The company achieved this performance despite net new access linegains 43 percent higher than in 1995. Further, order activity is typically highest duringthe third quarter. This usually causes an upward spike in held orders at this time of year.No such spike occurred in 1996. (An order is "held" when the company cannot deliverservice immediately upon receipt of that order.)
- Continued to drive increased residential penetration levels of value-added services: Call Waiting, 39.8 %; Caller ID, 20.1 %; Voice Messaging, 15.6 %.
- Continued aggressive deployment of U S WEST Network 21. This state-of-the-art,fiber-optic, bi-directional SONET ring architecture offers unprecedented survivability,reliability and flexibility for high-capacity services. These state-of-the-art rings dwarfin size what alternative access providers have put in place. Customers in Denver,Phoenix and Seattle are currently receiving the benefits of this enhanced self-healingnetwork, and construction is currently underway in other key cities.
- !NTERPRISE continued to enhance its Frame Relay network, and by year-end, expectsto have

38,000 Frame Relay ports in service. That division also began implementingFT-1 Frame Relay Service in preparation for entering the interLATA market. This offering will allow !NTERPRISE to package local and long distance data services for lower-cost, one-stop shopping. During the third quarter, !NTERPRISE also successfully introduced Audio Conferencing Dial Out Services, and began a controlled introduction of its new Managed Data Services, a suite of services that helps customers build and manage data internetworks.

U S WEST Communications Group provides telecommunications and high-speed dataservices to more than 25 million customers in 14 western and midwestern states. Thecompany is one of two major groups that make up U S WEST. U S WEST is in the connections business, helping customers share information, entertainment and communications services in local markets worldwide. U S WEST's other major group, U S WEST Media Group (NYSE:UMG), is involved in domestic and international cable and wireless networks, directory publishing and interactive multimedia services.

[Safe Harbor statement: Some of the information presented in or in connection with this announcementconstitutes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Actof 1995. Although the Company believes that its expectations are based on reasonable assumptions withinthe bounds of its knowledge of its business and operations, there can be no assurance that actual results willnot differ materially from its expectations. Factors that could cause actual results to differ from expectations include: (i) different than anticipated competition from new entrants into the local exchange and intralata toll markets, (ii) changes in demand for the Company's products and services, including optionalcustom calling features, (iii) different than anticipated employee levels, capital expenditures, and operatingexpenses as a result of unusually rapid, in-region growth, (iv) the gain or loss of significant customers, and(v) regulatory changes affecting the telecommunications industry, including changes that could have an impact on the competitive environment in the local exchange market.]

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Note: This release and the attached tables are available on the internet by accessing U S WEST's internet site: www.uswest.com

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U S WEST Communications Group 1996 Third Quarter Earnings Contents
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# Nevada's Population Growth Outpaced Any Other State's in the Latest Year

By DAVID WESSEL
*Staff Reporter of* THE WALL STREET JOURNAL

WASHINGTON – Nevada's population, fueled by the rapidly growing Las Vegas area, grew faster than any other state's between July 1, 1995, and July 1, 1996, according to Census Bureau estimates.

No other state came close to matching Nevada's 4.5% population spurt. Still smaller than 37 other states, Nevada had 1.6 million people as of July 1996, 70,000 more than a year earlier. Most of the newcomers were people who had moved from other parts of the U.S. Since 1990, Nevada has grown a whopping 33.4% while the U.S. as a whole has grown by 6.7%.

With 1.4% population growth, the West grew faster than any other region of the country in the 1995-96 period. Seven of the 10 fastest-growing states were in the West. The other three were in the South. Arizona was the second-fastest growing state with a population increase of 2.9%. Utah was third with 2.2%. The U.S. as a whole grew by 0.9% over the period.

The Census Bureau said California's population grew faster than the nation's for the first time in five years, increasing by 1.0%. More people left California – 259,000 – than any other state, but more foreigners moved to California – 246,000 – than to any other state. California also had the largest natural population increase, births minus deaths, than any other state, 328,000. With 31.9 million people, California is by far the largest state.

The biggest population loser was the District of Columbia. The Census Bureau estimated that its population declined by 2% to 543,000. But that still leaves the district larger than the state with the smallest population, Wyoming, which had 481,000 people.

Other population losers were Rhode Island, down 1,000 people, or 0.1%; New York, down 6,000 people, or less than 0.1%; and Pennsylvania, down 4,000 people, or less than 0.1%. The Northeast grew by only 0.1% in 1995-96, slower than any other region of the country.

## Population Picture

Estimated population changes from July 1, 1995 to July 1, 1996

**Overall...**

| | | | |
|---|---|---|---|
| U.S. | +0.9% | South | +1.2 |
| Northeast | +0.1 | Mountain | +2.3 |
| Midwest | +0.6 | Pacific | +1.1 |

[1]Includes east north central and west north central.
[2]Includes south atlantic, east south central and west south central

**The Biggest Gainers...**

| | | | |
|---|---|---|---|
| Nevada | +4.5% | Ga. | +2.0 |
| Arizona | +2.9 | Colo. | +2.0 |
| Utah | +2.2 | Idaho | +2.0 |

**And the Biggest Losers**

| | | | |
|---|---|---|---|
| Wash., D.C. | -2.0% | N.Y. | +0.0 |
| R.I. | -0.1 | Pa. | +0.0 |
| W. Va | +0.0 | | |

*Source: 1996 Census Bureau*

The South, which grew by 1.2%, was the only region to show more in-migration from other parts of the U.S. than out-migration. Georgia grew particularly fast, showing a 2% increase. Also in the top 10 were Texas and North Carolina.

The data underscore the influence of immigration from abroad. The Northeast, for instance, lost 326,000 people to other regions, but attracted 205,000 people from abroad. And the West lost 21,000 people to other regions, but attracted 318,000 foreign immigrants.

In all, the Census Bureau estimated that the net international migration to the U.S. totaled 856,000 in 1995-96. Natural population increase amounted to a much larger 1.55 million.

Details of the new state-by-state estimates are available on the Census Bureau's Internet site (http://www.census.gov).

ORIGINAL

# A4. CONSTRUCTION CHARGES AND OTHER SPECIAL CHARGES

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APPROVED FOR FILING
IN COMPLIANCE WITH
DECISION #: 57109

# 4. CONSTRUCTION CHARGES AND OTHER SPECIAL CHARGES

## 4.4 UNUSUAL INSTALLATIONS

### 4.4.1 EXTENSIONS FOR NEW REAL ESTATE ADDITIONS

A. Facility Charges for New Areas of Land Development

1. A facility charge (refundable) applies to the developer when, at the developer's request, the Company undertakes the provision of feeder and distribution facilities for exchange service before telephone demand is known.

2. The facility charge will equal the cost of the facilities requested and is payable in full by the developer prior to the start of any required construction by the Company.

3. The Company will not incur expenses prior to receiving payment (or payments) from the developer equal to the amount of the estimated costs.

4. The Company and the developer will enter into a written land development agreement for provision of the requested facilities. The agreement will include the following:

   a. A description of the development.

   b. The estimated net telephone primary access line gain within the development during the contract period.

   c. A description of the telephone facilities to be provided for the estimated telephone demand during the contract period.

   d. The amount of the facility charge.

   e. A provision for an annual refund to be made each year on the anniversary date of the agreement.

   f. A term of no longer than five years.

## 4. CONSTRUCTION CHARGES AND OTHER SPECIAL CHARGES

### 4.4 UNUSUAL INSTALLATIONS

#### 4.4.1 EXTENSIONS FOR NEW REAL ESTATE ADDITIONS

A. Facility Charges for New Areas of Land Development (Cont'd)

5. The annual adjustment refund is determined as follows:

   a. The facility charge is prorated to each of the net access lines estimated in the agreement between the developer and the Company.

   b. The annual net increase of access lines is determined on each anniversary date of the agreement. The developer's initial telephone service counts in the first year's annual increase.

   c. The annual refund will not exceed the prorated amount of the new annual increase in access lines. Later refunds are given only for those access lines in service beyond the number in servic^ at the end of the last period in which a refund was given.

   d. Refunds are not made for more primary access lines than the total number estimated in the agreement. A refund is not given for more than one access line per dwelling.

   e. Any balance which remains at the end of the contract period because access lines have not been developed, reverts to the Company.

6. If new community dial office facilities must be provided specifically to serve the development, additional charges will apply to the developer based on the nonrecoverable, nonreusable costs involved. These facilities and associated charge: will be included in the agreement.

7. The Company will use its best efforts to assure the availability of CO facilities consistent with its obligations to provide exchange service.

8. Zone Connection Charges will apply to applicants for each additional access line or line within the area specified as a new area of land development unless the area specified is within a base rate area.

# 4. CONSTRUCTION CHARGES AND OTHER SPECIAL CHARGES

## 4.4 UNUSUAL INSTALLATIONS

### 4.4.1 EXTENSIONS FOR NEW REAL ESTATE ADDITIONS (Cont'd)

B. Temporary Development Charge

1. A temporary development charge shall apply when, in the opinion of the Company, substantial evidence exists indicating that exchange telephone facilities will not be required beyond a ten year (or less) time period within the specific development.

2. Normally the temporary development charge shall be collected in advance from the developer and shall be in the amount of the present worth of the undepreciated portion of the nonrecoverable, nonreusable investment required to provide exchange services to the development assuming a depreciation period equal to the estimated economic life of the facilities provided.

3. The Company and the developer will enter into a written agreement covering a time period not to exceed ten years. Contract considerations include the following:

   Whenever possible the above agreement shall be incorporated with the land development agreement governing facility charges in new areas of land development and all terms of that contract as described in A.4., preceding, shall apply except that the facility charge refund per access line shall be reduced by an amount equal to the temporary development charge divided by the estimated number of access lines within the development.

# 4. CONSTRUCTION CHARGES AND OTHER SPECIAL CHARGES

## 4.4 UNUSUAL INSTALLATIONS

### 4.4.1 EXTENSIONS FOR NEW REAL ESTATE ADDITIONS

B. Temporary Development Charge (Cont'd)

4. The development shall be reclassified permanent under the following conditions:

   a. On the fifth anniversary date of the contract the Company determines that conditions are such that temporary status no longer applies to the specific development.

   b. On the sixth and subsequent anniversary dates prior to the tenth anniversary date of the contract the developer petitions the Company in writing for a review of the development's temporary status and the Company determines that temporary status no longer applies to the specific development.

   c. On the tenth anniversary of the contract, if access lines remain in service within the development, the development snall be classified permanent.

5. Refunds of all or a portion of the temporary development charge shall be made to the developer upon reclassification of the development to permanent based on primary access lines in service as follows:

   a. Determine the ratio of access lines in service to the estimated net primary access lines as specified in the agreement.

   b. The refund shall be an amount equal to the total temporary development charge times the ratio in 5.a., preceding.

   c. If a facility charge has been collected under a land development contract, the access line ratio in 5.a., preceding, shall not exceed the access line ratio calculated using access lines in service as of the fifth anniversary of the contract.

   d. There shall be only one refund made of the temporary development charge, or portion thereof, during the term of the contract.

# 4. CONSTRUCTION CHARGES AND OTHER SPECIAL CHARGES

## 4.4 UNUSUAL INSTALLATIONS

### 4.4.1 EXTENSIONS FOR NEW REAL ESTATE ADDITIONS

B. Temporary Development Charge (Cont'd)

6. In those instances when it is necessary to collect the temporary development charge from individual customers residing within the development, the temporary development charge shall be converted to a monthly increment per primary access line which shall be added to each customer's monthly billing.

   a. Collection of the monthly increment shall terminate, if in the opinion of the Company, conditions indicate that the development has attained permanent status or on the tenth anniversary date of initial access line service installation within the development, whichever occurs first.

   b. Individual customers residing within a temporary development may form an association for the purposes of negotiating a temporary development contract with the Company. Such association will be accorded the same rights, privileges and obligations as a developer under the terms of the written agreement.

   c. No refunds of the temporary development charge will be made to individual customers.

7. The temporary development charge applies in addition to any monthly, construction, zone connection, nonrecurring or installation charges applicable under existing tariffs.