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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

Arizona Corporation Commission

DOCKETED

MAR 16 2012

DOCKETED BY [Signature]

IN THE MATTER OF THE APPLICATION OF
QWEST CORPORATION D/B/A CENTURYLINK-
QC ("CENTURYLINK") TO CLASSIFY AND
REGULATE RETAIL LOCAL EXCHANGE
TELECOMMUNICATIONS SERVICES AS
COMPETITIVE, AND TO CLASSIFY AND
DEREGULATE CERTAIN SERVICES AS NON-
ESSENTIAL.

Docket No. T-01051B-11-0378

NOTICE OF FILING
TESTIMONY

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Pursuant to the requirements of the January 17, 2012 and March 9, 2012 Procedural
Orders, the Arizona Investment Council files the Direct Testimony of its President, Gary
Yaquinto, on its behalf in the above-entitled docket.

RESPECTFULLY SUBMITTED this 16th day of March, 2012.

GALLAGHER & KENNEDY, P.A.

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Original and 13 copies filed this
16th day of March, 2012, with:

Docket Control
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1200 West Washington Street
Phoenix, Arizona 85007

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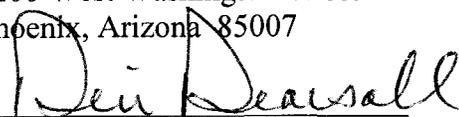
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Docket No. T-01051B-11-0378

Direct Testimony of

Gary M. Yaquinto

on Behalf of

Arizona Investment Council

March 16, 2012

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1. INTRODUCTION

Q. Please state your name, position and business address.

A. Gary M. Yaquinto. I am the President of the Arizona Investment Council ("AIC"). Our offices are located at 2100 North Central Avenue, Phoenix, Arizona 85004.

Q. Please summarize your educational background and professional experience.

A. I earned B.S. and M.S. Degrees in economics in 1974 from Arizona State University. In 2005, I received an M.B.A. from the University of Phoenix. From 1975 to 1977, I was employed by the State of Wyoming as an economist responsible for evaluating the economic, fiscal and demographic effects of resource and energy development in Wyoming. From 1977 to 1980, I was Chief Research Economist for the Arizona House of Representatives. From 1980 to 1984, I was employed as an economist in the consulting industry. Since 1984, I have worked in various capacities in government and the private sector in the areas of utility regulation and legislative affairs.

From 1984 to 1997, I was employed by the Utilities Division of the Arizona Corporation Commission. I served first as Assistant Director and was subsequently promoted to the position of Director, Utilities Division, a position I held from 1988 to 1997.

In January 1997, I was employed by GST Telecom, Inc., a regional competitive local exchange carrier ("CLEC") as Director of Legislative Affairs and was promoted to Vice President of Regulatory and Legislative Affairs in 1998.

1 I have also served as the Chief Economist at the Arizona Attorney General's Office
2 (2003-2005) and as Director, Office of Strategic Planning and Budgeting, under
3 Governor Janet Napolitano (2005-2006). I became President of AIC in December of
4 2006.

5
6 **Q. What is the purpose of your testimony in this case?**

7 A. The purpose of my testimony is to provide AIC's general perspective that the evolution
8 of competition within the telecommunications industry over the past several decades has
9 reached a point where regulation of most telecommunication services should give way to
10 market forces. The Commission's competitive telecommunications rules, adopted in
11 1995, specifically contemplate reducing and streamlining the regulation of competitive
12 telecommunications services, including the basic exchange services offered by Arizona's
13 largest incumbent provider, CenturyLink. Importantly, another consideration is the
14 leveling of the playing field among all providers of competitive services, which is an
15 essential ingredient to allow all providers to attract investment in Arizona's
16 telecommunications infrastructure.

17
18 I describe my role as a former member of the Utilities Division Staff in developing the
19 competitive telecommunications rules, which were approved by the Commission in 1995
20 and why I believe it is now appropriate for the Commission to authorize competitive
21 treatment for CenturyLink services, including basic service for residential and business
22 customers.

1 **Q. Mr. Yaquinto, is your testimony intended to provide a detailed technical or market**
2 **analysis in support of either the competitive pricing of CenturyLink's basic**
3 **exchange services or the deregulation of specific services?**

4 A. No. Although I have reviewed at a high level CenturyLink's application and
5 Mr. Brigham's very detailed analysis in support of competitive classification of certain
6 services and deregulation of others, my role is not as a technical expert. My testimony
7 instead is aimed at providing a policy examination of the emergence and evolution of
8 Arizona's telecommunications market and the Commission's changing role in regulating
9 that changing market. That testimony is based on my experiences as Utilities Division
10 Director at the time the Commission's competitive rules were adopted, my employment
11 as an executive with a CLEC and as a member of several telecommunications industry
12 associations.

13
14 **2. DEVELOPMENT AND PURPOSE OF ARTICLE 11. COMPETITIVE**
15 **TELECOMMUNICATIONS SERVICES, ARIZONA ADMINISTRATIVE CODE**
16 **R14-2-1101 THROUGH R14-2-1115**
17

18 **Q. Please describe your role in development of the Commission's competitive**
19 **telecommunications services rules.**

20 A. I joined the Utilities Division Staff in 1984, shortly after the break-up of the Bell system.
21 During my tenure as an ACC staff member from 1984 to 1997, I participated in numerous
22 proceedings in which segments of the telecommunications industry transitioned from a
23 monopolistic to a competitive environment. As both the industry and
24

1 telecommunications technology evolved, the Commission's approach to regulation of
2 telecommunications also needed to change to allow customers greater choice while
3 continuing to support ubiquitous and high quality service.
4

5 The 1980s and 1990s brought significant changes in both business and operating
6 structures, beginning with the breakup of the Bell system under Judge Green's Modified
7 Final Judgment ("MFJ") in 1983. The telecommunications landscape also changed at a
8 rapid pace throughout that period due to advances in technology. The MFJ separated
9 AT&T from its local telephone companies. The seven regional Bell operating companies
10 ("BOC"), known as the "Baby Bells," offered local dial tone and other services within
11 their respective regions. Arizona's BOC was Mountain States Telephone and Telegraph,
12 a.k.a. "Mountain Bell." At the time of the break-up of the Bell system, the BOCs held
13 local monopolies for their services, because there was little, if any, competition for local
14 exchange services. Various economic, legal and regulatory barriers essentially precluded
15 new entrants in the local exchange business.
16

17 While the Inter-LATA long-distance market experienced substantial growth in the
18 number of competitors offering long-distance service, the market for local exchange
19 service was slower to evolve.
20

21 Nevertheless, as new technologies brought us, among other things, fiber optics, digital
22 switching and wireless connectivity, companies began to explore opportunities to provide
23 local telecommunications services similar to the services provided by the incumbent
24

1 providers, including Mountain Bell (which was operating under its holding company
2 name, US West). Because the Arizona Constitution provides for ACC regulation of the
3 transmission of messages to the public or the furnishing of telephone service, the
4 Commission began receiving inquiries from potential competitive providers about the
5 legality of providing local service in Arizona. Similar discussions were taking place in
6 other states. By the mid-1990s, Congress began examining changes to the
7 Telecommunications Act of 1934 to accommodate competition in local
8 telecommunications markets.

9
10 Beginning in 1993, the ACC convened a series of workshops, which I led as Utilities
11 Division Director. The purpose was to examine issues of local exchange service
12 competition in Arizona and to develop rules governing both the certification of new
13 competitive entrants and the pricing of competitive services. During 1993 and 1994, we
14 held approximately ten such meetings attended by representatives of competitive
15 providers, incumbent providers, consumer groups and the ACC staff. The meetings led
16 to draft rules that provided requirements and guidelines for the entry and regulation of
17 competitive providers, as well as the pricing of competitive services. A rulemaking
18 proceeding was authorized by the Commission which entertained both public and
19 industry comments on the draft rules. Finally, after about three years of study, the
20 Commission officially adopted the rules in June 1995.

1 **Q. Mr. Yaquinto are the rules you assisted the Commission in adopting in 1995 the**
2 **same rules under which CenturyLink seeks competitive pricing of its services in this**
3 **proceeding?**

4 A. Yes.

5
6 **Q. At the time the Commission adopted its competitive telecommunications rules in**
7 **1995, was US West, CenturyLink's predecessor, considered to be a competitive**
8 **provider?**

9 A. No. As the incumbent, it held a monopoly position for most of its services. While some
10 of its retail central office services faced competitive pressures as a result of the prior
11 deregulation of customer-owned premises equipment (CPE), US West still held a nearly
12 100 percent share of the market for local dial tone service. As a result of this monopoly
13 position and its potential market power over prices in the local exchange market, it would
14 have been inappropriate to afford it competitive pricing of local exchange services at that
15 time.

16
17 **Q. When the Commission adopted its competitive telecommunications rules in 1995,**
18 **was it contemplated that an incumbent provider, such as CenturyLink, could**
19 **qualify for competitive pricing of its local exchange service under the rules if a**
20 **competitive market developed?**

21 A. Yes. Although we didn't know how long it would take competitive local exchange
22 providers to gain traction in the market, an incumbent provider could, under the proper
23

1 circumstances, seek competitive classification of its services and be eligible for flexible
2 and competitive pricing arrangements for its services when such competition developed.

3
4 For example, CenturyLink witness Robert Brigham cites several services, such as
5 directory assistance and private line service, among others, for which the company fairly
6 soon after adoption of the rules sought and received competitive pricing authorization
7 from the Commission under the rules.¹ Additionally, even prior to adoption of the
8 competitive telecommunication rules in 1995, the Commission had already approved
9 flexible pricing arrangements for many of CenturyLink's (then US West's) new services
10 that it determined were competitive at the time of a tariff filing. I recall the Commission
11 regularly authorizing flexible pricing arrangements for many competitive services as part
12 of tariff filings for competitive services offered by US West prior to adoption of the
13 competitive rules. Examples were Centrex service, which is a central office service
14 offered by US West as an alternative to Private Branch Exchange (PBX) and Integrated
15 Services Digital Network (ISDN), an early precursor to Digital Subscriber Line service.

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¹ Brigham Direct, pp. 9-10.

1 **3. PRICE-REGULATED SERVICES ARE SUBJECT TO SUBSTANTIAL**
2 **COMPETITION AND SHOULD BE CLASSIFIED AS COMPETITIVE**
3 **SERVICES AND AFFORDED COMPETITIVE PRICING UNDER**
4 **A.A.C. R14-2-1108**

5
6 **Q. Mr. Yaquinto, please provide a brief overview of the evolution of Arizona's**
7 **telecommunications market since adoption of the Commission's competitive**
8 **telecommunications rules in 1995.**

9 A. Since the mid-1990s, Arizona's telecommunications market has become increasingly
10 competitive. Numerous competitive providers are offering a dizzying array of local and
11 long-distance services. The competitive providers have entered the Arizona market under
12 a variety of business models, including facility-based carriers, resellers, companies
13 purchasing unbundled network elements from incumbent providers and wireless
14 providers. The vast majority of residential and business customers can now choose
15 among multiple providers for any form of telecommunication service.

16
17 In fact, the Commission's website lists 69 CLECs which have been authorized to provide
18 local exchange service in Arizona. Also listed on the Commission's website are 58
19 companies that have been authorized to provide resold local exchange services (RLECs).

20 In some cases, a single company has been certificated as both a CLEC and an RLEC.

21 While many of these competitive providers serve only in select areas and serve only
22 certain customer groups, providers like Cox Communications and other cable companies
23 provide local exchange services to residential and business customers in virtually all

1 areas served by CenturyLink. Additionally, non-regulated providers, such as wireless
2 providers and companies offering Voice-Over-Internet Protocol (“VoIP”) service,
3 provide these services throughout CenturyLink’s service territory.
4

5 The bottom line is, since adoption of the ACC’s competitive telecommunications rules 17
6 years ago, competition in Arizona’s local exchange market has flourished. Arizona
7 customers can now choose among a host of providers that offer functionally equivalent
8 voice and data services and CenturyLink’s basic exchange service is now only one of
9 many options available to customers.
10

11 **Q. What other evidence points to the increasing degree of competition in the local**
12 **exchange market?**

13 A. A very telling statistic is the loss of market share experienced by CenturyLink since local
14 exchange competition was introduced in Arizona. In the early 1990s, the legacy
15 CenturyLink provider² and other ILECs held close to 100 percent of the market for local
16 exchange service, because there were few-to-no competitive options. Currently, as
17 Mr. Brigham points out, “. . . the ILEC share of Arizona voice telecommunications
18 connections is now only 18.4%, and . . . CenturyLink now provides voice service to only
19 one-third of the occupied Arizona consumer households.” (Brigham Direct, p. 6.)
20

21 Further, as customers have migrated to other wireline and wireless competitive providers,
22 CenturyLink has experienced a significant decline in its access lines volume; they

23 ² For simplicity, I will subsequently refer to just CenturyLink in my testimony without reference to its prior legacy
24 providers.

1 dropped by 54% between 2001 and 2010. Further, the percentage of Arizona households
2 who have “cut the cord” and moved to wireless service exclusively was over 29% in
3 2010. (Brigham Direct, p. 50.)
4

5 CenturyLink’s diminishing share of the local exchange market is strong evidence that its
6 services face substantial competition from both a vast array of alternative providers and
7 substitute services.
8

9 **Q. Did the Commission anticipate these market developments when it adopted the**
10 **competitive rules in the mid-1990s?**

11 A. To some extent, it did and that is why the rules provide for an application such as the one
12 CenturyLink has filed to move services into the competitive pricing classification. As I
13 indicated previously, some competitors were, at that time, already participating in
14 portions of the market and more were anticipated. Further, wireless services were
15 beginning to be offered on a much wider scale to a larger consumer market than had been
16 the case in the 1980s and early 1990s. There are two market developments, however,
17 which we either did not fully appreciate the scope of or anticipate at all. The first of
18 those is the wireless phenomenon of “cutting the cord.” While wireless service was
19 becoming more broadly available and generally popular when the Commission passed the
20 rules, I certainly did not anticipate a time when almost one-third of consumers would
21 completely abandon wireline for wireless service—a trend which continues to grow.
22 Second, we also did not anticipate a time when so many consumers with regard to so
23 many of their messages would, in many instances, dispense with communicating orally
24

1 by phone and, instead, have text or e-mail “conversations.” Today, customers view these
2 intermodal methods of communicating as substitutes for traditional land-line telephone
3 service.

4
5 **Q. How do those developments bear on the issues presented in this case?**

6 A. They strengthen the arguments in support of CenturyLink’s application, because both
7 provide constraints on its market and pricing power. Consumers can “cut the cord”
8 and/or turn to alternative communication modes quite easily if CenturyLink does not
9 reasonably price its products to compete in a very liquid and competitive market.

10
11 **4. CENTURYLINK’S LOCAL EXCHANGE SERVICES MEET THE CRITERIA**
12 **FOR DESIGNATION OF COMPETITIVE SERVICES UNDER A.A.C. R14-2-1108**

13
14 **Q. What criteria are identified in the Commission’s rule for designating a service as a**
15 **competitive service?**

16 A. R14-2-1108 states that a telecommunications company may petition the Commission to
17 designate as competitive any service or group of services provided by it. The rule also
18 lists several criteria for designation of a service as competitive. They are:

- 19 1. A description of economic conditions which make the relevant market competitive;
- 20 2. The number of alternative providers for the service;
- 21 3. The estimated market share held by alternative providers;
- 22 4. The names and addresses of any affiliated alternative providers of the service;

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- 5. Alternative providers' ability to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions; and
- 6. Any other indicators of market power (or lack thereof), which may include growth and shifts in market share, entry and exit ease and affiliations among alternative providers of service.

Q. Mr. Yaquinto, based on your understanding of the Commission's rule for competitive service designation and your experience in Arizona's increasingly competitive telecommunications market, do you believe CenturyLink has met these criteria for competitive classification of its basic exchange services?

A. Yes. It has been almost 17 years since the Commission adopted its competitive telecommunications rules. Since that time, dozens of competitive providers have received certificates of convenience and necessity from the Commission to offer, and are offering, the same or similar local exchange services for which CenturyLink seeks competitive designation. Other, non-regulated providers like wireless companies and companies offering VoIP service offer functionally equivalent basic services throughout Arizona. Millions of emails and texts substitute daily for what previously would have been telephone conversations. As a result, CenturyLink's share of the market has declined precipitously and it can no longer exercise market power over prices for these services.

CenturyLink's application for competitive designation, supported by Mr. Brigham's direct testimony, offers very clear evidence that the company's basic exchange services

1 are subject to substantial competitive pressures and should receive a competitive pricing
2 determination by the Commission.
3

4 **Q. Are there other reasons why the Commission should authorize competitive pricing**
5 **for CenturyLink's basic services?**

6 A. Yes. The first is fairness. It is inequitable to allow competitors to operate under
7 streamlined regulatory practices, while continuing strict, fairly traditional rate regulation
8 of CenturyLink. As evidenced by CenturyLink's shrinking share of the local exchange
9 market over the past 17 years, it is now well past time to afford the Company the
10 opportunity to compete on an equal footing with cable and other competitive providers.
11

12 Second, CenturyLink's merger with Qwest resulted in a stronger, financially healthy
13 incumbent telecommunications provider in Arizona. As a condition of the merger,
14 CenturyLink agreed to invest \$70 million over five years in expanding and improving
15 broadband service throughout its service territory. Additionally, CenturyLink chose
16 Arizona for its Southwest Region Headquarters, bringing additional investment and jobs
17 to the State. The company's initial commitment to invest tens of millions of dollars in
18 improved communications infrastructure, despite the steep erosion of its market share to
19 competitors, demonstrates its desire to participate and compete for customers – both
20 business and residential customers – in Arizona. CenturyLink should be allowed to
21 compete on an equal and streamlined basis with those competitors under the
22 Commission's competitive rules. That will facilitate its ability to meet those
23 commitments to this Commission and Arizona.
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Third, contrasting regulatory practices for different companies providing essentially the same services creates confusion and uncertainty for investors. Investors need to understand the regulatory landscape before deciding where or how to invest. Having conflicting regulatory practices for similar providers offering the same services creates market uncertainty. As importantly, it unreasonably disadvantages CenturyLink in the competition for the necessary capital to maintain, expand and improve its system. Authorizing competitive pricing arrangements and streamlined regulation of CenturyLink's services signals to investors and rating agencies a more progressive and improved regulatory climate in Arizona.

Fourth, with an improving regulatory climate and competitive pricing authority equal to that of its regulated competitors, CenturyLink management also will have an incentive to make even greater infrastructure investments in Arizona. Since capital expenditure projects and budgets are approved and allocated among states at the corporate level, better competitive conditions in Arizona could help steer more investment toward Arizona than would otherwise be the case.

With its strong regional and national footprints, CenturyLink is an important player in Arizona's telecommunications market, with a demonstrated capacity to make critical and necessary investments in the State's telecommunications infrastructure. That's good for Arizona and leveling the playing field among providers will promote good capital investment.

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Q. Mr. Yaquinto, do you have an opinion about the second part of CenturyLink's application in this case to deregulate obsolete and non-essential services?

A. No. I have not attempted to perform any analysis concerning the deregulation of the services identified by CenturyLink's application. However, I have reviewed Mr. Brigham's deregulation analysis at pages 67-74 of his direct testimony and have no reason to take issue with it.

Q. Mr. Yaquinto does CenturyLink's application in this case pertain only to retail services and not wholesale services provided by CenturyLink to other providers?

A. Yes. CenturyLink is not seeking either competitive pricing arrangements or deregulation of wholesale services in this application.

Q. And finally, does CenturyLink's application request any new prices for competitive services?

A. No. CenturyLink is not asking to re-price or establish new prices for any of the competitive services involved in this application. My understanding is that, should CenturyLink decide to seek new prices for any of its services, it would do so through a separate filing following the Commission's decision in this case.

Q. Does this conclude your testimony?

A. Yes.