Exhibit No. ___TC (DJR-1TC)
Docket No. UT-061625
Witness: Deborah J. Reynolds
REDACTED VERSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of **QWEST CORPORATION** **To be Regulated Under an Alternative Form of Regulation Pursuant to RCW 80.36.135**	**DOCKET NO. UT-061625**

TESTIMONY OF

Deborah J. Reynolds

REGARDING WAIVERS OF SECURITIES, AFFILIATED INTERESTS, AND TRANSFERS OF PROPERTY STATUTES AND RULES, AS WELL AS INFRASTRUCTURE DEVELOPMENT

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

January 29, 2007

REDACTED PER PROTECTIVE ORDERS IN DOCKET UT-061625

TABLE OF CONTENTS

I. INTRODUCTION

Q. Please state your name and business address.

A. I am Deborah J. Reynolds. My business address is 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504. My e-mail address is dreynold@wutc.wa.gov.

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission as a Regulatory Analyst in the Telecommunications Section of the Regulatory Services Division.

Q. How long have you been employed by the Commission?

A. I have been employed by the Commission since July 1999.

Q. Would you please state your educational and professional background?

A. I hold a Master of Regional Planning degree and a Bachelor of Science degree in general studies from Washington State University. During my time with the Commission, I have worked on various telecommunications issues. I have presented recommendations to the Commission on late-filed interconnection agreements, petitions for rule exemptions, tariff changes, and commercial agreements. I filed policy testimony in Docket UT-050606, a boundary adjustment tariff case.

II. SCOPE OF TESTIMONY

Q. What is the purpose of your testimony?

A. My testimony responds, on behalf of Staff, to the petition by Qwest Corporation (Qwest or Company) in Docket No. UT-061625 for an alternative form of regulation (proposed AFOR). My testimony is organized in two major parts. In the first part of my testimony, I provide the Commission with a discussion and Staff recommendation for the waivers of the securities, transfer of property and affiliated interest statutes and rules that would apply if the Commission granted Qwest's proposed AFOR. In the second part of my testimony, I review two of the 12 statutory goals for the AFOR and recommend improvements to Qwest's proposed AFOR concerning infrastructure development.

III. SUMMARY OF TESTIMONY

Q. Please summarize your testimony.

A. In its proposed AFOR, Qwest asks to be treated as a competitive company. Under its proposed AFOR, it would not be subject to the statutes or rules regarding securities, transfers of property, cash transfers or affiliated interests.[1] During the four-year transition period, Qwest would agree to be bound by RCW 80.12 for purposes of reviewing any merger involving its regulated company. Qwest also agrees to be bound by the parts of the rules (WAC 480-120-369 and WAC 480-120-395) that are

[1] *See* MSR-1T, page 12, lines 1-10.

currently being challenged in the Court of Appeals of the State of Washington Division II, pending a final resolution of that appeal.[2]

In its proposed AFOR petition, Qwest's discussion of the need for the waivers of the securities, transfers of property, cash transfers, and affiliated interest rules is limited. Mr. Mark Reynolds' testimony, on page 18 and again on page 21, mentions streamlined reporting as a benefit of the proposed AFOR.

Staff recommends the following improvements to Qwest's proposed AFOR:

- Qwest should be permitted to stop complying with the securities statutes and rules in RCW 80.08, WAC 480-120-365 and WAC 480-120-389, except that Qwest should continue to comply with RCW 80.08.030, which requires that securities only be issued for certain purposes;
- Qwest should continue to comply with the statutes and rules in RCW 80.12, WAC 480-120-379 and WAC 480-143 for those transfers of property that are greater than one percent of Qwest's rate base ($15.6 million dollars);
- Qwest should continue to comply with the cash transfer rule, WAC 480-120-369;
- Qwest should continue to comply with the statutes and rules regarding affiliated interest transactions in RCW 80.16 and WAC 480-120-395 parts one through three, but should be allowed to stop filing

---

[2] *See* MSR-1T, page 10, lines 12-19.

individual affiliated interest transactions under RCW 80.16.020, WAC 480-120-375 and WAC 480-120-395 part four;

- Qwest should create and file a plan with the Commission within two years that will guarantee that advanced telecommunications services will be available in all of its wire centers by the end of the AFOR and further guarantee that such services will not decrease in percent availability by access line count during the course of the AFOR;
- Qwest should file a report on the implementation of advanced telecommunications services and technological improvements in Washington;
- When there is a major outage within Qwest's control in a wire center, Qwest should build either more redundancy to serve the affected area or add a technological improvement that removes the vulnerability that caused the outage.

Q. Could Qwest ask for rule waivers without filing an AFOR?

A. Yes. Qwest could ask for rule waivers without filing an AFOR, but the waivers of statutes require either an AFOR or competitive classification.

Q. What is the basis for Staff's recommendation that some of the statutes and rules should be waived?

A. RCW 80.36.135(5) provides that the Commission may waive such regulatory requirements under RCW Title 80 as may be appropriate to facilitate the implementation of an alternative form of regulation. However, even under an AFOR, the Commission still regulates in the public interest. (*See* RCW 80.36.135.) Therefore, Staff sought areas where the Commission could remove or reduce regulatory effort by Qwest while maintaining adequate public safeguards.

Q. What is the specific Staff recommendation regarding the requested waivers?

A. Please see Table 1 below.

Table 1 – Waiver Recommendations

Statute or rule to be waived	Recommendation	Conditions
Securities		
RCW 80.08 - Securities	Grant	Continue to comply with RCW 80.08.030 regarding use of proceeds
WAC 480-120-365 Securities Filings	Grant	
WAC 480-120-389 Securities Report	Grant	
Transfers of Property		
RCW 80.12.010 Definition	Deny	
RCW 80.12.020 Order required to sell, merge, etc.	Grant in part	$15.6 million floor
RCW 80.12.030 Disposal without authorization void.	Grant in part	$15.6 million floor
RCW 80.12.040 Authority required to acquire property or securities of utility.	Grant in part	$15.6 million floor
RCW 80.12.045 Small local exchange company -- Chapter does not apply.	Not applicable	
RCW 80.12.050 Rules and regulations.	Deny	
RCW 80.12.060 Penalty.	Deny	
WAC 480-120-379 Transfers of property	Grant in part	$15.6 million floor
WAC 480-143-100 Application of rules.	Deny	
WAC 480-143-110 Filing.	Deny	
WAC 480-143-120 Transfers of property.	Grant in part	$15.6 million floor

WAC 480-143-130 Purchase of property.	Grant in part	$15.6 million floor
WAC 480-143-140 General contents.	Deny	
WAC 480-143-150 Statement required for nonpublic service company purchases.	Deny	
WAC 480-143-160 Public hearing.	Deny	
WAC 480-143-170 Application in the public interest.	Deny	
WAC 480-143-180 Disposal and determination of necessary or useful property.	Grant in part	$15.6 million floor
WAC 480-143-190 Annual filing of property transferred without authorization.	Grant	
WAC 480-143-200 Certain telephone leases are exempt.	Deny	
WAC 480-143-210 Transfer customer notice requirements.	Deny	
Affiliated Interests		
RCW 80.16.010 Definitions.	Deny	
RCW 80.16.020 Dealings with affiliated interests -- Prior filing with commission required -- Commission may disapprove.	Grant	
RCW 80.16.030 Payments to affiliated interest disallowed if not reasonable.	Deny	
RCW 80.16.040 Satisfactory proof, what constitutes.	Deny	
RCW 80.16.050 Commission's control is continuing.	Deny	
RCW 80.16.055 Small local exchange company -- Chapter does not apply.	Deny	
RCW 80.16.060 Summary order on nonapproved payments.	Deny	
RCW 80.16.070 Summary order on payments after disallowance.	Deny	
RCW 80.16.080 Court action to enforce orders.	Deny	
RCW 80.16.090 Review of orders.	Deny	
WAC 480-120-375 - Affiliated interests — Contracts or arrangements.	Grant	
WAC 480-120-395 - Affiliated interest and subsidiary transactions report. (Parts 1-3)	Deny	
WAC 480-120-395 - Affiliated interest and subsidiary transactions report. (Part 4)	Grant	
Cash Transfers		
WAC 480-120-369 - Transferring cash or assuming obligations.	Deny	

Q. If the request for waiver of statutes and rules concerning securities, transfers of property, cash transfers, and affiliated interests were granted for the duration of the AFOR as staff recommends, will the Commission still have enough information to monitor the company's financial health during the AFOR?

A. The securities, transfer of property and affiliated interest statutes are in place so that the Commission can prevent or mitigate harm to the captive rate payer, and are intended to give the Commission information demonstrating that the company is acting in a prudent manner that protects the captive rate payer. Where effective competition exists, or where safeguards to protect captive rate payers are in place, then regulatory flexibility is appropriate. In the case of Qwest's proposed AFOR, the Commission must consider conditions that address both competitive and monopoly environments.

Adequate securities information for monitoring the company's financial health during the AFOR will be available in the company's annual financial reports to the Commission and to shareholders, and through investment rating services such as Moody's Investor's Service and Standard & Poor's L.L.C.

Staff recommends that transfers of property greater than one percent of Qwest's rate base ($1.56 billion) continue to be reported. The resulting $15.6 million floor recommendation will provide necessary property transfer information for a company of Qwest's size.

Staff also recommends the company continue to file annual affiliated interest reports. The recommended affiliated interest annual reports will provide needed information without requiring the company to file individual transactions.

Q. Will there be enough information available at the end of the AFOR to evaluate the company's financial health?

A. Yes. The reports Staff recommends the Commission continue to receive along with the annual reports and cash transfer reports, if necessary, will provide a profile of the company's financial health.

IV. DISCUSSION

A. Requested Waivers of Statutes or Rules.

1. Securities – RCW 80.08.

Q. What are the requirements of the securities statutes and rules that apply to Qwest?

A. Qwest is required by RCW 80.08 to inform the Commission before issuing securities. In addition, Qwest may not issue securities for maintenance of service. The securities statutes are implemented by WAC 480-120-365 requiring individual securities filings and WAC 480-120-389 requiring an annual report.

Q. Is the information filed by Qwest for securities transactions publicly available?

A. Yes. Qwest Communications International Inc, Qwest Corporation's parent company, includes Qwest Corporation securities filing information in its annual report to shareholders. For example, the securities issuance in Qwest Corporation's annual securities report, filed with this Commission in Docket UT-060397, can be found on page 77 of Qwest Communications International's 2005 Annual Report. This report is available at the Qwest's Web site under http://www.qwest.com/about/investor.

Q. What is the Staff recommendation?

A. Staff recommends the Commission grant the waiver of RCW 80.08 and its implementing rules WAC 480-120-365 and WAC 480-120-389 for the duration of the AFOR because the securities information is publicly available and, therefore, would be available to the commission during review of the AFOR. However, Staff also recommends that the company continue to comply with RCW 80.08.030, which limits the use to which Qwest can put the funds raised through a securities issuance.

2. Transfers of property – RCW 80.12.

Q. What are the requirements of the transfers of property statutes and rules that apply to Qwest?

A. Qwest is required by RCW 80.12 to obtain the Commission's approval before completing a transfer of any property, regardless of value, that is necessary or useful for the performance of its public duties. A transfer of property includes the sale, lease, assignment, or other disposal of any part of Qwest's properties, franchises, or facilities. The statute also covers mergers or consolidations of any of Qwest's franchises, properties or facilities with any other public service company. *See* RCW 80.12.020 and WAC 480-143-120. The transfer of property statutes are implemented by WAC 480-143 and WAC 480-120-379.

In addition to permission to transfer necessary or useful property, WAC 480-143-180 also requires Qwest to ask for and receive a Commission determination regarding the transfer of all property with a value exceeding $1,561,793[3] that the property is not necessary or useful to the performance of its public duties. WAC 480-143-190 requires an annual certification by Qwest covering property with values between $156,179[4] and $1,561,793, stating that the property was not necessary or useful.

Q. Please describe Qwest's recent filing activity required under the transfers of property statutes and rules.

A. Qwest completed four filings in the last seven years. The four filings were for computer equipment valued at $725,000,[5] an in-kind trade of real property,[6] a building valued at $20 million,[7] and the Qwest yellow pages sale,[8] with a gain-on-

[3] 0.1 percent of rate base established in UT-950200, 15th Supplemental Order, 4/11/1996. Page 77.
[4] 0.01 percent of rate base established in UT-950200, 15th Supplemental Order, 4/11/1996. Page 77.
[5] UT-011399, Qwest Corporation.
[6] UT-000143, US West Corporation.
[7] UT-051281, Qwest Corporation.
[8] UT-021120, Qwest Corporation.

sale of $942 million. The real property traded in-kind was determined to be property that was neither necessary nor useful.

Q. What does Qwest ask for in the proposed AFOR, and how would it affect Qwest's filings of transfers of property?

A. The proposed AFOR waives RCW 80.12 and its implementing rules in WAC 480-143. In Transition Period Requirement No. 5, Qwest offers to continue filing merger requests for four years. The four transactions discussed immediately above would not have been filed if the proposed AFOR had been in effect.

Q. What is the Staff recommendation?

A. Staff recommends the Commission deny the complete waiver of RCW 80.12 and instead establish in the AFOR order a transaction threshold of $15.6 million dollars, or one percent of Qwest's rate base. The Staff analysis of the four filings made by Qwest in the last seven years (computer equipment valued at $725,000, an in-kind trade of real property, a building valued at $20 million, and the Qwest yellow pages sale, with a gain-on-sale of $942 million) shows how different they were in magnitude from one another. In particular, the yellow pages sale was heavily litigated by Commission Staff members, Public Counsel, Qwest, and others. Staff believes that transactions similar to the yellow pages sale should continue to come before the Commission. However, in evaluating the smaller transactions, the Commission granted permission for the transfers and, in one case, found that the property was not necessary or useful. Staff believes the smaller transactions could be waived for Qwest, so Staff proposes a one-percent threshold in order to keep the larger transactions within Qwest's filing requirement.

3. Cash transfers – WAC 480-120-369.

Q. What is the specific cash transfer rule that applies to Qwest?

A. WAC 480-120-369 regarding transferring cash or assuming obligations applies to Qwest. If Qwest's corporate/issuer rating improves, so that it is in one of the four-highest rating categories of either Standard & Poor's L.L.C. or Moody's Investors Service, Inc., the rule will no longer apply.

Q. What are the investment grade ratings?

A. See Table 2 below. The shaded rows show the required investment grade ratings to avoid filing cash transfers.

Table 2 – Investment grate ratings

Category	Moody's Investors Service	Moody's Definitions[9]	Standard & Poor's, L.L.C.	S&P Definitions[10]
1.	Aaa	Highest quality, minimal risk	AAA	Extremely strong
2.	Aa	High quality, very low risk	AA	Very strong
3.	A	Upper medium quality, low risk	A	Strong
4.	Baa	Medium quality, moderate risk	BBB	Adequate
5.	Ba **(Qwest's)**	Speculative elements, substantial risk	BB **(Qwest's)**	Less vulnerable
6.	B	Speculative, high risk	B	More vulnerable
7.	Caa	Poor quality, very high risk	CCC	Currently vulnerable
8.	Ca	Highly speculative, in or near default	CC	Currently highly-vulnerable
9.	C	Lowest quality, in default	SD or D	Selective Default or Default

In addition to the letters in the investment grade, both Moody's and S&P's use a series of modifiers to assist in comparing companies. Moody's uses one, two and three, with one as the best and three as the worst. S&P's uses a plus or minus to indicate a company's relative level within the letter grade.

Q. What is Qwest's investment rating?

A. Qwest Communications International Inc., Qwest Corporation's parent company, has a current Standard & Poor's L.L.C. long-term issuer credit rating of BB-. This rating is one step below the lowest required rating of BBB. Qwest Corporation's current Moody's Investors Service, Inc. rating is Ba1. This rating was upgraded in

[9] Moody's Investors Service. Moody's Rating Symbols and Definitions, August 2004.
[10] Standard & Poor's. S&P Long-Term Issuer Credit Ratings Definitions. May 17, 2002.

November 2006, from Ba2 to Ba1. It is still one step below the lowest-required rating of Baa. It appears to Staff that Qwest's financial health is improving at this time.

Q. What is the purpose of the rule about cash transfers?

A. The cash transfer rule is intended to monitor large cash transfers from a regulated company to a parent company. The primary purpose of the cash transfer rule is to protect the rate payer under traditional rate of return regulation. The following excerpt from the Commission's adoption order in the rulemaking on cash transfers and subsidiary transactions best explains why the Commission has a rule about cash transfers:

> Transfers of large amounts of cash from the regulated utility or its subsidiaries could have serious and detrimental effects on ratepayers. Regulated utilities collect cash from customers as they pay for utility services, and regulated utilities use cash to fund operations and capital investment. A large transfer of cash from the control of the regulated utility could effectively disable funding for utility operations or render the utility unable to make necessary capital investments. Either circumstance could cause an immediate harm to customers. Providing the Commission with five days' advance notice of such transfers would allow the Commission to immediately commence ratemaking or prudence proceedings, or, in particularly egregious instances, to seek to enjoin the utility from proceeding with the cash transfer altogether, if necessary to protect the interests of the ratepayers or the public interest. RCW 80.36.140 and RCW 80.28.020 authorize the Commission to determine, after hearing, that a company's "practices" or "practices affecting rates" are unreasonable, to determine the just, reasonable, and proper practices to be thereafter observed and used, and to "fix the same by order or rule.
>
> The Commission is particularly concerned about large cash transactions by non-investment grade companies, because a parent company that is in a weak financial condition is both more likely to take advantage of cash held by a utility subsidiary and because such a

> company would have greater difficulty raising capital to offset the loss of cash. Large cash transfers by non-investment grade companies are more likely to directly affect the rates or service provided to ratepayers. Providing the Commission with five days' advance notice does not unreasonably burden the company, and it affords the Commission with sufficient time to take remedial action, if necessary, in advance of any irreparable harm to ratepayers or to the public interest.[11]

Q. What is the status of the cash transfer rule?

A. This rule is currently being appealed by Qwest in the Washington Court of Appeals Division II.[12] Qwest has filed no reports since the rule went into effect in March 2005.

Q. What does Qwest ask for under the proposed AFOR, and how would it affect Qwest's cash transfer filings?

A. The proposed AFOR would implement the decision of the appeals court for the four-year-transition period. If the appeal were granted, it would relieve Qwest of the duty to file cash transfer reports with the Commission. If denied, Qwest would agree to begin filing cash transfer reports with the Commission. After the transition period, the proposed AFOR would waive the rule completely.

---

[11] A-021178, General Order R-518, March 4, 2005, Paragraphs 26-27.
[12] COA No. 34523-4-II.

Q. Why should the cash transfer rule continue to apply during the proposed AFOR?

A. It should continue to apply because Qwest is still providing tariffed services to a large portion of the residential customer class, and a subset of those tariffed-service customers do not have access to competitive choices for basic service. Without the cash transfer rule, it would be difficult to monitor the financial health of the company completely enough to ensure fair treatment of those customers.

Q. What does Staff recommend?

A. Staff recommends that the Commission deny the waiver of WAC 480-120-369, because it needs to be able to reconstruct the company's financial situation after the four years. The Commission's duty to protect the subset of tariffed-service customers that do not have access to competitive choices for basic service by gathering information about cash transfers is as valid today as it was in 2005, when the rule was enacted.

4. Affiliated Interests – RCW 80.16.

Q. What is the statute regarding affiliated interests?

A. RCW 80.16 concerns the Commission's responsibilities regarding affiliated transactions. The implementing rules, WAC 480-120-375 and 480-120-395, are materially the same as the statutes. The subsidiary transactions portion of WAC

480-120-395 is being challenged in the Court of Appeals along with the cash transfer rule.

Q. Why is it important to have affiliated interest statutes?

A. The primary purpose of the affiliated interest statutes is to protect the rate payer under traditional rate of return regulation. The following excerpt from the Affidavit of Paula M. Strain in Docket UT-980948 best explains these rules:

> There is a strong public policy rationale for the regulatory authority over affiliated transactions of a regulated utility, such as US West Communications. The control of affiliated companies by a common owner gives the affiliates opportunities to experience savings through economies of scale and the lack of having to compete for the affiliates' business with nonaffiliates. The owner company, through its control of the affiliates, can direct them in the pricing of services and products to each other; can control their capital structures; and can control their ability to obtain services from nonaffiliates even if the cost would be lower.
>
> This ability of the owner of an affiliated group of companies has resulted in actions being taken that shift costs to affiliates subject to rate of return regulation, and shifts profits to nonregulated affiliates in the same group. Since rate of return regulation bases rates on costs and a set return on investment, and nonregulated companies can charge prices without being limited to a set rate of return, non-arms-length behavior among members of the affiliated group can maximize the profits from the group as a whole.[13]

[13] UT-980948, Affidavit of Paula M. Strain, February 18, 1999.

Q. Why is it important to have a rule about annual reports for subsidiary transactions?

A. The primary purpose of the rule is to protect captive rate payers under traditional rate of return regulation. The following excerpt from the Commission's order adopting the subsidiary transactions rule best addresses this question:

> The Commission has broad authority under RCW 80.04.080 to require special reports from regulated companies concerning any matters about which it is authorized or required to keep itself informed. These include transactions involving a regulated company's subsidiaries, which can directly and substantially affect the assets and liabilities of the regulated company, and in turn, the rates and services provided by the regulated company to its ratepayers. The Commission also has broad authority to examine the accounts, books, and documents of the regulated company, including its subsidiaries, pursuant to RCW 80.04.070. The Commission also rejects Verizon's alternative proposal to specifically exempt subsidiaries that are local exchange companies. The fact that a subsidiary of a utility is itself a regulated utility does not, in and of itself, eliminate the possibility that transactions between the two entities could be disadvantageous to one of them. The regulator would not have reviewed the terms of the transaction, and it would not be at arms length. Therefore effective oversight of the regulated utility requires information on its transactions with regulated subsidiaries. If there are specific circumstances where this concern is not present, the affected utility may seek an exemption.[14]

Q. Please describe Qwest's recent filing activity required under the affiliated interest statutes and rules.

A. Qwest, as required by both statute and rule, filed an average of two affiliated interest filings per month over the last five years. Almost half of the affiliated interest documents filed by Qwest are agreements with registered, competitively-classified companies such as Qwest Long Distance, Qwest Communications and OnFiber

[14] A-021178, General Order R-518, March 4, 2005, Paragraph 39.

Communications. The company also filed annual reports about its affiliated transactions. The filings are reviewed by Commission Staff and processed on the Commission's no-action open meeting agenda.

Q. What is the scope of Qwest's subsidiary transactions with its affiliates?

A. Table 3 provides an indication of the magnitude of these transactions. In general, payments to affiliates are about one sixth of the company's total regulated income. This is a significant portion of the company's cash flow.

Table 3 –

Comparison of Affiliated Interest Payments[15] to Qwest Intrastate Income[16]

Confidential numbers in shaded boxes

Year	Payments to Affiliates	Payments from Affiliates	Net Payments	Net Pymt / Income	Total Qwest Corp. Intrastate Income	Pymt to Affil/ Income
2000	$97,497,557	$29,735,459	$67,762,098	6.3%	$1,083,146,844	9.0%
2001	$80,970,522	$24,617,578	$56,352,944	5.5%	$1,018,729,298	7.9%
2002	$120,661,344	$26,158,905	$94,502,439	10.1%	$938,824,662	12.9%
2003	$131,821,529	$22,057,255	$109,764,274	12.3%	$889,107,611	14.8%
2004	[redacted]	[redacted]	[redacted]	[redacted]	$854,114,154	[redacted]
2005	[redacted]	[redacted]	[redacted]	[redacted]	$801,420,517	[redacted]

[15] Dollar amounts for payments to and from affiliates come from Qwest's annual reports on affiliated interest transactions on file with the Commission Records Center.
[16] Dollar amounts for Qwest intrastate income taken from Qwest annual reports on file in the Commission Records Center.

Q. What specific relief has Qwest requested under the proposed AFOR?

A. The proposed AFOR would allow Qwest to stop making both individual affiliated interest filings and the annual report of affiliated interest filings to the Commission.

Q. Why should the affiliated interest statutes and rules continue to apply during the proposed AFOR?

A. The affiliated interest statutes and rules should continue to apply because Qwest is still providing tariffed services to a large portion of the residential customer class, and a subset of those tariffed-service customers do not have access to competitive choices for basic service. Without the affiliated interest statutes and rules, it would be difficult to monitor the financial transactions of the company completely enough to ensure fair treatment of those customers.

Q. What does Staff recommend?

A. Staff recommends that the Commission permit Qwest to stop filing individual transactions for the period of the proposed AFOR, but require Qwest to continue filing the annual affiliated interest reports with the Commission. Staff believes the information in the annual reports will be sufficient to monitor the volume and character of affiliated interest transactions. Staff also recommends the Commission retain its authority to require an individual filing on the request of the Commission in the event the annual reports show affiliated transactions that may have a significant adverse impact upon Qwest.

Q. WAC 480-120-395 also requires annual reports of subsidiary transactions. What is the Staff recommendation about subsidiary transactions?

A. Staff recommends the Commission deny the requested waiver of WAC 480-120-395 because the concern about arms-length transactions is as true for subsidiaries as it is for affiliates.

B. INFRASTRUCTURE DEVELOPMENT

Q. How has the telecommunications network in Washington evolved?

A. The telecommunications network has developed and changed significantly. A system that used to provide only "plain old telephone service," is now integral to the delivery of many other, technologically advanced services.[17] Staff recognizes that Qwest is operating in a much different environment today, and that the portion of Qwest's network, over which the Commission has regulatory jurisdiction and being considered under this AFOR, does not include all the new aspects of the broad, technological enhancements of the last 25 years. In addition, Staff recognizes that traditional rate-of-return regulation has not always encouraged higher risk investment in technological enhancements. (*See* Exhibit No. ___-TC (TLW-1TC).)

[17] Huurdeman, Anton A. The Worldwide History of Telecommunications. July, 2003. Wiley-IEEE Press. Pages 8, 11.

Q. Please describe the Commission's jurisdiction over the telecommunications system.

A. The Commission retains specific rate-setting and other authority over telecommunications, but services like digital subscriber line (DSL), provided over the same copper network as voice grade services, have been classified as interstate services or information services by the Federal Communications Commission (FCC). Other services, such as voice-over internet protocol (VOIP), that can be provided using DSL service, may not be regulated by the Commission at all.[18] Additionally, Qwest competes against wireless and cellular providers and cable providers of IP telephony that are not regulated by the Commission.

Q. Does the Commission still regulate any advanced telecommunications services?

A. Yes. Newton's Telecom Dictionary defines advanced services as "the availability of high-speed, switched, broadband telecommunications that enable users to originate and receive high-quality voice, data, graphics, and video using any technology."[19] According to the FCC, state commissions are still responsible for intrastate stand-alone ATM (asynchronous transfer mode) service, frame relay, gigabit Ethernet service, and other high-capacity special access services.[20] Under the proposed AFOR, these are the services that would be treated as competitive, even in those wire centers where competition is not strong.

---

[18] *See* FCC 04-267, WC Docket No. 03-211. In the Matter of Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission. Adopted 11/9/2004.

[19] Newton's Telecom Dictionary. 22nd Edition. Page 92.

[20] *See* FCC Order 05-150. In the matters of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities. Adopted August 5, 2005. Paragraph 9.

Q. Is there any statutory guidance about infrastructure development in Washington?

A. Yes. RCW 80.36.135(2)(a) directs the Commission to consider whether an AFOR will "facilitate the broad deployment of technological improvements and advanced telecommunications services to *underserved areas or underserved customer classes*." [Emphasis added.] In addition, RCW 80.36.300(5) makes it the policy of the state to "promote diversity in the supply of telecommunications services and products in telecommunications markets *throughout* the state." [Emphasis added.]

Q. Given the statutes, should Qwest have a plan under the proposed AFOR for infrastructure development in Washington?

A. Yes, Staff believes Qwest should have a plan for infrastructure development in Washington to show that the proposed AFOR considers the policies contained in the statutes. Under traditional rate-of-return regulation, the Commission's main concern would have been ensuring that retail rates were just and reasonable to consumers, and that the company could earn sufficient funds to cover its expenses as well as a fair rate of return on its investment.[21] The fair rate of return on investment tended to encourage expansion of the network.

Because the Commission's telecommunications policy statute requires that Commission decisions "promote diversity in the supply of telecommunications

[21] Rosenberg, Ed, Ph.D. and Joe McGarvey. NRRI Briefing Paper: What to Think About When You Think About Telecommunications Deregulation. April 2005. < http://www.nrri.ohio-state.edu/dspace/bitstream/2068/278/1/05-04-rosenberg%2Bmcgarvey.pdf >

services and products in telecommunications markets *throughout* the state," Staff strongly believes that the company should have a plan for adding technological improvements and advanced telecommunications services in less competitive wire centers under the proposed AFOR and should report on those additions to the Commission.

Q. What is the effect of competition on infrastructure deployment?

A. As competition increases, the company focuses its attention on those parts of the network where competition is having the greatest effect. Even though less than [redacted] of Qwest's wire centers are still without DSL, half of those wire centers without DSL available have experienced [redacted] in the number of access lines. (*See* Exhibit No. ___-C (TLW-7C) and Exhibit No. ___-C (DLT-2C).) The company's focus can leave less-competitive wire centers with fewer service options, because the company has to address the immediate challenge it faces in line losses in more competitive exchanges. (*See* Exhibit No. ___-C (TLW-7C).)

Q. How does Qwest's proposed AFOR address advanced telecommunications services?

A. The AFOR statute directs the commission to consider whether the proposed AFOR will "facilitate the broad deployment of technological improvements and advanced telecommunications services to underserved areas or underserved customer classes." Mr. Mark Reynolds, in his testimony on Page 20, says that "nothing in the AFOR affects Qwest's ongoing commitment to deploy quality and technologically current products to its customers throughout its operating territory." This does not address whether the AFOR "facilitate[s] broad deployment of technological improvements and advanced telecommunications services to underserved areas or underserved customer classes."

Mr. Reynolds' testimony goes on to say that Qwest's provision to keep geographically averaged rates for any of the services that would be treated as competitively classified under this AFOR would protect rural customers from price increases, and seems to suggest that this meets the statutory goal of broad deployment. (*See* Exhibit No. ___-T (MSR-1T), page 20.) To the contrary, Staff believes that the company's agreement to keep geographically averaged rates may create an unintended incentive for the company to keep advanced telecommunications services in higher-cost areas as they are until after the AFOR concludes. In order for the AFOR to avoid running afoul of the statutory goal, infrastructure development must be addressed in the AFOR.

Q. What advanced services will be affected by the AFOR?

A. Exhibit No. ___ (MSR-3) presents a list of all services affected by the AFOR. The advanced services in the list, which will be treated as if they were competitively classified, are:

- Digital PBX Service,
  - WN U-40 Section 5.3 Private Branch Exchange Trunks – Digital;
- Digital Business Exchange Services (statewide),

- WN U-40 Section 14 ISDN BRS/PRS (statewide),
- WN U-40 Section 15.1 Digital Switched Service (statewide),
- WN U-40 Section 15.3 Integrated T-1 Service (statewide),
- WN U-40 Section 15. 4 Uniform Access Service (statewide),
- WN U-39 Section 5 Frame Relay Service (statewide),
- WN U-39 Section 9 LAN Switching Service (statewide),
- WN U-39 Section 11 Metro Optical Ethernet (statewide);

- Digital Private Line Services (statewide),
  - WN U-41 Section 5.2.10 Digital Data Service (DDS) (statewide),
  - WN U-41 Sections 5.2.11 and 6.2.11 DS1 Service (statewide),
  - WN U-41 Sections 5.2.12 and 6.2.12 DS3 Service (statewide),
  - WN U-41 Sections 5.2.13 and 6.2.13 Self-Healing Network Service (statewide).

Q. Have AFOR programs in other states included infrastructure development?

A. Yes. On December 28, 2006, Qwest agreed to a settlement regarding Qwest's failure to invest enough capital during its New Mexico AFOR. Qwest specifically agreed "to bring high speed internet capabilities to 83 percent of the homes and businesses in its service area over three years, including at least 50 percent in rural areas."[22] Indiana has a requirement that SBC and Verizon extend DSL to 77 percent and 75 percent of customers, respectively, by 2008. Kansas required SBC to extend DSL to all exchanges over 1000 lines and to provide ubiquitous DSL in eight cities.

[22] Smith, Jeff. N.M., Qwest settle; upgrades ordered. Rocky Mountain News. December 29, 2006.

Louisiana required BellSouth to make DSL available throughout its service territory by 2004.[23]

Q. What is the current status of Qwest's broadband deployment in Washington?

A. The FCC's broadband web site describes broadband as "advanced communications systems capable of providing high-speed transmission of services such as data, voice and video over the Internet and other networks."[24] It goes on to describe how such services are delivered, referring to "digital subscriber line and fiber optic cable, coaxial cable, wireless technology, and satellite." Staff specifically reviewed the expansion of DSL services as a proxy for broadband deployment throughout Qwest's network, and found that, in the last six years, Qwest had added DSL services in [redacted] of its wire centers, bringing its DSL-capable wire center count to [redacted] out of [redacted]. (Wire center count from Exhibit No. ___-C (DLT-2C).) This service expansion resulted in a [redacted] increase in business DSL subscribers and an [redacted] increase in residential DSL subscribers. (*See* Exhibit No. ___-C (TLW-7C).) Qwest's current network configuration makes DSL available to [redacted] of customers. Qwest believes that it could increase DSL availability to [redacted] through line conditioning.

---

[23] NRRI. State of Regulation State Survey. Table 4. March 2006.

[24] Federal Communications Commission, Broadband Strategic Goals, Viewed January 24, 2007. Available at http://www.fcc.gov/broadband/

Q. Qwest reports major telecommunications outages to the Commission under WAC 480-120-412. Please summarize Qwest's major outages in 2006.

A. A major outage is defined as

> "a service failure lasting for thirty or more minutes that causes the disruption of local exchange or toll services to more than one thousand customers; total loss of service to a public safety answering point or emergency response agency; intercompany trunks or toll trunks not meeting service requirements for four hours or more and affecting service; or an intermodal link blockage (no dial tone) in excess of five percent for more than one hour in any switch or remote switch."[25]

Qwest reported 14 outages in 2006. Because of the variations in Qwest's reporting format, it was not possible to identify whether each outage should be categorized as "major." Most of the reported outages were the result of circumstances beyond Qwest's control, such as vandalism or storms. (*See* Exhibit No. ___C (DJR-2C).) Staff recommends that when there is a major outage within Qwest's control in a wire center, Qwest should build either more redundancy to serve the affected area or add a technological improvement that removes the vulnerability that caused the outage.

Q. What should be covered by Qwest's infrastructure investment plan under the AFOR?

A. Staff recommends, consistent with Qwest's status as a public utility, that the Commission require the company to create and file a plan with the Commission within two years that will guarantee that advanced telecommunications services will be available in all of its wire centers by the end of the AFOR, and further guarantee

[25] WAC 480-120-021

that such services will not decrease in percent availability by access line count during the course of the AFOR. Staff believes that wire centers without advanced telecommunications services may include the following wire centers where Qwest had no DSL line counts: [redacted]. For the review of the AFOR in four years, Qwest should file a report on infrastructure development and progress achieved towards these goals during the AFOR.

V. CONCLUSION

Q. Please summarize the Staff recommendation.

A. Staff recommends the following improvements to Qwest's proposed AFOR:

- Qwest should be permitted to stop complying with the securities statutes and rules in RCW 80.08, WAC 480-120-365 and WAC 480-120-389, except RCW 80.08.030, which requires that securities only be issued for certain purposes;
- Qwest should continue to comply with the statutes and rules in RCW 80.12, WAC 480-120-379 and WAC 480-143 for those transfers of property that are greater than one percent of Qwest's rate base ($15.6 million dollars);
- Qwest should continue to comply with the cash transfer rule, WAC 480-120-369;

- Qwest should continue to comply with the statutes and rules regarding affiliated interest transactions in RCW 80.16 and WAC 480-120-395, parts one through three, but should be allowed to stop filing individual affiliated interest transactions under RCW 80.16.020, WAC 480-120-375 and WAC 480-120-395 part four;
- Qwest should create and file a plan with the Commission within two years that will guarantee that advanced telecommunications services will be available in all of its wire centers by the end of the AFOR, and further guarantee that such services will not decrease in percent availability by access line count during the course of the AFOR;
- Qwest should file a report on the implementation of advanced telecommunications services and technological improvements in Washington;
- When there is a major outage within Qwest's control in a wire center, Qwest should build either more redundancy to serve the affected area or add a technological improvement that removes the vulnerability that caused the outage.

Q. Does this conclude your testimony?

A. Yes.