Exhibit ___-TC (TLW-1TC)
Docket UT-061625
Witness: Tom Wilson
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**

ERRATA TO TESTIMONY OF

Thomas L. Wilson, Jr.

STAFF OF
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Legislative Version (changes shown)

February 25, 2007

REDACTED PER PROTECTIVE ORDERS IN DOCKET UT-061625

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INTRODUCTION

Q. Please state your name and business address.

A. I am Thomas L. Wilson, Jr. My business address is 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504.

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

A. I am employed by the Washington Utilities and Transportation Commission (commission) as a senior telecommunications analyst.

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

A. Twenty one years.

Q. What are your education and experience qualifications?

A. I have been a Telecommunications Analyst on staff at the Commission since January 1986. Please see Exhibit No. ___ (TLW-2) for a complete description of my educational background and job experience.

Q. Please list the additional staff witnesses and the subjects upon which they provide testimony.

A. Deborah Reynolds:

- affiliated interests, securities, transfers of property, infrastructure development.

Kristen Russell:

- Service quality.

Paula Strain:

- financial review, accounting, and reporting requirements.

SUMMARY

Q. What are staff's recommendations?

A. Staff recommends an improved alternative form of regulation (AFOR) plan for Qwest, amounting to modification of Qwest's AFOR proposal as follows:

1) Qwest's affiliated interest transactions should be reviewed pursuant to a streamlined process, but only RCW 80.16.020[1] and WAC 480-120-375[2] should be waived. Qwest should be required to file annual reports on affiliated interest and subsidiary transactions, but individual filings at the time of the transaction would no longer be necessary for the four years of the AFOR. The remaining affiliated interest statutes allow the commission to investigate and disallow affiliated transactions, and Qwest should remain subject to those statutes. The report includes important information that the commission will need to evaluate performance under the AFOR in four years (*see* testimony of staff witness Deborah Reynolds). In addition, the information in the report will be used in monitoring the development of the market.

[1] Dealings with affiliated interests — Prior filing with commission required — Commission may disapprove.
[2] Affiliated interests — Contracts or arrangements.

2) Qwest's proposed waiver of securities statutes should be granted, except that Qwest should continue to comply with RCW 80.08.030 concerning the use of proceeds. Securities information is available publicly in case the commission has a need for it at a later date (*see* testimony of staff witness Deborah Reynolds).

3) Qwest's proposed waiver of the transfer of property statutes should be modified to require Qwest to obtain commission approval of any transfer of property greater than one percent of Qwest's rate base ($15.6 million dollars). For example, if Qwest is purchased by, acquires, or is merged with another entity, Qwest must still file for approval under the statutes (*see* testimony of staff witness Deborah Reynolds).

4) Qwest should be required to satisfy the following infrastructure investment conditions:

   a) At the end of year two of the plan, Qwest should provide a plan for infrastructure development. At the end of the AFOR, for the review process, Qwest should file a report on infrastructure development informing the commission about Qwest's progress in promoting the infrastructure plan (*see* testimony of staff witness Deborah Reynolds).

   b) Any time there is a major outage in a given area with a cause that is within Qwest's control, and that affects the availability of advanced telecommunications services, the company must build in either more redundancy to serve that area or a technological improvement that removes the vulnerability that caused the outage (*see* testimony of staff witness Deborah Reynolds).

5) Qwest's proposed waiver of service quality rules under WAC 480-120-439 should be denied, and during the AFOR, Qwest should be required to maintain or improve its performance under the customer service guarantee program and the Seventeenth Supplemental Order in Docket No. UT-991358 (*see* testimony of staff witness Kristen Russell).

a) Qwest should continue filing customer service guarantee reports, albeit quarterly rather than monthly. Staff and Qwest have agreed upon significantly streamlined reporting formats that substantially reduce reporting burdens while preserving information needed to evaluate performance under the AFOR.

b) Qwest should be allowed to exercise its option under the plan to increase the rate for standalone residential flat-rated service by up to fifty cents per line per month in years two through four only if the number of service quality complaints reported to the commission improves by more than five percent over the previous year. For example, please refer to staff witness Kristen Russell's testimony at page 18, Table 2, which shows that in 2004 the total number of service quality complaints was 627, and in 2005 it was 516. The improvement in 2005 was (627-516)/627 = 17.7 percent. Since a 17.7 percent improvement is greater than a five percent improvement, then in the example, Qwest would have been allowed up to the $0.50 increase for 2006.

6. Qwest's request to be relieved of the requirement to maintain a jurisdictional set of accounting books should be denied. Rather, the staff's proposal is to improve the plan by maintaining modified and streamlined reporting requirements, and updated accounting procedures (*see* staff witness Paula Strain's testimony).

7. Staff recommends improving the plan by requiring Qwest to continue allowing for each residential line and Centrex-type dormitory station line, one direct dialed call to directory assistance per month at no charge when an intraLATA phone number is requested under the Directory Assistance Service tariff (WN U-40 Section 6.2.4). In addition, the free call allowance for directory assistance would also be maintained for IntraLATA and National Directory Assistance charges originating from telephone services Qwest has determined are used on a continuing basis by a person(s) certified incapable of using a published telephone directory. Additionally, IntraLATA Directory Assistance charges will not be applicable for calls that originate from hospitals.

Q. Please describe specifically how staff's improvements to Qwest's AFOR plan would look as a single document.

A. Exhibit No. ___ (TLW-3) illustrates the specific improvements to Qwest's AFOR proposal that staff recommends, and also tabulates all of staff's recommendations concerning waivers under the improved AFOR plan.

Q. Please summarize your testimony.

A. My testimony provides background information, reviews Qwest's AFOR proposal, and analyzes the proposal in light of statutory policy goals and AFOR considerations. I am the lead staff witness in this case concerning Qwest Corporation's (Qwest) petition for approval of an alternative form of regulation (AFOR) pursuant to RCW 80.36.135. I provide general and overall policy testimony on behalf of staff, and I rely upon the testimony of other staff witnesses.

Staff recommends an improved proposal for a Qwest AFOR with several important changes made to Qwest's proposal to protect the public interest. Staff recommends that the commission approve Qwest's proposal to waive the application of several statutes during the period of the AFOR, and that it implement most of Qwest's plan to give the company some necessary regulatory flexibility. In effect, to make sure that statutory policy goals and considerations governing AFORs are properly considered, staff recommends improving the plan by maintaining, or even streamlining, certain service quality, financial, accounting, reporting and record-keeping requirements. Staff also recommends that the company address infrastructure deployment as a condition of approval of the AFOR, and that the company should have a service quality performance incentive to achieve proposed rate increases for core customers. Otherwise, the plan proposed by Qwest requires no further modification for approval because with staff's suggested improvements the plan will properly balance the need for regulatory flexibility with the public interest.

Q. Please summarize your analysis of Qwest's current environment.

A. While decreasing costs through advances in technology have driven competition, it is a challenge to make sure all consumers enjoy the benefits. Qwest is in a situation where additional flexibility coupled with appropriate protection will make a good social contract as the market for information communications technologies continues to change.

The economics of Qwest's regulated situation are that the company has been steadily losing a significant amount of market share in the most vulnerable as well as the most profitable segments of the market, while at the same time remaining the only provider in less profitable and more difficult to serve markets. In my testimony I provide analysis of the economic conditions Qwest faces today, including an analysis of the economies of rural versus urban access line density.

According to Qwest's witnesses, Qwest is losing many lines every month. These line losses affect the majority of urban-dominated markets, and as I show in my testimony, competitive losses are also impacting rural exchanges. Qwest is also losing lines in both the business and residential markets. Qwest's witnesses describe significant anecdotal evidence of intermodal competition by cable television companies providing telephony over the Internet, and cellular phone companies capturing Qwest market share. However this evidence is of insufficient detail as to permit rigorous analysis of the contours of the market data pursuant to the statutory criteria under the competitive classification statutes. Still, there may be vestiges, or remaining pockets, of market power where there is less than effective competition.[3]

Staff recommends approval of an AFOR that provides Qwest with additional flexibility while protecting customer groups who may have less choice. I provide analysis of competitive line loss with the knowledge that a large part of the loss is occurring due to evidence of intermodal competition.

Referring to the analysis provided by staff witness Paula Strain, it is also staff's opinion that even when Qwest's earnings are adjusted to account for the jurisdictional mismatch of revenues and costs caused by the separations freeze, and for additional revenues Qwest could potentially receive during the AFOR term, Qwest is still not earning its authorized rate of return. Even if the increases to standalone residential rates in the improved plan were implemented, it would still not be enough additional revenue to allow Qwest to earn its authorized rate of return. Furthermore, there is a great deal of common cost allocated to the local exchange that is not directly attributable to residential or business markets. Common costs can only be allocated according to arbitrary methods. This means that denial of the requested rate increases on the basis of a full-blown rate case analysis would be subject to different experts arguing based on a large amount of money that can be

[3] "Effective competition" means there are available alternatives, and no significant captive customers. The determination considers other market-based factors such as ease of entry, market share, and number of alternative providers, RCW 80.36.330.

allocated a variety of ways, and is big enough to make a huge difference, one way or the other. It would be better to avoid that in an AFOR.

Q. Would the AFOR recommendation for Qwest be applicable to any other company?

A. Not necessarily. The AFOR recommendation for Qwest may not be applicable to other companies unless similar prerequisite conditions are in place. For example, there must be a structural framework for competition to ensure a level playing field and the potential for market forces to constrain the behavior of the firm under the plan. Also, similar prerequisite conditions must be in place to provide for adequate protection of service quality, and to ensure proper alignment of prices and costs. Staff reserves the right to look at each AFOR on its own merit.

BACKGROUND AND HISTORY

Q. Please describe your understanding of the background and history of the AFOR statute.

A. Adopted in 1989, the AFOR statute, RCW 80.36.135, was the first major piece of telecommunications reform since the landmark changes authorized by the Regulatory Flexibility Act of 1985 that gave the commission authority to streamline regulation to address the effect of competition in the industry. The AFOR statute is described in the 1989 legislative report concerning SSB 5098, laws of 1989. The background statement in the report sets the stage for understanding the AFOR statute with the indication that AFOR can be used as another tool besides competitive classification for addressing competition, allowing for regulatory flexibility, and promoting state policy goals. The AFOR statute was at least in part written in direct response to the first three years of experience gained during the early implementation of the Regulatory Flexibility Act of 1985. The 1989 legislative report notes in the background statement that:

> "The telecommunications industry consists of firms offering services with a wide range of competitiveness. In 1985 legislation was enacted which allows the Utilities and Transportation Commission (UTC) to classify companies or services as competitive, a classification which allows pricing freedom. [¶] Unless a service has been declared competitive by the UTC, a telephone company must submit its rates for UTC approval. This process can last nearly a year, and critics contend the present system lacks effective incentives for companies to become efficient."

The AFOR statute grants the commission the authority to trade traditional rate of return regulation for an alternative form of regulation subject to a set of statutory policy goals and AFOR considerations. AFOR is a set of non-traditional tools in the commission's tool box. The statute first references Washington's public policy goals for telecommunications found at RCW 80.36.300:

> (1) Preserve affordable universal telecommunications service;
> (2) Maintain and advance the efficiency and availability of telecommunications service;
> (4) Ensure that rates for noncompetitive telecommunications services do not subsidize competitive ventures of regulated telecommunications companies;
> (5) Promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state;
> (6) Permit flexible regulation of competitive telecommunications companies and services.

In addition to the public policy goals declared in RCW 80.36.300, the commission must also consider, in determining the appropriateness of any proposed alternative form of regulation, whether it will:

(a) Facilitate the broad deployment of technological improvements and advanced telecommunications services to underserved areas or underserved customer classes;
(b) Improve the efficiency of the regulatory process;
(c) Preserve or enhance the development of effective competition and protect against the exercise of market power during its development;
(d) Preserve or enhance service quality and protect against the degradation of the quality or availability of efficient telecommunications services;
(e) Provide for rates and charges that are fair, just, reasonable, sufficient, and not unduly discriminatory or preferential; and
(f) Not unduly or unreasonably prejudice or disadvantage any particular customer class.

Q. Does the statute require an affirmative finding on each of these considerations?

A. No. The statute does not require that the commission make an affirmative finding that the AFOR will satisfy or go beyond the status quo for each of these considerations. Rather, the commission must only consider whether the AFOR will further the considerations. The commission may still approve an AFOR that is neutral with regard to one or more of the considerations.

Q. Is the plan, as modified by staff, consistent with the statute?

A. Yes. The improved AFOR plan for Qwest is consistent with each of the statutory goals and considerations, and there is no impediment to the commission approving the improved plan.

AFOR BASICS

Q. Please describe the basics of an AFOR, and discuss how, together with the staff's recommended improvements, the plan meets the needs of an AFOR.

A. An AFOR attempts to increase efficiency incentives for utilities. Major components of an AFOR typically include the following:

- Definition of performance based upon data external to the utility
- Reward-penalty system
- Efficiency gains that are shared with the ratepayer
- Greater flexibility for the utility
- Protections for ratepayers from abuse of market power. [4]

The following summary of a discussion by David Sappington provides some academic background for designing an AFOR.

> In practice, the firm's information about its environment is often better than the regulator's information. The information asymmetry arises naturally because of such factors as staff, differences in technical training, and proximity to both consumers and the production process. Since the regulator is unable to monitor all relevant activities directly, the regulator is forced to provide indirect incentives for the firm to act diligently. These indirect incentives are created by basing the firm's compensation on observable measures that are correlated with the firm's unobserved behavior . . .
> . . . The optimal use of performance measures depends critically on the properties of the performance measures that are available. Two characteristics of performance measures that are particularly important: sensitivity, and variability . . .
>
> - There may be ways to reduce undesired variability. One applicable general principle is to hold the firm responsible for outcomes that are clearly under its control, and to limit the financial responsibility of the firm for outcomes that are largely beyond its control . . .
> - Often, the regulator is not certain how difficult or costly it would be for the firm to improve its performance . . . [t]hus, the better the firm's information about how to best achieve a broad goal relative to the regulator's information, the stronger the case for setting broad

[4] Johannes M. Bauer, Michigan State University, Performance Based Regulation, 40th Annual Regulatory Studies Program, East Lansing, Michigan, August 5, 1998.

> performance standards, thereby delegating to the firm greater discretion in how to achieve the identified goal.[5]

This is why staff recommends a report on infrastructure development at the end of the four year period – to inform the commission rather than arbitrarily choosing performance benchmarks which could inadvertently lead to ill-effects such as unintended winners and losers. Sappington continues . . .

> The key is to make it unattractive for the firm to implicitly understate its capabilities by selecting a very modest performance target and subsequently earn large rewards for exceeding the target.
>
> - One way to limit the chances that a proposed incentive scheme will jeopardize the financial integrity of the firm is to allow the firm to choose one incentive scheme from a carefully designed menu of alternative schemes. This can induce the regulated firm to reveal the difficulty of the task it faces. The AFOR statute makes the status quo an option for the firm by allowing the commission to approve a plan which then the company may choose whether it wishes to opt in. In essence, current performance serves as the benchmark against which future performance is measured and rewarded.
> - The regulator is often under significant pressure to change the rules of the game after the fact.[6]

The improved plan strikes a balance with a four year plan that will be completed and reviewed at the end. Incentive plans have to have limited flexibility during the duration of the plan.[7]

Q. Why would the commission want to do an AFOR?

A. The commission may choose to do an AFOR because the commission is heavily reliant on information supplied by the utility. Due to the asymmetry, the commission

[5] David Sappington , Review of Industrial Organization, 9, June 1994, 245-272 "Designing Incentive Regulation."
[6] Sappington.
[7] Id."

may not be able to adequately assess the effort of the utility to improve efficiency. In the face of rapidly evolving market conditions, it is wise to create a new social contract with the company, in effect negotiating solutions to regulatory problems that may be created when the old social contract departs from traditional rate of return regulation. The old contract was for a quasi-exclusive franchise in exchange for the opportunity to earn a fair rate of return. In exchange, the public interest was protected with economic regulation and the obligation to serve. This worked to provide economic efficiency when there was one provider. However, today, apparently almost all of Qwest's markets are contestable, and so average prices and cross-subsidies are no longer economically efficient, inhibiting technological advancement.

THE SOCIAL CONTRACT

Q. How does the plan as modified by staff address the needs of the social contract?

A. Faced with these changes, the improved plan provides the commission with a new social contract that:

- Provides stability and certainty for standalone basic exchange services for core residential customers, limiting the potential for cross-subsidization;
- Prohibits de-averaging core rates or abandoning core markets;
- Commits to a modernization program;
- Protects quality of service;
- Protects competition; and
- Allows the commission to monitor financial performance.[8]

[8] For further discussion of the social contract, please *see* "Thoughts on a New Social Contract," Funding the Future of the Telecommunications Industry; Managing Technological Innovation to Satisfy Consumer Demands, by V. Louise McCarren, presented at Rensselaer Polytechnic Institute, Saratoga Springs, New York, June 3 – 5, 1985, Revised July 26, 1985.

Borrowing from McCarren, this new social contract reflects expectations about what the state of technology will be, and the notion that competition is increasing in most markets. If competition or technology does not prove out, then an AFOR with an overly long period would be a mistake.[9] The improved plan strikes an appropriate balance.

Core monopoly residential standalone rates are the subject of the most debate, and so the plan is supported by staff analysis of whether the rates under the plan are fair, just, reasonable, sufficient, and promote universal service. The plan shifts some of the risk in Qwest's future away from the core monopoly residential customer. The proposal allows the commission to manage dual competing goals of economic efficiency and consumer welfare. In so doing, the plan also ensures that the level playing field conditions that the commission has worked long and hard to implement will continue to have their market-opening effect and improve consumer welfare. The plan does not require the presence of competition in every service and geographic market. Since ubiquitous competition for certain pockets of services and geographic markets may be weaker, the plan strikes an appropriate balance between flexibility for Qwest and protecting the public interest. The plan also solves the problem of protecting monopoly ratepayers at the same time that investment in new technology is being deployed. Qwest is likely to be far more constrained by the effects of competition under the improved plan, than it will ever be by the

[9] Id. page 9.

commission. In many markets characterized by competition, explicit governmental intervention is inferior to private, individual negotiation and contracting.[10]

SUMMARY OF AFOR BASICS

Q. Please summarize the typical types of applications for an AFOR.

A. Typically, an AFOR is used in the following applications:

- Regulating the price of remaining monopoly segments,
- Regulating the price of "essential" inputs like unbundled network elements,
- Setting quality of service benchmarks,
- Implementing universal service policies.[11]

AFORs have been used in the UK, US, NZ, Latin America. [12]

TRADITIONAL RATE OF RETURN BASICS

Q. Please briefly summarize traditional rate-base, rate of return regulation (ROR).

A. With typical rate-base rate of return regulation, investments, expenses, and the cost of capital are approximated with allowed operating income. The commission determines a revenue requirement, performs a demand forecast and rate design, and then reviews the plan and compares it with actual results.[13] In the case of Qwest this is accomplished using Qwest's accounting records, and demand data to determine Qwest's intrastate results of operations which are modified to include specific commission-based adjustments.

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[10] *See* "Economic Efficiency, the Economics Discipline, and the "Affected-With-A-Public-Interest" Concept" by Edythe S. Miller, Journal of Economic issues, Volume XXIV, No. 3 September 1990.
[11] Bauer.
[12] Bauer.
[13] Bauer.

PROBLEMS WITH TRADITIONAL RATE OF RETURN REGULATION

Q. Please briefly summarize problems with traditional rate-base, rate of return regulation (ROR).

A. Traditional rate-base ROR regulation results in a "cost plus mentality" that can lead to various problems including over-investment and gold plating, high administrative costs, incompatibility with emerging competitive environment and the need for flexibility to react to changing market conditions. Also, traditional rate-base ROR regulation impedes risk-taking, creates an incentive to cross-subsidize, and is usually a poor performance yardstick.[14]

We can also learn from previous experience with inter-carrier compensation.[15]

- Long run marginal costs, rather than average total costs, are the proper basis for understanding pricing decisions.
- Nevertheless, not all rates can be set at long run marginal cost and still cover average total cost.
- Nor should all rates be set at long run marginal cost because of differences between service and geographic markets, particularly when customers compete with one another using the services – secondary effects can be significant.
- Sometimes efficient pricing at the producer level can result in serious and unintended effects at the secondary business level.[16]

As Kahn notes,

> "Special consideration may have to be given to the institutional implications and consequences of discriminatory price competition. This would include the following: (a) the important stimulus that price competition imparts to keeping companies on their toes, energetic in cutting costs, enterprising in

[14] Id.
[15] "The Economics of Regulation – Principles and Institutions," Volume I, Economic Principles, Seventh Printing, MIT 1988, by Alfred E. Kahn, Chapter Six, Ratemaking in the Presence of Competition, page 160.
[16] Id.

experimenting with price reductions, innovative in service, and (b) the possibility that competition will be predatory or destructive."[17]

AFOR'S ADVANTAGES AND DISADVANTAGES

Q. What are some of AFOR's advantages over traditional rate of return regulation?

A. AFOR plans can reward efficiency, productivity, process and service innovations and gains, ~~ensure that~~ gains ~~are~~ may be shared with shareholders, and an AFOR is generally more compatible with a competitive environment. Additionally, an AFOR can allow diversification but can be designed to eliminate the incentive to shift costs to captive customers, and it can also provide for corporate risk-taking while protecting core monopoly customers.

Q. What are some of AFOR's disadvantages?

A. There can be several disadvantages to an AFOR, particularly with twenty-twenty hindsight. For example, I will later provide a discussion of the dissatisfactory experience Washington had under an AFOR with Qwest's predecessor, U S WEST (*see* Table 1). As Bauer notes, although an AFOR can avoid many of the drawbacks of traditional rate of return regulation when partial competition is happening, it can be difficult to design an AFOR that sufficiently addresses all interests under changing conditions. Therefore, an AFOR works best as a transitional tool and may lose its effectiveness over the long run. Determining the appropriate length and level

[17] Id.

of intervention is critical for the incentive mechanism of an AFOR to be effective and in the public interest.[18]

Q. Can an AFOR protect monopoly customers, or will it allow the utility to engage in cross-subsidization? Please comment.

A. An AFOR can be designed with constraining conditions to protect monopoly customers. But it is not simple in the case of price cap regulation. The problems of price cap regulation include: the transformation from rate-of-return regulation, the adoption of a price cap formula, cross-subsidization, and the relationship between regulation and competition.[19] These potential results imply that the regulator must periodically review price cap results to realign prices with the cost of service and to ensure that a level playing field that would nurture competition develops in every market.[20]

Q. Does the plan recommended by staff address these issues?

A. Yes. The improved plan recognizes and addresses these issues. A transformation of the financing, accounting, reporting and record-keeping requirements is effectuated subject to rigorous review and analysis as testified by staff witness Paula Strain. A schedule for prices of core monopoly services is set, and cross-subsidization is addressed by the status quo regulatory regime as well as staff's analysis of rates in this case. The relationship between competition and regulation is addressed with

[18] Id.
[19] Robert Loube, Journal of Land Economics, August 1995, 71 (3) 286-98.
[20] Id.

significant flexibility as warranted. Staff's proposal to improve the plan provides for a periodic review to allow for realignment of prices and costs, if necessary, and the plan ensures continuation of level playing field conditions to allow competition.

AFOR VERSUS COMPETITIVE CLASSIFICATION AS A TOOL

Q. Is the AFOR approach rather than competitive classification an acceptable approach to Qwest's need for flexibility at this time?

A. Yes, because competitive classification for some services is problematic in some cases, and a good AFOR plan can provide flexibility but still retain appropriate protections. For example, some of Qwest's services retain vestiges of market power like standalone residential, WTAP, access, and others listed as exceptions under the plan, as well as business services that have not yet been classified as competitive. Therefore, standalone residential service, WTAP, access services and others are protected by remaining available *a là carte* under tariff in the AFOR and vestigial non-competitive business services are to be given competitive flexibility, but they are protected as well by prohibitions on geographic deaveraging.

THE U S WEST AFOR; 1990 - 1994

Q. What was the commission's prior experience with AFOR for the largest local exchange company, Qwest (formerly known as U S WEST)?

A. In October 1988 the commission issued an open letter on incentive regulation, stating that the ultimate criteria in judging incentive regulation proposals would be whether they serve the public interest and generate real benefits for consumers.

In February 1989, in Docket No. U-89-2698-F, the commission issued an over-earnings complaint, later amended, against Pacific Northwest Bell Telephone Company d/b/a/ U S WEST Communications (now Qwest). Several months later parties submitted a proposed settlement and a stipulation to an alternative form of regulation, and U S WEST subsequently asked for approval of the alternative form of regulation.

In January 1990, the commission approved the five year plan for an AFOR for U S WEST, stating that each similar proposal would be evaluated on its own merits. The settlement, as approved, provided an estimated cumulative five-year revenue decrease of $337.75 million. The commission said that the plan ensured that ratepayers would benefit from efficiency gains and cost savings arising out of regulatory change, and would afford ratepayers the opportunity to benefit from improvements in productivity due to technological change. The commission believed that the modified plan would not result in a degradation of the quality or availability of efficient telecommunications services, and that rates would be fair, just and reasonable.

The U S WEST AFOR agreement covered the five year period 1989-1994, with a two month "window" in July 1992 for the commission to determine whether the agreement should be terminated early. During the agreement period there were to be no increases in the monthly recurring rates for exchange residence or business service. The minimum authorized rate of return under the AFOR was 9.25 percent, with the sharing of earnings after 11 percent, and all excess profits due to mandatory cost factors like tax and accounting changes going to ratepayers. Otherwise excess earnings between 11 percent and 11.625 percent were distributed with 60 percent being returned back to ratepayers. Between 11.625 percent and 12.25 percent, half of excess profits went back to ratepayers, and above that, 40 percent went back to ratepayers.

The total sharing dollars under the plan are shown in Table 1 below. The company was required to file periodic earnings statements that were reviewed by staff in a three week period. The process of earnings reviews was always very difficult and stressful due to the quantity of information filed, and the limited time available to review it.

TABLE 1

U S WEST Earnings Sharing, First AFOR 1990 - 1994

Row		1990	1991	1992	1993	1994	Total
1	Total USWC Share	$22,429,000	$31,778,273	$38,829,168	$4,200,000	$0	$97,236,441
2	USWC share to depreciation reserve	$5,172,740	$10,593,127		$4,200,000		$19,965,867
2.1	1993 Interest accrual				$453,000		$453,000
2.2	1994 Interest accrual				$337,000		$337,000
3	USWC share to shareholders	$17,256,260	$21,185,146	$38,829,168	-$790,000	$0	$76,480,574
	(Row 1-2-3-2.1-2.2)						
4	Total Ratepayer Share	$21,680,000	$28,658,000	$33,300,000	$12,937,000	$0	$96,575,000
5	Ratepayer share to refund (res, bus, carrier common line)	$14,880,000	$19,105,000				$33,985,000
6	Ratepayer share to depreciation reserve	$5,000,000	$9,553,000				$14,553,000
7	E-911 service improvements	$1,800,000					$1,800,000
8	Ratepayer share to compress rate groups/restructure business			$24,100,000			$24,100,000
9	Ratepayer share to toll rate restructure			$7,200,000			$7,200,000
10	Ratepayer share to access charge restructure			$2,000,000			$2,000,000
11	Total Excess Revenues Dedicated to	$26,852,740	$39,251,127	$33,300,000	$17,927,000	$0	$117,330,867

	Benefit Ratepayer						
	(Row 1+2+2.1+2.2+4)						
12	Total Excess Revenues (Row 1+ Row 4)	$44,109,000	$60,436,273	$72,129,168	$17,137,000	$0	$193,811,441

Under the U S WEST AFOR, excess revenues to be flowed to the ratepayers were available for commission-directed service improvements or rate restructures, reducing depreciation reserves (which were large as digital technology was being adopted), or refunds. Excess ratepayer funds used to adjust the depreciation reserve had to be matched by the company.

In May 1993, the commission initiated an inquiry, under the "Open Window" clause in the plan, to determine whether the public interest justified termination of the AFOR. In May 1994, staff recommended that the commission rescind its approval of the AFOR and initiate a formal complaint against U S WEST's earnings. The staff position was premised upon problems identified with the AFOR, including:

1. No demonstration that excess earnings were the result of improvements in productivity and operating efficiency;
2. Current rate levels were no longer fair, just, and reasonable;
3. An increase in held orders, and held order complaints, showed a diminution of service quality;
4. A comparison of new tariffed offerings before, and after implementation of, the plan indicated the plan's failure to stimulate innovation of services; and
5. the plan had not reduced regulatory delay or costs.

Staff suggested the following modifications as an alternative to terminating the plan:

1. Re-basing rates to effect an equal percent reduction in local exchange access line rates, based upon the latest 12 month commission-adjusted results of operations using the authorized rate of return (ROR) of 10.53 percent;
2. Setting a maximum cap on earnings at 13.5 percent overall ROR, with all excess earnings returned to the ratepayer;
3. Requiring U S WEST to reduce held orders to historic levels, with penalties for failing to meet the benchmark, including reducing shareholders' excess earnings;
4. Ordering U S WEST to file a rate case prior to termination of the AFOR, and to assume the burden of proof in that proceeding; and
5. Ordering U S WEST to report at the end of the AFOR on the operation of the AFOR, a quality of service study, a productivity study, a list of innovative and new services introduced during the plan, and a description of U S WEST's proposal for a new AFOR.

Ultimately, the U S WEST AFOR was not renewed. In February 1995, U S WEST filed a general rate case in Docket No. UT-950200. In December 1996 the commission issued the 15th Supplemental Order setting new rates. In August 1997, Qwest filed for rate adjustments to "make the company whole" in Docket No. UT-970766. In January 1998, the commission's Tenth Supplemental Order was issued rejecting tariff revisions, and requiring re-filing.

Q. Please discuss lessons that the commission can learn from the previous AFOR experience with U S WEST for purposes of informing its decision on the current proposal from Qwest.

A. The previous AFOR with U S WEST does not provide a basis for denial of the current proposal or staff's recommended improvements. The previous experience informs the commission very little in the instant matter. As the names suggest, U S WEST is not even the same company that Qwest is today.

The company's position in the market has changed drastically. In the early 1990s at the time of the U S WEST AFOR, there was really not much opportunity for competition to benefit U S WEST ratepayers. Local exchange competition had not even been ratified until the State Supreme Court ELI decision in 1994.[21]

In 1990 – 1994, the commission had yet to implement the prerequisites for effective local competition. The commission had not addressed interconnection until Docket No. UT-941464. The market-opening regulatory reforms of the Telecommunications Act of 1996 had not yet occurred. The cost of unbundled network elements had not been addressed until the generic cost of service docket series beginning with Docket No. UT-960369. The development of competition-friendly operations support systems and wholesale performance incentives had not been created for Washington until this century in the proceedings to address whether the Bell Company had opened up its local market to competition and should be permitted to compete for in-region long distance service under Section 271 of the Telecommunications Act of 1996.[22] U S WEST was in a completely different operating environment then, compared to today's Qwest, and the unsatisfying results of the previous AFOR should not be expected to recur due to the existence of a viable competitive

[21] 123 Wn. 2d 530, IN RE CONSOLIDATED CASES, Mar. 1994 [No. 59999 – 8. En Banc. March 17, 1994.] In the Matter of the Consolidated Cases Concerning the Registration of Electric Lightwave, Inc. and Registration and Classification of Digital Direct of Seattle, Inc. ELECTRIC LIGHTWAVE, INC., ET AL, Respondents. WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION, ET AL, Appellants, V THE UTILTIES AND TRANSPORTATION COMMISSION, Appellant.

[22] *See*, In the matter of the investigation into U S WEST Communications, Inc., compliance with Section 271 of the Telecommunications Act of 1996, Docket No. UT-003022, Qwest long term PID administration and QPAP review, Docket No. UT-030388, and Docket No. UT-003040, allowing Statement of Generally Available Terms filed by U S WEST Communications, Inc., as amended June 12, 2000, to go into effect pending completion of Commission review, pursuant to the Telecommunications Act of 1996.

environment necessary to provide the company behavioral discipline and the specific conditions set forth in the improved proposal with staff's recommendations designed to protect the public interest.

REVIEW OF QWEST'S PETITION

Q. Please summarize your understanding of Qwest's AFOR proposal.

A. In its petition, Qwest wants to be accorded the same regulatory flexibility that is granted to competitively classified companies. Qwest proposes provisions for streamlined review and approval of rates, service quality and various regulatory filing requirements subject to certain exceptions and transition period requirements.

The commission grants a list of waivers for competitively classified telecommunications companies because when these companies are subject to effective competition, various rules meant for monopolies are no longer necessary. The list of waivers for competitively classified telecommunications companies is memorialized at WAC 480-121-363, and includes waiver of the following requirements:

(a) RCW 80.04.300 (Budgets to be filed by companies -- Supplementary budgets);
(b) RCW 80.04.310 (Commission's control over expenditures);
(c) RCW 80.04.320 (Budget rules);
(d) RCW 80.04.330 (Effect of unauthorized expenditure -- Emergencies);
(e) RCW 80.04.360 (Earnings in excess of reasonable rate -- Consideration in fixing rates);
(f) RCW 80.04.460 (Investigation of accidents);
(g) RCW 80.04.520 (Approval of lease of utility facilities);
(h) RCW 80.36.100 (Tariff schedules to be filed and open to public);

(i) RCW 80.36.110 (Tariff changes -- Statutory notice -- Exception);
(j) Chapter 80.08 RCW (Securities) (except RCW 80.08.140, State not obligated);
(k) Chapter 80.12 RCW (Transfers of property);
(l) Chapter 80.16 RCW (Affiliated interests);
(m) WAC 480-80-101 Tariff requirements through WAC 480-80-143 Special contracts for gas, electric, and water companies;
(n) Chapter 480-140 WAC (Commission general -- Budgets);
(o) Chapter 480-143 WAC (Commission general -- Transfers of property);
(p) WAC 480-120-102 (Service offered);
(q) WAC 480-120-339 (Streamlined filing requirements for Class B telecommunications company rate increases);
(r) WAC 480-120-399 (Access charge and universal service reporting);
(s) WAC 480-120-344 (Expenditures for political or legislative activities);
(t) WAC 480-120-352 (Washington Exchange Carrier Association (WECA));
(u) WAC 480-120-369 (Transferring cash or assuming obligation);
(v) WAC 480-120-375 (Affiliated interests -- Contracts or arrangements);
(w) WAC 480-120-389 (Securities report); and
(x) WAC 480-120-395 (Affiliated interest and subsidiary transactions report).

In addition, with the recent elimination of the price list filing requirement, RCW 80.36.100 (Tariff schedules to be filed and open to public — Exceptions) is no longer applicable to competitively classified services under RCW 80.36.100(5).[23]

Q. What elements of regulation would remain in place under Qwest's proposal?

A. Current regulation not impacted by the petition would remain subject to the *status quo*, including all orders and rules governing wholesale arrangements. This would mean, for example, that Qwest would still be subject to wholesale service quality and market-opening provisions, and to normal prohibitions against pricing below cost

[23] See also RCW 80.36.333 (Price lists in effect before June 7, 2006 — Extension) and RCW 80.36.338 (Withdrawal of price list — Customer information, opportunity to accept changes in rates, terms, or conditions — Cancellation period).

found in RCW 80.36.300(4),[24] RCW 80.36.330(6), [25] and most rules and regulations governing telecommunications operations.[26]

In addition, under new section WAC 480-120-266[27], although competitively classified service offerings are not treated as a tariff and are not reviewed or approved by the commission at the time of filing, the commission will, when appropriate, investigate or complain against a rate, term, or condition provided pursuant to competitive classification. If the commission determines that a rate, term, or condition offered pursuant to competitive classification is ambiguous or conflicts with other offers, there is a rebuttable presumption that the conflict or ambiguity should be construed in favor of the customer unless the rate, term or condition was not proposed by the company.

Finally, the rates, charges, and prices of services classified as competitive under RCW 80.36.330 must cover the cost of providing the service. Costs must be determined using a long-run incremental cost analysis, including as part of the

[24] "[e]nsuring that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of regulated telecommunications companies"
[25] "[n]o losses incurred by a telecommunications company in the provision of competitive services may be recovered through rates for noncompetitive services. The commission may order refunds or credits to any class of subscribers to a noncompetitive telecommunications service which has paid excessive rates because of below cost pricing of competitive telecommunications services"
[26] *See* WAC 480-120, including provisions governing general rules, establishing service and credit, payments and disputes, discontinuing and restoring service, posting and publication of notices, customer information, telecommunications services, safety and standards rules, and adoptions by reference to other standards setting bodies.
[27] In the rulemaking to eliminate the price list filing requirement, the commission plans to rewrite current WAC 480-80-202 into NEW SECTION WAC 480-120-266, carrying forward several regulations while editing them to acknowledge price lists will no longer be filed at the commission. The language in my testimony here is based upon the upcoming version.

incremental cost, the price charged by the offering company to other telecommunications companies for any essential function used to provide the service, or any other commission-approved cost method. These provisions are currently being moved from WAC 480-80 to a new section, WAC 480-120-266 in the current rulemaking to eliminate price list filing requirements, UT-060676.

Under the AFOR, Qwest would still be a regulated company subject to significant regulatory oversight. Upon review in four years, the commission can also decide to continue or terminate all or part of the AFOR. The commission's rules governing competitively classified services provide that the commission retains the authority to impose additional or different requirements on any telecommunications company in appropriate circumstances, consistent with the requirements of law (WAC 480-121-016(2)).

<u>GREATER FLEXIBILITY IN A CHANGING MARKET</u>

Q. Please describe and comment upon the proposed provisions for regulatory flexibility.

A. Qwest would be treated as though it had been classified by the commission as a competitive telecommunications company, subject to several important conditions constraining the company's behavior to protect customers who may be subject to vestiges of market power.

Chapter 347, Laws of 2006, enacted in the 2006 legislative session, eliminated the requirement that telecommunications companies file price lists for services the Commission has found to be competitive in nature. This would mean that subject to important exceptions listed in the petition and described below, Qwest would not file for approval with the commission for the rates, terms or conditions for services treated as competitive.

Q. What Qwest services are already classified as competitive?

A. Qwest has already received competitive classification of many of its services including toll and centrex, as well as almost all business switched digital local exchange and almost all dedicated services in almost all urban areas. Furthermore, competitive classification has been granted statewide for Qwest for analog local exchange switched business services. In some cases, certain digital business exchange services remain subject to tariff in more rural areas of the state. Please refer to Qwest witness Mark Reynolds' exhibit MSR -3 for a concise listing of all competitive and non-competitive services to see how they would be affected by the petition.

Q. Please discuss the provision that Qwest will be subject to the same regulation as companies classified as competitive pursuant to RCW 80.36.320, subject to certain exceptions and certain transition period requirements.

A. In summary, Qwest's petition has a relatively small incremental effect on the regulatory status of the company as a whole. The change would amount to additional competitive flexibility only for a relatively small number of additional customers, primarily in rural areas.

Qwest should only be granted competitive company treatment for the four years of the AFOR. At the end of the AFOR, the commission should be able to consider whether the plan was a success, and may consider permanent waivers at that time.

As illustrated in Figure 1, since the 1980s Qwest's industrial environment has gone from one technology, device, and regulated provider to multiple technologies, devices, and providers with robust competition in many markets.

FIGURE 1[28]

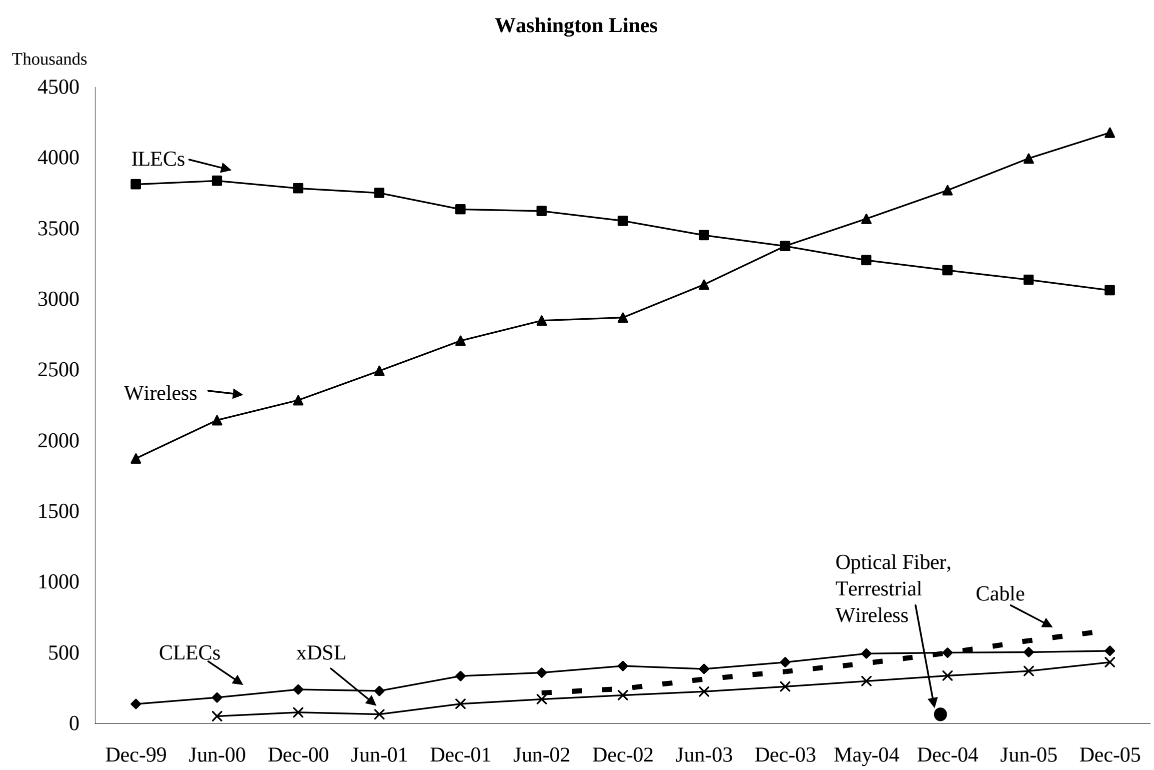
1980		**NOW**
One	**Technology**	Multiple
One	**Device**	Multiple
One	**Provider**	Multiple

[28] From "The Evolving Economics of Competition" by Charles Davidson and Michael Santorelli, Advanced Communications Law and Policy Institute, A Division of the Media Center at New York Law School, Presented at the Qwest Regional Oversight Committee Meetings, Rapid City, South Dakota, October 18, 2006. http://www.regionaloversightcommittee.org/Fall%2006%20RC/handoutroc06.htm

Regulated	**Price**	Robust Competition

Qwest's regulated telecommunications services - both non-competitive and competitive - are subject to increasing levels of competition in a market where consumers choose from an array of regulated and unregulated services offered over a variety of intermodal technologies. This effect is vividly illustrated by studying the market for lines in Washington. Figure 2 illustrates FCC competition data since December of 1999.[29]

FIGURE 2



[29] *See* FCC Wireline Competition Bureau Statistical Reports at http://www.fcc.gov/wcb/iatd/stats.html.

Today, as Figure 2 shows with supporting figures from Table 2 below, there are more wireless subscribers than wireline subscribers. There are also more cable lines than CLEC lines, even though there weren't even enough cable lines to measure just five years ago in 2001. Keep in mind that CLECs have been authorized to operate in Washington since before the Telecommunications Act of 1996, so cable's rise is all the more significant. Notice further, as shown in Table 2 below, that Qwest's percent share of all ILEC lines has declined in the past six years from almost 68 percent down to a little over 61 percent, indicating that line losses are affecting Qwest particularly hard.

Table 2[30]

Row	**Lines**	**December 2000**	**December 2005**	**2005 Percent Share of Total**
1	CLECs	240,514	514,149	5.8%
2	ILECs	3,784,183	3,062,790	34.6%
3	Wireless	2,286,082	4,177,196	47.2%
4	xDSL	79,130	434,505	4.9%
5	Cable		660,151	7.5%
6	Total Washington	6,389,909	8,848,791	100.0%
7				
8	Qwest	2,571,025	1,903,498	
9	Qwest Percent of ILEC Lines	67.9%	62.1%	
10	Qwest Percent of Total	40.2%	21.5%	

[30] Note: Qwest lines are December 2000 and June 2006.

I made this analysis to illustrate how the choices that consumers have in Washington today are changing. For purposes of the analysis I assume that all lines counted in the FCC reports are equivalent because they all provide access to telecommunications. A consumer could use any of these lines for voice telecommunications, and in many circumstances, for data as well. The relevant market encompasses telecommunications broadly. Market participants include CLECs, cable companies, VoIP, and wireless service providers.[31] With that assumption, the analysis compares wireline activity by incumbent local exchange companies (ILECs) and competitive local exchange companies (CLECs) with wireless carriers, and also with high speed lines (greater than 200 kbps) provided over xDSL, optical fiber, terrestrial wireless, and cable.

Consumers can choose to purchase access to telecommunications from any of these intermodal competitors in many parts of Qwest's territory and the data shows that consumers are enjoying the choice of alternatives more and more. Although the data is statewide, and thus includes not only Qwest territory, but also other ILEC territory as well, the data is reflective of Qwest's experiences, and typical of most ILECs, because Qwest does still serve over 60 percent of the ILEC lines in the state.

Also, almost 50 percent of the current interconnection agreements on file with the commission are with Qwest (Qwest currently has local interconnection agreements

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[31] *See* the California commission's landmark August 2006 decision assessing and revising the regulation of Verizon and other telecommunications utilities in its rulemaking 05-04-005 succinctly expressing the point that voice constitutes a single communications market, page 70.

pursuant to Sections 251 and 252 of the Telecommunications Act of 1996 with approximately 100 competing carriers, not including commercial agreements).

EFFECTIVE COMPETITION

Q. Please describe the commission's experience with determining the prerequisites for effective local competition.

A. The commission recognized a list of eleven prerequisites for effective local competition in 1995:

1. central office interconnection arrangements
2. connections to unbundled network elements
3. seamless integration into local exchange company interoffice networks
4. seamless integration into local exchange company signaling networks
5. equal status in/control of network databases
6. local number portability
7. reciprocal inter-carrier compensation arrangements
8. equal rights to/control over number resources
9. cooperative practices and procedures
10. economically efficient pricing signals
11. intraLATA equal access[32]

This list was a common theme once again in staff's approach to generic interconnection in Docket No. UT-941464 (preceding the Telecommunications Act of 1996).[33] Also, with regard to the prerequisites for local competition, Dr. Lee

[32] In the Matter of the Petition of Electric Lightwave, Inc., for an Order Granting Competitive Telecommunications Company Classification, Docket No. UT-940403, Order Granting Petition, at 4 (January 11, 1995).

[33] BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. U S WEST COMMUNICATIONS, INC., Respondent, DOCKET NO. UT-941464, TCG SEATTLE AND DIGITAL DIRECT OF SEATTLE, INC., Complainant, vs. U S WEST COMMUNICATIONS, INC., Respondent, DOCKET NO. UT-941465, TCG SEATTLE, Complainant, v. GTE NORTHWEST, INC., Respondent, DOCKET NO. UT-950146, GTE NORTHWEST, INC., Third Party Complainant, v. U S WEST COMMUNICATIONS, INC., Third Party Respondent, ELECTRIC LIGHTWAVE, INC., Complainant, v.

Selwyn of Economics and Technology, Inc., and Hatfield Associates, Inc., wrote a book in 1994 entitled The Enduring Local Bottleneck – Monopoly Power and the Local Exchange Carriers. The authors described the local exchange bottleneck and the prerequisites for local competition, and predicted the local bottleneck would endure for five to ten years. They listed the following prerequisites, among other discussion: full local exchange company interconnection, local number portability, control of numbering, control of distribution, control of switching, and control of transport. These prerequisites were all measured and met by Qwest in the 271 cases.[34] Together with the evidence of actual competition, the structural framework of the 271-mandated provisions and safeguards in place are critical to staff's analysis.

Q. Please discuss the commission's experience with relevant competitive classification cases.

A In the case of Qwest, this commission has substantial experience gauging and addressing effective competition. In Docket UT-86-34 et al, the commission classified centrex-type services of Pacific Northwest Bell (PNB) as competitive, not including the local loop.[35] One of the major issues in that case was measuring the cost of service in order to address concerns at the time about cross-subsidization. In

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GTE NORTHWEST, INC., Respondent, DOCKET NO. UT-950256, Direct Testimony of Thomas L. Wilson, Jr., On Behalf of the Washington Utilities and Transportation Commission, April 17, 1995, page 30.

[34] *See*, In the matter of the investigation into U S WEST Communications, Inc., compliance with Section 271 of the Telecommunications Act of 1996, Docket No. UT-003022, Qwest long term PID administration and QPAP review, Docket No. UT-030388, and Docket No. UT-003040, allowing Statement of Generally Available Terms filed by U S WEST Communications, Inc., as amended June 12, 2000, to go into effect pending completion of Commission review, pursuant to the Telecommunications Act of 1996.

[35] Cause No. U-86-34 Et. Al, Fourth Supplemental Order, April 7, 1987.

1987, in a case involving a historically dominant carrier, the commission classified AT&T as a competitive telecommunications company. At that time AT&T retained a 75 percent market share.[36]

In Docket No. U-88-1997-P the commission classified PNB's Billing and Collection Services as competitive, and in Docket No. U-88-2052-P, the Company's high volume long distance was classified as competitive.

Up until 1999 the commission had not received petitions for competitive classification of a service for less than the entire operating territory of a company in Washington. In Docket No. UT-990022 the commission relied on the phrase "relevant market" and approved competitive classification of U S WEST DS3 services in certain wire centers. Although the commission noted that competitors did not have physical plant in service at every single location in the affected wire centers, the commission found that entry into the market was occurring.

> We find that because competitors have the ability to construct their own facilities or to lease unbundled network elements at cost-based rates or resell existing facilities pursuant to the Telecommunications Act of 1996, U S WEST lacks the ability to sustain prices substantially above cost in these two areas without losing market share. [37]

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[36] *In the Matter of the Petition of AT&T Communications of the Pacific Northwest, Inc., for Classification as a Competitive Telecommunications Company*, Docket No. U-86-113, Fourth Supplemental Order at 11 (June 5, 1987).

[37] In the Matter of the Petition of U S WEST COMMUNICATIONS, INC., for Competitive Classification of its High Capacity Circuits in Selected Geographical Locations, Docket No. UT-990022, Eighth Supplemental Order Granting Amended Petition for Competitive Classification at 14 (December 21, 1999.)

The commission found that the services were subject to effective competition in some Seattle wire centers and a portion of Spokane.

In Docket No. UT-000883 the commission classified local business analog services provided over DS1 as competitive in the following urban wire centers: Bellevue: Glencourt and Sherwood; Seattle: Atwater, Campus, Cherry, Duwamish, East, Elliott, Emerson, Lakeview, Main, Sunset and West; Spokane: Chestnut, Fairfax, Hudson, Keystone, Moran, Riverside, Walnut and Whitworth; Vancouver: Orchards and Oxford. Statewide authority was requested but denied partly on the basis of inadequate evidence of competition (the Hirschmann-Hirfindahl Index was relied on heavily in an anti-trust-like review focused on that particular measure of market concentration), but also, because OSS was not yet in place to promote wholesale/retail service quality parity, and prerequisites for effective local competition were still under evaluation and development in the 271 case. The innermost layer of the onion – the local exchange -- was being unpeeled a little more, revealing remaining monopoly services at the core.

In Docket No. UT-021257 the commission classified digital business exchange services over a DS1 in certain wire centers: Bellevue: Glencourt and Sherwood; Seattle: Atwater, Campus, Cherry, Duwamish, East, Elliott, Emerson, Lakeview, Main, Sunset and West; Spokane: Chestnut, Fairfax, Hudson, Keystone, Moran, Riverside, Walnut and Whitworth; Vancouver: Orchards and Oxford. This item was approved at an open meeting by a voice vote.

In Docket No. UT-030614, recognizing the full implementation of market-opening measures was taking effect, the commission classified all Qwest business analog local exchange services as competitive statewide. In Docket No. UT-050258 the commission classified by voice vote at a regular open meeting all remaining digital business exchange services including private line, frame relay and all types of digital services in specific geographic areas served by 58 wire centers in the following six competitive market areas: Seattle/Tacoma (38 wire centers), Spokane (7), Olympia/Longview (4), Vancouver (5), Pasco/Yakima (3), and Bellingham (1).

In summary, at this time, Qwest has pursued competitive classification in nearly all of its service areas and for almost all of its services.

Q. Has Qwest opened its local market to competition?

A. Yes. According to approval recommendations by the commission[38] and the U.S. Department of Justice for authority to provide in-region long distance pursuant to Section 271 of the Telecommunications Act of 1996, Qwest has met the 14-point competitive checklist.[39] In addition, Qwest has opened its local market to

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[38] *See*, In the matter of the investigation into U S WEST Communications, Inc., compliance with Section 271 of the Telecommunications Act of 1996, Docket No. UT-003022.

[39] SEC. 271(c)(2)(B) [47 U.S.C. 271] BELL OPERATING COMPANY ENTRY INTO INTERLATA SERVICES.COMPETITIVE CHECKLIST.--Access or interconnection provided or generally offered by a Bell operating company to other telecommunications carriers meets the requirements of this subparagraph if such access and interconnection includes each of the following:

(i) Interconnection in accordance with the requirements of sections 251(c)(2) and 252(d)(1).

(ii) Nondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1).

competition. Qwest accordingly received 271 approval for Washington from the Federal Communications Commission (FCC) with findings of provisioning parity, deployment of operations support systems, and change management processes. Qwest has filed and received approval of a Statement of Generally Available Terms,[40] and the Company is subject to provisions for performance assurance, reporting, monitoring and compliance.[41]

WAIVERS

(iii) Nondiscriminatory access to the poles, ducts, conduits, and rights-of-way owned or controlled by the Bell operating company at just and reasonable rates in accordance with the requirements of section 224.

(iv) Local loop transmission from the central office to the customer's premises, unbundled from local switching or other services.

(v) Local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services.

(vi) Local switching unbundled from transport, local loop transmission, or other services.

(vii) Nondiscriminatory access to--

(I) 911 and E911 services;

(II) directory assistance services to allow the other carrier's customers to obtain telephone numbers; and

(III) operator call completion services.

(viii) White pages directory listings for customers of the other carrier's telephone exchange service.

(ix) Until the date by which telecommunications numbering administration guidelines, plan, or rules are established, nondiscriminatory access to telephone numbers for assignment to the other carrier's telephone exchange service customers. After that date, compliance with such guidelines, plan, or rules.

(x) Nondiscriminatory access to databases and associated signaling necessary for call routing and completion.

(xi) Until the date by which the Commission issues regulations pursuant to section 251 to require number portability, interim telecommunications number portability through remote call forwarding, direct inward dialing trunks, or other comparable arrangements, with as little impairment of functioning, quality, reliability, and convenience as possible. After that date, full compliance with such regulations.

(xii) Nondiscriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of section 251(b)(3).

(xiii) Reciprocal compensation arrangements in accordance with the requirements of section 252(d)(2).

(xiv) Telecommunications services are available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3).

[40] Docket No. UT-003040, allowing Statement of Generally Available Terms filed by U S WEST Communications, Inc., as amended June 12, 2000, to go into effect pending completion of Commission review, pursuant to the Telecommunications Act of 1996.

[41] Qwest long term PID administration and QPAP review, Docket No. UT-030388

Q. If Qwest were treated as a competitively classified telecommunications company, various statutes and rules would be waived. Please discuss the requested waivers that Qwest seeks in its AFOR proposal.

A. Competition will serve the same purpose as the statutes and rules that would be waived with a few exceptions for affiliated interests, transfers of property, and cash transfers, as discussed in the testimony of staff witness Deborah Reynolds. Qwest would still be subject to all remaining rules and statutes including prohibitions on below cost pricing, telecommunications operations and service quality requirements at both the retail and wholesale levels. Staff witnesses Paula Strain and Kristen Russell recommend modification of the waivers as related to compliance with the accounting and service quality provisions in the rules. Staff recommends approval of the plan with those improvements. The competitive influences of the market along with the retained regulatory controls of the AFOR as further improved by staff's recommendations should provide adequate safeguards for the public.

SERVICE QUALITY

Q. Please describe Qwest's proposed provisions concerning retail service quality.

A. Please refer to the testimony of staff witness Kristen Russell for a complete review. Qwest is seeking waiver of retail service quality requirements immediately. However, Qwest would continue compliance with all Class A reporting requirements during the four years of the AFOR.

Under its proposal, Qwest would not report to the commission every month; however, Qwest would still have to retain records that would be relevant, in the event of a complaint or investigation, to a determination of the company's compliance with the service quality standards. Also, Qwest proposes to be relieved of customer service guarantee program reporting requirements in the Seventeenth Supplemental Order in Docket UT-991358.

Q. Please provide staff's critical analysis of the proposed provisions concerning service quality.

A. Staff recommends maintaining service quality regulation for Qwest that is consistent with all other Class A carriers during the four years of the AFOR. Please refer to the testimony of staff witness Kristen Russell for a complete review. This would put Qwest on the same basis as Verizon, Embarq, Eschelon, and CenturyTel during the four year period.

The service quality reporting requirements should not be waived at the beginning of the transition period, and instead, the issue should be considered once again during the review period at the end of the AFOR in four years. To waive the rules now would mean that in four years the commission would have to take back the waiver then if it felt that service quality was an issue. It would be more appropriate for Qwest to show in four years why it should be removed, rather than placing the burden elsewhere.

Qwest has already reached an agreement on minimal reporting requirements with staff, as Ms. Russell indicates in her testimony. There is no need for service quality reporting for this major carrier to differ from the levels established in rule for similarly situated carriers.

In order to provide Qwest with an appropriate service quality incentive, staff recommends the following: Qwest should be allowed to exercise its option under the plan to increase the rate for standalone residential flat-rated service by up to fifty cents per line per month in years two through four only if the number of service quality complaints reported to the commission improves by more than five percent. For example, please refer to staff witness Kristen Russell's testimony at page 18, Table 2, which shows that in 2004 the total number of service quality complaints was 627, and in 2005 it was 516. The improvement in 2005 was (627-516)/627 = 17.7 percent. Therefore, in the example, since a 17.7 percent improvement is better than a five percent improvement, Qwest would have been allowed up to the $0.50 increase for 2006.

In addition, to promote service quality in the future, any time there is a major outage in a given area with a cause that is within Qwest's control, and that affects the availability of advanced telecommunications services, Qwest should build in either more redundancy to serve that area or a technological improvement that removes the vulnerability that caused the outage (*see* testimony of staff witness Deborah Reynolds).

DURATION AND REVIEW

Q. Please describe the four year term and review process at the end of the AFOR.

A. The terms of the AFOR would be effective upon approval by the commission and remain in effect for at least four years. Six months prior to the four year anniversary there would be a review of the provisions of this AFOR to determine if changing market conditions warrant modifications to the plan. At the four year anniversary, either the commission or Qwest may reopen the AFOR proceeding to propose modifications to the plan.

Q. Please critically analyze the provisions for the length of the AFOR period and the review process at the end of the AFOR.

A. The proposal is for a four year term with a review to begin six months before the end of the four years. With an AFOR, there are tradeoffs between the length of the period before the plan is subjected a comprehensive review, the allocative efficiency of the plan, and the productive efficiency incentives of the plan.[42] Given the rate at which Qwest's position in the market seems to be changing, a plan shorter than two years would probably be too short to gain any insights, but a plan longer than four years would probably be too long and might result in unforeseeable circumstances. The review process should be timely and allow opportunity for interested parties to participate. It is staff's understanding that parties with intervener status in this

[42] Johannes M. Bauer, Michigan State University, Performance Based Regulation, 40th Annual Regulatory Studies Program, East Lansing, Michigan, August 5, 1998

proceeding would automatically be involved in the review if it occurs in this same docket.

PROTECTIONS

Q. Please describe the exceptions that Qwest proposes to the provisions.

A. The streamlined regulatory regime that would be granted to Qwest under the provisions of the four year AFOR proposal carves out a list of services that would not be granted the flexibility of competitive classification. The services listed in this exception would remain subject to the full range of the commission's oversight including the tariff filing requirements of RCW 80.36.100.

The services subject to this exception are subject to significant public interest concerns as vital public goods and can also be viewed as being subject to vestiges of market power. The list of services in the exception would include the following basic and wholesale services:

a. Standalone Residential Exchange Services: Exchange Areas; Flat/Measured Exchange Service Options; Hunting Service; Public Response Calling Service; Directory Services – Listing Services and Custom Number Service; Operator Services – Local Operator Service Surcharges; Intercept Service; and Operator Verification/Interrupt Service. As described by Qwest witness Mark Reynolds, this means that even though Qwest would have pricing flexibility for business services, and almost all other services it offers except those listed here, Qwest would still have to file a tariff for approval to change any aspect of the rates, terms, or conditions of residential services including line extensions, extended area service, and various ancillary services.

b. Washington Telephone Assistance Program (WTAP). This provision would protect low income residents in Washington from any tariff changes to the WTAP program by requiring that it remain subject to the full range of commission oversight.

c. Tribal Lifeline. This provision would protect Native Americans, who may have little bargaining power.[43]

d. Link-up Programs.

e. Basic and Enhanced Universal Emergency Number Service – 911. This provision guarantees that any change to the rates, terms, or conditions of emergency service would be subject to commission review and approval in the tariff filing process.

f. The AFOR leaves the commission's authority to regulate Qwest's wholesale obligation under the Telecommunications Act of 1996 intact, and does not address existing carrier-to-carrier service quality requirements, including service quality standards or performance measures for interconnection and appropriate enforcement or remedial provisions in the event Qwest fails to meet service quality standard or performance measures. Essentially, Telecom Act issues are off the table.

[43] "By just about any measure used, individuals living in Native communities or villages typically have less income, receive less education, and suffer from higher unemployment and poverty rates than individuals in non-Native communities. Native communities lag far behind non-Native communities in basic infrastructure such as roads, utilities, and housing. . . . Only 39 percent of rural households in Native communities have telephones compared to 94 percent for non-Native rural communities." Assessment of Technology Infrastructure in Native Communities, Final Report, June 1999, Prepared by the College of Engineering, New Mexico State University, for the Economic Development Administration, U.S. Department of Commerce. Executive Summary.

g. Interconnection Service. The provision of crucial competitive access to operations support systems (OSS), and to bottleneck unbundled network elements (UNEs), collocation, and interconnection under the Telecommunications Act of 1996 would not be changed by Qwest's AFOR proposal. The commission's implementation and oversight of its responsibilities under the Telecommunications Act of 1996 would not be altered, including the performance/penalty payments for OSS. Non-competitive network services that are prerequisites for effective local competition would still be available subject to full commission review. This will ensure that the commission has full oversight of the conditions promoting competitive market discipline for Qwest's behavior under the terms of the AFOR proposal.

h. Resale Service. By absolutely preserving the availability of the resale option for competitors, even new entrants can readily provide Qwest with significant market pressure to keep rates, conditions and terms for all of its services within a range of reasonableness.

i. Access Service. The AFOR proposal does not change the status quo tariff filing requirement and review process governing the provision of access services for the origination and termination of competitors' traffic.

<u>RETAIL PROTECTION</u>

Q. Please analyze the proposal to exclude competitive treatment for Qwest's provision of standalone residential services.

A. Standalone residential service will remain subject to full tariff oversight. This is another necessary condition for approval. Although staff believes that Qwest is experiencing significant competition in the market for residential local exchange services, staff also believes that the market for residential local exchange services is still characterized by vestiges of market power. For example, staff does not believe that all residential consumers have the choice of an alternative provider in all geographic areas within Qwest's service territory. Keeping the provision of this service under the commission's full oversight under tariff ensures that Qwest will have to first obtain the commission's approval to change any of the rates, terms or conditions governing residential local exchange service. That way the commission can make sure that captive customers are not abused under the plan. This condition includes protection of existing extended area service routes (EAS) and the availability of directory services and operator assistance. The same philosophy applies to the other services that will remain subject to tariff oversight.

<u>Protecting Low Income Subscribers</u>

Q. Please analyze and discuss the provision to maintain tariff oversight of WTAP, and please begin by describing WTAP.

A. WAC 480-122-020 requires every telecommunications carrier eligible to receive federal universal service funds (ETCs) under Section 214 of the Telecommunications Act of 1996 to offer WTAP assistance rates and discounts. WTAP is funded by a telephone assistance tax on all switched access lines and is collected by wireline local exchange companies. There is a matching federal funds component to the program. The fund is administered by the Washington Department of Social and Health Services (DSHS). These are critical public interest services that should not be placed in conflict with any telecommunications company's operations and the commission should approve this aspect of the plan.

Q. How many WTAP customers are impacted by Qwest's proposal?

A. As of November 30, 2006, Qwest had 73,883 WTAP customers. Additionally, Qwest provided WTAP credits to 16 resale accounts. The number of WTAP customers that Qwest serves changes from time to time. From November 2005, to November 2006, Qwest experienced a one percent reduction in the number of WTAP customers. Qwest states that it believes this reduction is due primarily to the overall decline of Qwest access lines in the state. Assuming a similar decline of access lines in future years, Qwest anticipates the number of WTAP customers to be as follows:

2007: 73,144
2008: 72,413
2009: 71,689
2010: 70,972.

Q. Please describe the pricing for WTAP.

A. Qwest bills residential customers in Washington $12.50 a month for a flat-rated line. While all of Qwest's residential customers in the state are charged the same rate for this service, WTAP customers receive a Federal Lifeline credit of $2.67 and a State WTAP credit of $1.83 to help offset the cost of their basic line. These credits have effect of reducing the lifeline rate for WTAP customers to only $8.00. The federal subscriber line charge for residential customers in Washington is $5.84. WTAP customers get a corresponding Federal Lifeline credit of $5.84 to offset this charge.

If Qwest raises the standalone rate for residential service by $0.50 per month, per line, then the Federal Lifeline credit and State WTAP credits would be increased to maintain the lifeline rate for WTAP customers at $8.00. Thus if Qwest increases the rate, then the "draw" on the fund would increase.

Q. How many WTAP households receive reduced monthly charge benefits?

A. In State Fiscal Year (SFY) 2005, WTAP provided reduced monthly charge benefits to 166,223 households.[44]

Q. How many households could potentially be served by WTAP?

A. In SFY 2005 DSHS sent 402,995 additional notices of potential eligibility for WTAP to households receiving qualifying cash, food or medical assistance.[45] Thus, with 166,223 households participating in the program, and with 402,995 additional households potentially eligible, the program served 29 percent of all of the

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[44] Report to the Legislature, Washington Telephone Assistance Program, Year 18 of Program Operation, July 1, 2004, through June 30, 2005, December 2005, Department of Social and Health Services Economic Services Administration , Division of Employment and Assistance Programs.
[45] DSHS, id.

households that were potentially eligible in SFY 2005.In 1999, Washington was ranked with the ninth highest lifeline take rate in the country.[46]

Q. Should Qwest be required to absorb any increases in standalone residential rates to hold WTAP harmless under the four year AFOR plan?

A. No. In the Verizon rate case, Docket No. UT-040788, Verizon was authorized to increase the rate for residential services by $2.43 per month in 2004, and an additional $1.47 in July of 2007. Verizon did not have to absorb the difference for WTAP customers. The Federal Lifeline credit and State WTAP credit absorbed the increase without further commission consideration. Although Qwest serves more WTAP customers than any other ILEC, the same treatment that was afforded to Verizon in Docket No. UT-040788 should be afforded to Qwest here. Thus, the increases should be permitted with the understanding that an increased draw on the State WTAP fund will result.

The "take rate" of 29 percent implies that the program can be designed to absorb additional revenue requirements posed by the potential for Qwest standalone residential increases under the improved plan. Therefore, low income subscribers will be protected. The 2004 penetration rate for telephone service in Washington of

[46] "Closing the Gap: Universal Service for Low-Income Households" by Carol Weinhaus – Telecommunications Industries and Analysis Project, Tom Wilson - WUTC, Gordon Calaway - NECA, Robert Kwiatowski – NECA, Mark Lemler – AT&T, Dan Harris – Verizon, Eugene Goldrick – Verizon, Pat McLarney – Illinois Commerce Commission, Sally Simmons – Florida Public Service Commission, August 1, 2000, page 10.

96.5 percent is still very high and compares favorably to the national average of 95.7 percent in 2004.[47]

Wholesale Protection

Q. Please provide critical analysis of the proposal to exclude regulatory flexibility from Qwest's provision of interconnection under the Telecommunications Act of 1996.

A. The AFOR does not address the commission's authority to regulate Qwest's wholesale obligation under the Telecommunications Act of 1996, nor does it address existing carrier-to-carrier service quality requirements, including service quality standards or performance measures for interconnection and appropriate enforcement or remedial provisions in the event Qwest fails to meet service quality standard or performance measures. Staff does not believe that this condition is diminished if Qwest negotiates new commercial agreements outside of the context of the market-opening provisions of Sections 251 and 252 of the Telecommunications Act of 1996, because of stipulations with WeBTEC, FEA/DOD and Joint CLECs memorialized in the improved plan to ensure that the commission will have a full opportunity to review such matters if they become germane.

This condition on the AFOR is desirable because it ensures that all of the commission's work to open the market to competition remains in place. Competitive

[47] See FCC Wireline Competition Bureau statistical reports, Recent Releases, December 2006 Monitoring Report, Section 6, Tables 6.4 and 6.2 respectively.

discipline constraining Qwest's behavior under a regime of streamlined regulatory oversight will be a key to the plan's success. With provisions for effective competition, Qwest's price behavior will be subject to the potential for continuing current and future forms of market discipline.

REQUIREMENTS – YEARS 0 - 4

Q. Please describe the transition period requirements of the AFOR proposal.

A. During the four year transition period several requirements would apply:

1. The current rate for standalone residential service is $12.50. To protect customers in the residential market from unwarranted price increases (assuming residential customers are subject to more Qwest market power than other classes of customers, especially in low-demand, high-cost areas), Qwest would be allowed to make a tariff filing to increase the standalone residential exchange service recurring rate by no more than 50 cents in any year of the four year transition period. Qwest would not be compelled to increase the price, so Qwest's decision will be at least partially subject to the conditions that the market will bear. Under the AFOR, the standalone residential exchange service recurring price would be capped at $14.50.

2. According to Qwest's proposal for an AFOR, although Qwest's digital business services, analog private line services, and residential exchange service features and packages would be treated as competitively classified services, Qwest would be prohibited from geographically de-averaging the non-recurring and monthly recurring rates for these services. This will have the effect of allowing all

boats to rise with the tide. If competition pressures Qwest to reduce rates in urban areas, Qwest will have to offer the benefit of that competitive pressure to subscribers in rural areas as well, where competition may not be as fierce.

3. As mentioned earlier when I described provisions for service quality, Qwest will continue to provide service quality reporting during the 4 year transition period consistent with the 'Class A' company reporting requirements in WAC 480-120-439(1). Qwest will modify its current service quality report such that it complies with WAC 480-120-439, but provides a level of reporting detail consistent with that provided by other Class A companies. Specifically, Qwest's monthly service quality reporting detail will be consistent with that provided by Verizon, CenturyTel, and Embarq. In any AFOR proposal service quality is often considered to be of prime importance, because it is theoretically possible that a carrier under an AFOR could perceive that it has an incentive to reduce investment and expenses associated with repair, maintenance and investment in service quality enhancing measures. Staff's recommendation for modification to tie the potential for price increases to standalone residential services provides an incentive for performance, and ensures that the commission will continue to have complete oversight of service quality data to ensure that service quality remains high. Please refer to the testimony of staff witness Kristen Russell for a detailed analysis of service quality reporting issues.

4. Qwest's AFOR proposal is to treat Qwest as a competitive company. That would therefore grant Qwest waiver of WAC 480-120-355 from compliance with

standardized commission accounting rules which specify that Qwest must follow the 1998 version of the federal Uniform System of Accounts (USOA) with modifications to meet Washington accounting requirements.

5. Even though Qwest seeks to be afforded the same regulatory waivers that the commission commonly grants competitive companies by rule, WAC 480-120-366, Qwest proposes to be bound by the transfer of property statute, RCW 80.12, for purposes of reviewing any merger involving its regulated company for the four-year transition period. Further, even though a competitively classified telecommunications company would be granted a waiver of the cash transfer rule and subsidiary transactions rules, Qwest proposes, for a four-year transition period, to be bound by the parts of those rules that are currently being challenged in the Court of Appeals of the State of Washington Division II pending a decision by that Court. If the decision is in Qwest's favor the rules will not apply to Qwest. If the decision is in the Commission's favor, Qwest agrees to be bound by the rules.

<u>RISING STANDALONE RESIDENTIAL RATES, FALLING ECONOMIES OF SCALE</u>

Q. Please analyze Qwest's proposal for pricing standalone residential services during the four years of the plan - cap the monthly price of standalone residential exchange service at $14.50 - Qwest may increase the standalone residential exchange service recurring rate by up to $.50 in any year.

A. Any AFOR containing a provision for automatic price increases should have an objective basis in cost. Staff witness Paula Strain provides detailed financial and accounting analysis of Qwest's rate of return which shows that the current rates [redacted], and that the proposed increases to the residential rate are not likely to change that outcome.

In addition, please see Exhibit ___ -C (TLW-4-C) for a hypothetical analysis of Qwest's basic exchange rates versus rates based upon total element long run incremental cost (TELRIC). In this analysis, I have assumed that all residential customers simply pay the standalone rate of $12.50, and multiplied the number of lines in each exchange by that rate. Then I compared that result to hypothetical revenues that would be achieved at TELRIC prices listed in Qwest's interconnection tariff for unbundled network element loops, which a competitor can purchase according to a five-zone pricing scheme that recognizes that costs go up in rural exchanges where economies of scale and access line densities are low. The analysis uses the same access line density method I used in Exhibit ___ -C (TLW-5-C) and classifies a rural exchange as one with less than 100 access lines per square mile, and urban exchanges as those with more than 100 access lines per square mile.

Exhibit ___ -C (TLW-4-C) shows that Qwest's average rates are hypothetically compensatory overall and for business services statewide, but that residential rates are hypothetically not priced above TELRIC statewide. Even residential urban rates are below a hypothetical TELRIC level, and residential rural rates are also substantially below TELRIC (hypothetically). Overall, rural rates are hypothetically not generating enough revenue to cover TELRIC, although rural business rates are hypothetically making money. If residential rates were increased to $13 per line per month, the results of the hypothetical would not change, and residential service would hypothetically still not earn as much money at the basic rate compared to what it would be if the rate were equal to TELRIC. Heroically assuming no more line loss (all else being equal), if the residential rate were increased to the maximum allowed under the improved plan, $14.50 per line per month, then both residential and urban rates for standalone residential service would be sufficient together to cover overall hypothetical TELRIC costs by a margin of approximately $20 million.

Q. Please explain how economies of scale are related to the discussion of Qwest's production environment.

A. Underlying the structural, behavioral, and performance conditions of the telecommunications industry, economy of scale is an important, technologically driven determinant, shaping the industry itself. [48] Economies of scale mean that the average cost of production declines with an increase in size, prevailing when the down slope ends at minimum efficient size.[49] The production function for telecommunications services is subject to economies of scale.

For example, economies of scale occur in switching when the cost per line of providing switching service declines as the number of lines increases. However, these economies are not available in sparsely populated areas because of the high

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[48] The Economics of Industrial Organization, Second Edition, by William G. Shepherd, 1979 by Prentice Hall, page 7.
[49] Id. Page 40.

cost of providing loop plant sufficient to serve enough users to achieve economies of scale in switching.[50]

Exhibit ___-C (TLW-5-C) is an analysis of the economics of scale upon Qwest's provision of basic service. The analysis provides access line densities for Qwest exchanges in 2000 and 2006 for both residential and business lines and includes public access lines. Using mapping software that digitizes maps of Qwest's exchanges in Washington, the square mileage of each exchange is estimated. Dividing the number of lines by the square miles in an exchange yields an estimate of access line density. Sorting the Qwest exchanges by access line density (page 1 of Exhibit ___-C (TLW-5-C), the analysis assumes that exchanges with access line density per square mile greater than 100 are urban.[51] When I sorted the data by change in access line density (change in lines) on page two of the exhibit, you can see that both rural and urban exchanges are losing lines and decreasing in density.

Q. Please discuss the comparability of Qwest's rates.

A. The current rate for residential service was set several years ago and it is not unreasonable for Qwest to seek to adjust the rate to more appropriately meet today's conditions.

[50] The Annual Report on the Status of the Telecommunications Industry, Presented to the Washington State Legislature, by the Washington Utilities and Transportation Commission, January 12, 1987, page 77.
[51] *See*, The Annual Report on the Status of the Washington Telecommunications Industry, Presented to the Legislature January 12, 1987, by the Washington Utilities and Transportation Commission, page 73.

Qwest's current standalone residential rate of $12.50 per line per month is already considered to be comparable to other companies' prices for purposes of comparing rural and urban rates.[52] Furthermore, Exhibit ___ (TLW-6) shows that Qwest's rate of $12.50 is less than the average rate of $13.90 for all other ILECs in the state. Even if the commission were to grant Qwest's AFOR proposal and if Qwest were to avail itself of the opportunity to raise residential rates as described, the resulting rate in four years would still be within the range of rates determined by this commission to be fair, just and reasonable for other ILECs, given that the current range is from a maximum of $26.00 to a minimum of $8.47. It is also worth noting that Verizon was granted a rate increase in its last rate case, increasing its residential rate to $15.43, and that rate will go up again in July 2007, to $16.90. Qwest's proposal would still result in a rate less than the next largest ILEC in the state.

GEOGRAPHIC DEAVERAGING

Q. Please discuss and analyze the four-year transition period provision prohibiting Qwest from geographically de-averaging rates for digital business services, analog private line services, and residential exchange service features and packages although the latter set will be treated as competitively classified services.

[52] See September 13, 2006 letter to the FCC from Carole Washburn, the commission's executive secretary, in Docket UT-063064, in the matter of Embarq, Qwest, and Verizon, certifying the comparability of urban rates nationwide to residential rates in rural areas of the state served by non-rural ILECs (Qwest is such a carrier and its residential rate is the same in urban and rural areas).

A. This is a critical condition necessary for approval of the AFOR. It will prevent the company from exercising market power over customers who do not enjoy the benefits of effective competition in rural, underserved and high-cost areas.

Q. Is line loss more intense in urban areas or business markets as compared to rural areas and residential markets?

A. Not necessarily. Based upon Qwest line loss data, there is increasing competitive opportunity in almost all markets for almost all services. In my testimony I look at Qwest's operations on the basis of access lines per square mile. Density of access lines is an important economic indicator of the cost of providing service. Competition for telecommunications typically follows where economies of scale are the greatest and where technological advances have been deployed. This is why competition occurred first in the long distance industry, and then in the competitive access provider industry, as the advantages of fiber optic transmission and traffic aggregation took place. With advances in switching technology competitors began to target the local exchange. But like miners in a gold rush, competitors staked out the most lucrative claims first. So competition occurred first in high-volume, densely packed areas where economies of scale and technological advances create the biggest advantage. As time has passed, additional advances in wireless and Internet-based, non-circuit-switched technologies have taken place and today competition is occurring to a greater degree than ever before.

My analysis, in Exhibit ___ -C (TLW-5-C) and the data in Qwest witness Tietzel's Exhibit ___ -C (DLT-2-C) reveals that about 38.8 percent of Qwest exchanges are urban. Access line densities in 2006 range from a high of 2,621 access lines per square mile in the most densely populated exchange, Seattle, to a low of two access lines per square mile in Pomeroy, with a statewide estimated average in 2006 of 150 access lines per square mile.

I also analyze the exchanges based upon the change in access line density from 2000 to 2006. Page 2 of Exhibit ___-C (TLW-5-C) sorts the exchanges on the basis of the percent change (percent line loss is the same thing mathematically) in access line density to reveal that while Qwest is certainly losing substantial numbers of lines in urban (shaded grey) exchanges, it is also losing lines (and access line density) in many rural exchanges (as much as an estimated 28.9 percent in [redacted]).

This information shows that left unfettered, Qwest has a strong incentive to de-average rates across its territory to more effectively reflect economies of scale in rural and urban areas. This is why staff considers of critical importance and significance the prohibition in the AFOR plan on geographically de-averaged rates for standalone residential services and for various business services in parts of the state where there remain vestiges of market power as determined by the commission's review and disposition of competitive classification petitions.

Under this provision of the plan, if Qwest responds to competition in urban areas with price decreases, then it must also reduce rates for rural subscribers. Conversely, if Qwest increases prices in rural areas to cover cost, then it must likewise increase rates in urban areas proportionately. This condition assures that all boats will rise with the tide and rural, high-cost, low-demand consumers will benefit from the welfare producing effects of competition.

STREAMLINED ACCOUNTING

Q. Qwest proposes to be relieved from keeping a separate set of accounting records for purposes of compliance with commission-basis rules and adjustments, with some modifications. Please analyze this proposal.

A. Qwest's proposal should be partially granted by implementing staff's recommendations instead. Please see the testimony of staff witness Paula Strain for details. Staff's improved plan allows for finance, accounting, reporting and record-keeping to assure the commission can consider whether rates and charges will be fair, just and reasonable under the plan.

WAC 480-120-355 allows competitively classified telecommunications companies to follow generally accepted accounting principles (GAAP) rules, which do not require jurisdictional separations procedures to prevent regulated monopolies from inappropriately justifying rates to recover interstate or deregulated expenses or shift profits. In contrast, commission rules for Qwest require accounting records to allow the commission to readily determine intrastate operations revenues, investments, and expenses for ratemaking purposes.

Qwest proposes to no longer maintain a second set of "state" books but instead keep its accounts pursuant to the FCC's accounting rules. Nevertheless, Qwest is still subject on the interstate side to the FCC's current rules defining the USOA.

Q. Qwest is requesting relief from various financial reporting requirements. Please discuss this proposal.

A. Qwest's proposals for streamlined financial oversight are, for the most part, acceptable, subject to a few modifications (see the testimony of staff witness Paula Strain). Qwest would file its annual financial report pursuant to WAC 480-120-382, based on its books of account kept for FCC reporting purposes (MR books) in accordance with the Uniform System of Accounts ("USOA"), Part 32, as specified in WAC 480-120-359 (1)(a), except that the effective date for Part 32 would be as currently promulgated, not the date specified in WAC 480-120-999 (4)(a). Qwest's annual report would also include a directory revenue credit in the amount specified by the settlement agreement the Commission approved in the Dex case. Qwest would also include the credits to its depreciation reserve required for a prior sale of rural exchanges and for sharing under a prior AFOR. Finally, Qwest would include a standing adjustment reflecting the difference in rate base between its MR books and its Washington jurisdictional books of account (JR books) on the date of transition from JR books to MR books. Please see the testimony of staff witness

Paula Strain for a complete and detailed review of Qwest's accounting and reporting proposal and of staff's recommended improvements. Under its proposal, Qwest would no longer file quarterly financial reports as required in WAC 480-120-385(2).

Q. Qwest proposes to remain subject to commission review and oversight if it sells or merges the company, and to continue following the cash transfer rule requirements subject to the outcome of the appeal in court. Please analyze this arrangement.

A. Staff recommends Qwest continue to be subject to commission oversight and review. Please see the testimony of staff witness Deborah Reynolds for more detailed discussion of this issue.

CRITICAL ANALYSIS OF THE AFOR, WITH SPECIFIC ATTENTION TO STATUTORY GOALS AND CONSIDERATIONS

Universal Service

Q. Please discuss the AFOR and the goal of preserving affordable universal telecommunications service.

A. Qwest's plan preserves affordable universal telecommunications service, but staff recommends improving the plan by adding a free directory assistance call allowance. Staff takes into consideration the relatively high penetration rate in Washington, and the fact that the plan leaves WTAP, Link-up and Tribal subsidies the subject of full tariff review by the commission. Although rate increases could result under the plan for standalone residential subscribers, the lifeline provisions will protect consumers from adverse effects on universal service. The “take rate” for WTAP remains relatively low.

By keeping basic residential service in the tariff and by making any changes subject to commission approval, line extension charges and extended area service are also protected to preserve affordable universal service. The FCC’s 2006 Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service by the Industry Analysis and Technology Division of the Wireline Competition Bureau shows that the national average charge for flat rate service is $14.75. The highest possible comparable rate under the plan for Qwest’s standalone residential subscribers in Washington would be less than that at $14.50. Therefore the plan preserves affordable universal telecommunications service.[53] Most recently, on September 13, 2006, the commission wrote the Universal Service Administrative Company (USAC) to certify that the commission has reviewed the comparability of urban rates nationwide to residential rates in rural areas of the state served by non-rural incumbent local exchange carriers (including Qwest), and certified that the rates are comparable for purposes of Section 254(b)(3) of the Telecommunications Act of 1996.[54] Since the plan provides rates that satisfy these criteria, then it preserves affordable universal telecommunications service.

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[53] *See* Table 1.1 of the report. http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-266857A1.pdf

[54] Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

<u>An Efficient, Robust Backbone</u>

Q. Does the plan maintain and advance the efficiency and availability of telecommunications service?

A. Qwest's plan is deficient in this regard, although Qwest's arguments tend to be persuasive that competitive forces will provide guidance on Qwest investment decisions. Thus, the AFOR might have some positive effect. In order to design an appropriate AFOR for Qwest under the conditions Qwest is facing, the commission has to take into account that Qwest is under competitive assault and Qwest alone is best able to decide where it can make investments that will maintain and advance the efficiency of service as well as make profit. In order to pursue statutory goals, it is important to keep in mind the asymmetry of information and the overall complexity of regulation in the face of competition.

Q. Please describe the staff's recommendations for improvements to the plan to provide for additional efficiency and availability of services.

A. Staff recommends that in two years, Qwest should provide a plan for infrastructure development. At the end of the AFOR, for the review process, Qwest should file a report on infrastructure development informing the commission about Qwest's progress in promoting the infrastructure plan. Additionally, any time there is a major outage in a given area with a cause that is within Qwest's control, and that affects the availability of advanced telecommunications services, the company must build in either more redundancy to serve that area or a technological improvement that removes the vulnerability that caused the outage (*see* testimony of staff witness Deborah Reynolds).

Q. If Qwest is under competitive assault for lines on the intrastate side of its business, is it not true that Qwest is making up the difference by selling xDSL services on the interstate side?

A. No. Qwest is not making up for lost lines on the intrastate side by adding xDSL lines on the interstate side. Qwest lost [redacted] residential, business, and payphone lines from 2000 – 2006, as shown on page 2 of Exhibit ___ - C (TLW – 5C). On page 2 of Exhibit ___ - C (TLW-7-C) it shows that Qwest only added an estimated [redacted] xDSL lines during that period. Therefore, Qwest did not add enough xDSL lines to make up for the loss in intrastate lines during 2000 – 2006.

Protecting Against Cross Subsidy

Q. Does the plan ensure that rates for noncompetitive telecommunications services will not subsidize Qwest's competitive ventures?

A. Yes. Staff has reviewed Qwest's results of operations and done "what-if" analyses to respond to this question. Please see the testimony of staff witness Paula Strain for information about Qwest's financial results. In addition, inferences can be drawn from my analysis of economies of scale and hypothetical revenues in Exhibit ___-C (TLW-4-C), which provides information concerning the effects of cross-subsidy and line losses on Qwest.

Furthermore, financial, accounting, reporting, and record-keeping provisions and elements of current regulation not impacted by the petition would remain subject to the *status quo*, including all orders and rules governing wholesale arrangements. This would mean, for example, that Qwest would be subject to the requirement to sell unbundled network elements at TELRIC. TELRIC serves as an appropriate imputation floor for Qwest retail pricing and will be readily available to the commission during the plan. There are also still normal prohibitions against pricing below cost in RCW 80.36.300(4)[55] and RCW 80.36.330(6).[56]

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[55] [e]nsuring that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of regulated telecommunications companies.

[56] [n]o losses incurred by a telecommunications company in the provision of competitive services may be recovered through rates for noncompetitive services. The commission may order refunds or credits to any class of subscribers to a noncompetitive telecommunications service which has paid excessive rates because of below cost pricing of competitive telecommunications services.

Diversity of Supply

Q. Please discuss whether the plan promotes diversity in the supply of telecommunications services and products in Washington.

A. The staff's recommendations addressing this statutory goal require Qwest to study the problem and report to the commission. The plan also contains a requirement to improve the efficiency and availability of services whenever there are lessons to be learned and opportunities for improvement.

Staff bases its analysis of this issue primarily upon DSL data as a proxy for information concerning the availability of advanced services. ~~Qwest's Response to Public Counsel Data Request 6.b. shows that i~~In 2000, [redacted] Qwest wire centers did not have DSL available, but in 2006 all but [redacted] low-density rural wire centers have DSL available. Qwest has added [redacted] more residential DSL subscribers and [redacted] business DSL customers for a total of over [redacted] new DSL subscribers since 2000. By granting Qwest streamlined oversight and added flexibility, subject to an informative reporting requirement at the end of the AFOR, the commission will have considered whether the plan will promote the diversity in the supply of services and products.

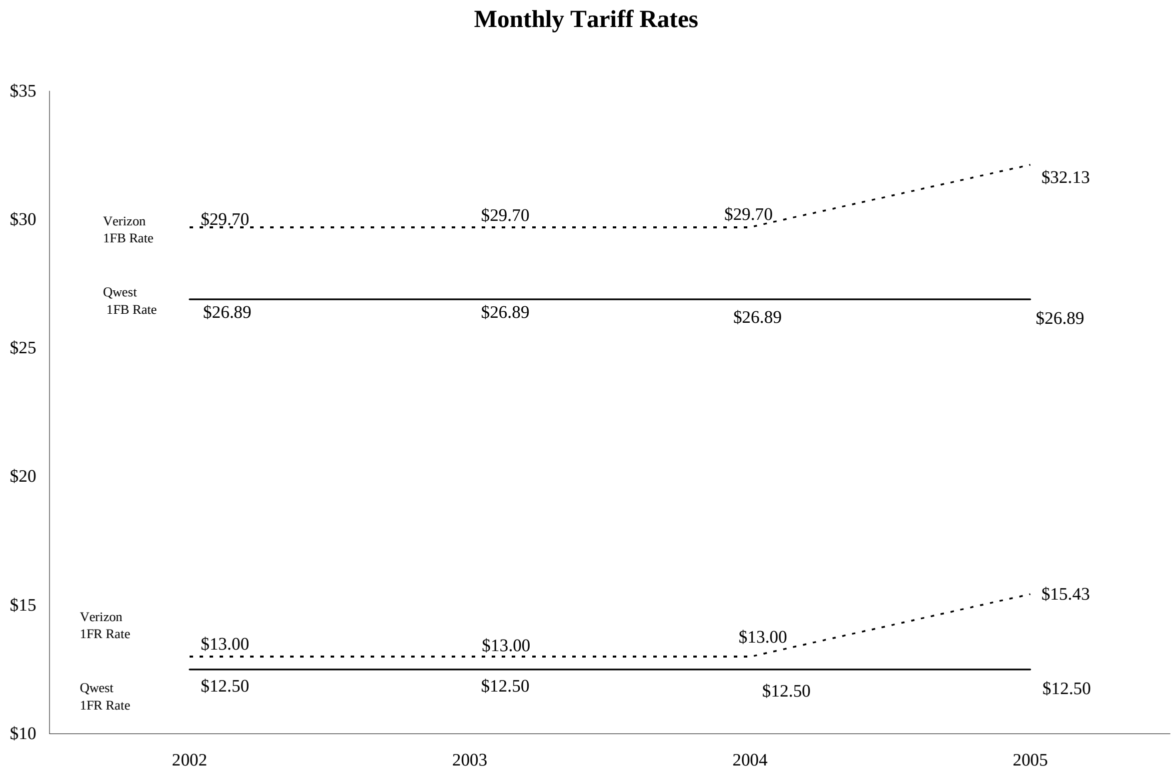
Economies of access line density, inflation, and technological advances are all extremely difficult problems for Qwest and the commission to solve in designing an AFOR to promote or advance the diversity and availability of advanced services. As shown in Exhibit ___ - C (TLW-5-C) on page 3, access line density in Qwest territory was 1,480 access lines per square mile in 1985, which the company may have felt were the halcyon days of near monopoly. Today access line density is less than a fourth what it was then. Today Qwest only has an average of 261 lines per square mile from which to derive economies of scale.

Economies of scale in Seattle have changed drastically as access line density fell for Qwest by 32 percent over the past six years. That is very significant because Seattle is supposed to be Qwest's most densely populated exchange, where the potential to earn profits is very important if rural areas are to continue to receive extra support, as illustrated in Exhibit ___ -C (TLW-5-C) and the hypothetical rate analysis in Exhibit ___ - C (TLW-4-C).

Evidence of the harsh transition from monopoly to competition is also reflected in the figures for rate base per line. Adjusted for an inflation multiplier of 3.2 from 1984 to 2006, the Company's rate base per line has plummeted from $1,244 in 1985 to just over $250 per line today (expressed in 1984 dollars). At the same time, adjusting for inflation once again, revenue per access line dropped about 75 percent from $614 in 1985 to $150 today (expressed in 1984 dollars).

Looking at the monthly tariff rates for Qwest and comparing to Verizon in Figure 3, it is apparent that Qwest rates are possibly insufficient to fund new investment when taking into account the difference in average revenue per line shown in Exhibit ____ C (TLW-8-C).

FIGURE 3



<u>Regulatory Efficiency</u>

Q. Will the plan improve the efficiency of the regulatory process?

A. It is likely that the plan will improve the efficiency of the regulatory process. A substantial relief of the burden of making filings to react to changing market conditions, and streamlined reporting, will benefit the company.

In 2006, Qwest made 169 filings before the commission. This included ten affiliated interest filings, 39 special contracts, 20 price lists, and 30 tariff filings. If the staff's improved AFOR plan were in place, the ten affiliated interest filings could have been handled one time in an annual format, rather than ten times on the commission's No Action Agenda. The 39 contract filings would be eliminated under the plan, and 24 of the tariff filings would be eliminated (two that would not have been eliminated were promotions for win-back of residential subscribers). Thus, it can be estimated that the improved plan would reduce Qwest filing activity alone by 43 percent in the first year – a potentially substantial increase in regulatory efficiency.

More Competition

Q. Will the plan preserve or enhance the development of effective competition and protect against the exercise of market power during its development?

A. Yes. The plan protects competition by maintaining the status quo for all of the market-opening and wholesale provisions under the Telecommunications Act of 1996. Competition will be the best discipline to constrain Qwest from exercising market power during its development.

Q. What other condition is staff recommending in order for this AFOR to meet the statutory goal for competition?

A. Staff recommends that during the four-year AFOR period, Qwest should not seek forbearance for the state of Washington. Staff believes that Qwest should not be relieved of its obligations to provide access to UNEs and to continue its wholesale service measures that are required by Federal statutes and the Triennial Review Remand Order (TRRO) decision.

Q. Could you explain why it is important to include this condition in the AFOR plan?

A. Yes. In the TRRO, FCC has established standards for non-impairment. For Qwest, this Commission has validated 13 wire centers to meet that standard. For those wire centers, Qwest has no obligation to continue to offer DS1, DS3, and/or dark fiber interoffice transport as UNEs at TELRIC-based prices. CLECs will need to purchase the same services from the Qwest retail tariff. The price differential is large. If Qwest were to file a forbearance petition for the state of Washington that was granted by the FCC, Qwest would be relieved of its obligation to continue to offer these service elements at UNE prices, even in wire centers where Qwest has not met the non-impairment standard.

<u>Service Quality</u>

Q. Please discuss how the plan will preserve or enhance service quality and protect against the degradation of the quality or availability of efficient telecommunications services.

A. Staff recommends improvements to the plan to provide for improved availability of advanced services, and a more robust backbone. The staff also recommends that Qwest be given the incentive to perform high quality service because potential rate increases will not be permitted unless service quality measures show improvement each year. Existing service quality programs for both wholesale and retail service quality protection and oversight would remain in place under Qwest's proposal and as modified by staff's recommendations for improvement.

Fair Rates

Q. Please discuss the statutory AFOR consideration of whether the plan provides for rates and charges that are fair, just, reasonable, sufficient, and not unduly discriminatory or preferential.

A. Please see the testimony of staff witness Paula Strain. Under the plan standalone residential rates are subject to a starting point going into the plan, in the form of the existing, commission-approved tariff. Therefore, the beginning rate is fair, just, reasonable, and sufficient. Furthermore, future rate increases to standalone residential rates under the plan will be subject to service quality improvements according to a verifiable service quality index that will give Qwest the incentive to provide good service for a fair price.

Though not based on rates derived from a full rate case, staff's improved AFOR plan provides for rates and charges that are fair, just and reasonable. Staff's conclusion is based upon comparison to other affordable rates, analysis of TELRIC cost based rates, and rural versus urban implications of economies of scale and a solid review of Qwest's financial and accounting results of operations and its rate of return.

The commission does not need to perform a full-scale, fully contested and completely rigorous rate case in order to determine whether the plan provides for fair, just and reasonable rates for purposes of considering this AFOR. For purposes of the AFOR, it is appropriate and sufficient for the commission to review objective, verifiable evidence. It is not necessary for the commission to reach the degree of certainty contemplated by a full-scale rate case. A full rate case requires accurate forecasts of what subsequent rate cases would produce over the period of an AFOR. The changing telecommunications market, increasingly dominated by wireless and other services, makes it difficult to predict local wire line rates for the four years of the AFOR. In addition, even if the AFOR were more expensive to ratepayers in the first (test) year, it could still be less expensive over the duration of the AFOR. The AFOR process is designed to promote telephone utilities' heightened efficiency and innovation in an increasingly competitive industry, ultimately resulting in savings to the ratepayers. To this end, an AFOR remains in effect for a multi-year term during which the telephone utility enjoys the benefit of any cost savings it achieves over and above the savings assumed in the AFOR and the ratepayers enjoy the benefit of being insulated from increased rates resulting from annual rate cases and upward cost fluctuations. The AFOR also decreases regulatory costs by avoiding rate cases that arise under the traditional ratemaking process.

An AFOR should provide: (1) the price for a service must be as low as possible; (2) it must not be higher than it would be in a rate-base determination; (3) it must be reasonable; (4) it must be sufficient to cover the utility's cost; and (5) it must not be so high that it is a mechanism for transferring the risk of non-local or unregulated business activities. Therefore, the AFOR encourages increased efficiency by permitting the telephone utility to reap at least some of the benefit of its innovations and heightened efficiency. The staff's improved AFOR does require an analysis of the linkage between rates and costs. The comparison of rates is required before the commission adopts an AFOR except in the most extraordinary of circumstances, when dispensing with the comparison would be in the ratepayers' best interests. The existence of such circumstances has not yet been demonstrated on the present record in this case.

Q. Will the plan unduly or unreasonably prejudice or disadvantage any particular customer class?

A. The plan is designed to avoid this problem, particularly with regard to rural versus urban distinctions. Staff's plan does not unduly or unreasonably prejudice or disadvantage any particular customer class. The plan protects customers subject to vestiges of market power by placing such services under full commission oversight and discretion. In addition, a discriminatory pricing scheme is only feasible when the producer has sufficient market power to be able to create separate classes of customers between which it will discriminate. The discrimination scheme would then be to offer different rates, terms, or conditions to one group than the other. If the different customer classes are able to find substitutes or alternatives to the discriminatory service, that is to say, violate the discriminatory customer class distinctions, then the discriminatory scheme does not succeed. With the existence of competition, Qwest will be hard pressed to maintain a discriminatory scheme because customers will find that Qwest does not have the market power to prevent customers from choosing alternatives that violate that scheme. Please see my analysis of the prohibition on geographic de-averaging.

Federalism

Q. Does staff have any other over-all policy observations concerning this matter?

A. Yes. Staff also notes that the improved plan comports well with the NARUC Legislative Task Force Report on Federalism and Telecom, July 2005. It recognizes the changes taking place in the industry, and focuses on core public interests and relative strengths of the state commission – local rates, low income, high-cost and special interests, service quality, consumer protection, and local markets subject to market power.

Q. Does this conclude your testimony?

A. Yes.

GLOSSARY OF TELECOMMUNICATIONS TERMS
Docket UT-061625

TERM	DESCRIPTION
Access	A local carrier must allow customers access to their preferred long-distance carrier. Customers pay an access charge to their local carrier for access to their long distance carrier and long distance carriers pay access charges to the local carrier to connect to the local carrier's network. *(From Newton's Telecom Dictionary, at pages 26-27.)*
Access line	A telephone line from a central office to the local premises. *See also* local loop. *(From Newton's Telecom Dictionary, at page 27.)*
Advanced Services	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.
AFOR	Alternative form of regulation
ARMIS	Automated Reporting Management Information System. The FCC's database of telecommunication carriers' network, financial and service quality data. Carriers update the information annually on April 1.
Basic service	• Single-party service; Voice grade access to the public switched network; Support for local usage; touch-tone; Access to emergency services (E911); Access to operator services; Access to interexchange services; Access to directory assistance; and Toll limitation services.
Broadband	Advanced communications systems capable of providing high-speed transmission of services such as data, voice, and video over the Internet and other networks delivered by various technologies such as digital subscriber line and fiber optic cable, coaxial cable, wireless technology, and satellite.
Business line	A loop or line used for business purposes, i.e., not a residential line.
Central Office	A building where the local loops are connected to switches to allow connection to other customers; also referred to as a wire center where there are several switches functioning as a switch exchange. *(From Newton's Telecom Dictionary, at page 157.)* A company facility that houses the switching and trunking equipment serving a defined area.
Centrex	A telecommunications service providing a customer with direct inward dialing to telephone extensions and direct outward dialing

TERM	DESCRIPTION
	from them.
Class A company	A local exchange company with two percent or more of the access lines within the state of Washington. The method of determining whether a company is a Class A company is specified in WAC 480-120-034 (Classification of local exchange companies as Class A or Class B).
Class B company	A local exchange company with less than two percent of the access lines within the state of Washington. The method of determining whether a company is a Class B company is specified in WAC 480-120-034 (Classification of local exchange companies as Class A or Class B).
Circuit	"The physical connection (or) path of channels, conductors and equipment between two given points through which an electric current may be established." *(From Newton's Telecom Dictionary, at page 167.)*
CLEC	Competitive local exchange company. A company competing with an incumbent local exchange company (ILEC) for local service customers; generally subject to limited regulation.
Collocation/ Collocator	**Collocation** occurs when a competing local carrier locates its switches within another local exchange carrier's central office. A **collocator** is a carrier that collocates its switches in another carrier's central office. *(From Newton's Telecom Dictionary, at page 182.)*
Dedicated transport	Facilities dedicated to a particular competitive carrier that the carrier uses for transmission between or among ILEC central offices and tandem switching offices, and to connect its local network to the ILEC's network. (*TRRO*, ¶ 67)
DSL	Digital Subscriber Line – high speed data and voice.
DS0 / Voice grade	The digital representation of the capacity of an analog voice channel, *i.e.*, the traditional copper pair loop, transmitting information at 64 kilobytes per second (kbps). (*TRO, n. 634*)
DS1	The initial level of multiplexing in the time division hierarchy of the telephone network; a 1.544 megabytes per second (Mbps) signal that provides the equivalent of **24 64 kbps DSO channels**. The same as a T1 facility. (*TRO, n. 634*)
DS3	A digital local loop having a total digital signal speed of 44.736 Mbps provided over various transmission media, including, but not limited to fiber optics, coaxial cable, or radio. DS3 loops can be

TERM	DESCRIPTION
	channelized into **28 DS1 channels**, or unchannelized to provide a continuous bit stream for data. (*TRO, n. 634*)
EAS	Extended area service. Telephone service extending beyond a customer's exchange, for which the customer may pay an additional flat-rate amount per month.
High-capacity	High-capacity refers to the ability of the facility to handle a large amount of traffic or information at a single time, e.g., DS1, DS3, OCn capacity.
ILEC	Incumbent local exchange company. A local exchange company in operation at the time the Act was enacted (August 1996).
Interconnection	Connection between facilities or equipment of a telecommunications carrier with a local exchange carrier's network under Section 251(c)(2).
Interconnection Agreement	An agreement between an ILEC and requesting telecommunications carrier (which may be a CLEC) addressing terms, conditions and prices for interconnection, services or network elements pursuant to Section 251.
IntraLATA	A term used to describe services, revenues, functions, etc., that relate to telecommunications that originate and terminate within the same LATA.
JR	Jurisdictional Reporting - the term that Qwest uses to describe accounting and reporting that follows Washington rules and orders.
kbps	kilobytes per second
LATA	Local Access Transport Area - defined by the commission in conformance with applicable federal law at the break up of the Bell system ,to define the boundaries beyond which Bell companies were not permitted to transport toll calls.
Local exchange	A geographic area consisting of one or more central offices. *(From Newton's Telecom Dictionary, at page 301*.) A geographic area established by a company for telecommunications service within that area.
Loop	The local loop. The copper wire, fiber, or cable serving a particular customer, generally running from a central office to a residence or building.
Mbps	Megabytes per second; synonymous with MEG

TERM	DESCRIPTION
MR	"Management Reporting" - term used by Qwest to describe its books of account kept for FCC reporting purposes
Network element	A facility or equipment used in providing telecommunications services.
Non-impaired	A term relating to whether a competing carrier has access to unbundled network elements. Under Section 251(d)(2), an ILEC must provide unbundled access to an element if failure to provide the element would impair the carrier's ability to provide service. Under the TRRO, the FCC determined that competing carriers are not impaired under Section 251(d)(2) without unbundled access to high-capacity elements at a wire center if the wire center meets certain criteria. If a wire center meets the criteria, it is designated **non-impaired,** meaning competitors are not allowed unbundled access to high-capacity loops and transport in the wire center.
OCn	OCn (OC is Optical Channel) is an optical interface designed to work with a Synchronous Optical Network (SONET). OCn transmission facilities are deployed as SONET channels having a bandwidth of typically 155.52 Mbps (megabytes per second)(OC3) or higher. (*TRO, n. 631*).
OSS	Operations Support Systems - Ordering and Provisioning, Repair and Maintenance, and Billing.
Part 32	The section of federal law (Code of Federal Regulations, Title 47, Part 32) setting forth the Uniform System of Accounts for telecommunications companies
QPAP	Qwest Performance Assurance Plan – OSS monitoring and compliance activity provides penalty payments to CLECs for OSS wholesale functions rendered at less than parity with Qwest's own retail service performance.
ROR	Rate of Return Regulation
RORB	Return on Rate Base – the overall rate of return, including cost of debt and return on equity.
Residential line	A loop or line connecting a residence; used generally for residential, rather than business, purposes.
Section 251(c)(3)	The section of the Act that requires ILECs to provide competing carriers with access to network elements on an unbundled or individual basis. The unbundled elements provided under this

TERM	DESCRIPTION
	section are known as UNEs.
SFY	State Fiscal Year
Switched access	The connection between a customer's phone and a long distance carrier's switch when making a local or long distance call over standard telephone lines. *(From Newton's Telecom Dictionary, at page 756.)*
TELRIC	Total Element Long Run Incremental Cost. A method of determining the cost, and prices for network elements using a forward-looking process, rather than the existing network of a carrier. Generally, the pricing methodology for UNEs.
TRO	The FCC's Triennial Review Order. August 2003 order addressing UNEs and the impairment standard for UNEs, vacated in part and remanded in part by the D.C. Circuit Court of Appeals in *USTA II v. FCC*.
TRRO	The FCC's Triennial Review Remand Order. March 2005 order entered in response to D.C. Circuit's *USTA II* decision: Eliminates local switching as a UNE as of March 11, 2006, and limits unbundling of high-capacity transport and loops.
Transport	Lines or connections used to transmit voice or data through a carrier's network. Transport media include copper wire, fiber optics, microwave, or satellite. *(From Newton's Telecom Dictionary, at page 815.) See* dedicated transport.
Trunk, Also trunked transport	A communication line between two switching systems. A single trunk, capable of carrying a single conversation, is referred to DS0.
Unbundled	A network element that is provided by itself, not in connection with or "bundled" with another network element. A means for a carrier to request particular services from an ILEC to customize the service the carrier provides, without having to accept a package of elements and services that the carrier must take as an all or nothing option.
UNE	Unbundled network element. Generally a network element an ILEC must make available under Section 251(c)(3) of the Act.
UNE-P, also UNE-P line	Unbundled Network Element Platform, or a combination of local loops, switching and transport offered by the ILEC.
UNE-loop, or UNE-L	Unbundled network element loop, or a stand-alone loop provided without the combination of switching and transport provided via

TERM	DESCRIPTION
	UNE-P.
USOA	Uniform System of Accounts
Wire center	The location where a telephone company terminates and switches local lines, or loops. A wire center may have one or more class 5 central offices or exchanges. *(From Newton's Telecom Dictionary, at page 884.)*
WTAP	Washington Telephone Assistance Program.
xDSL	Digital Subscriber Line service at the following speeds: 256K, 1.5MEG, 3MEG, 5MEG, 7MEG.