

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

**REDACTED
CONFIDENTIAL EXHIBIT TO
REBUTTAL TESTIMONY OF
PHILIP E. GRATE
ON BEHALF OF
QWEST CORPORATION**

Response to Staff's Proposed Adjustments to Qwest Earnings

FEBRUARY 16, 2007

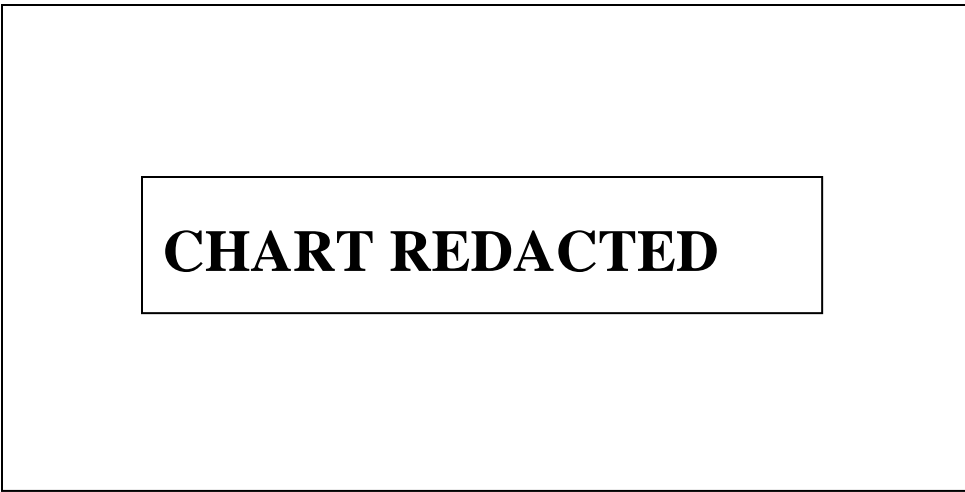
**REDACTED
CONFIDENTIAL PURSUANT TO WAC_480-07-160**

1 **A. *Shifts in Revenue***

2 **Q. MS. STRAIN ASSERTS THAT QWEST’S INTRASTATE RETURN ON RATE**
3 **BASE IS DECLINING BECAUSE OF SHIFTS IN REVENUE.¹**

4 **A.** I am not certain what Ms. Strain means by “shifts in revenue.” So I will offer an
5 analysis of Qwest’s revenues.

6 The following graph shows Qwest’s Washington total (intrastate and interstate)
7 revenues subject to separations. ****BEGIN CONFIDENTIAL**

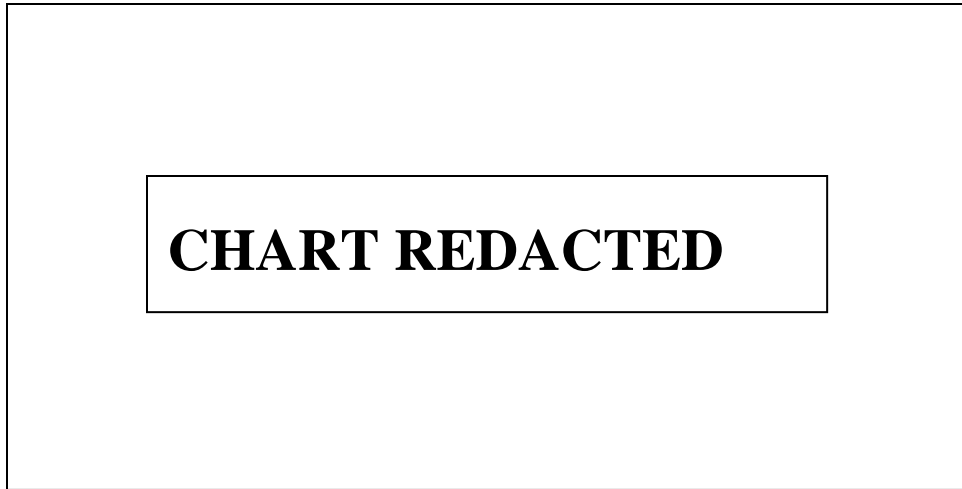


8
9 **END CONFIDENTIAL**** Total operating revenues subject to separations peaked at
10 ****BEGIN CONFIDENTIAL** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
11 XX. **END CONFIDENTIAL****

¹ Testimony of Paula M. Strain, page 13, lines 9 and 19.

1 The components of the total state revenue change are shown on the following graph.

2 ****BEGIN CONFIDENTIAL**



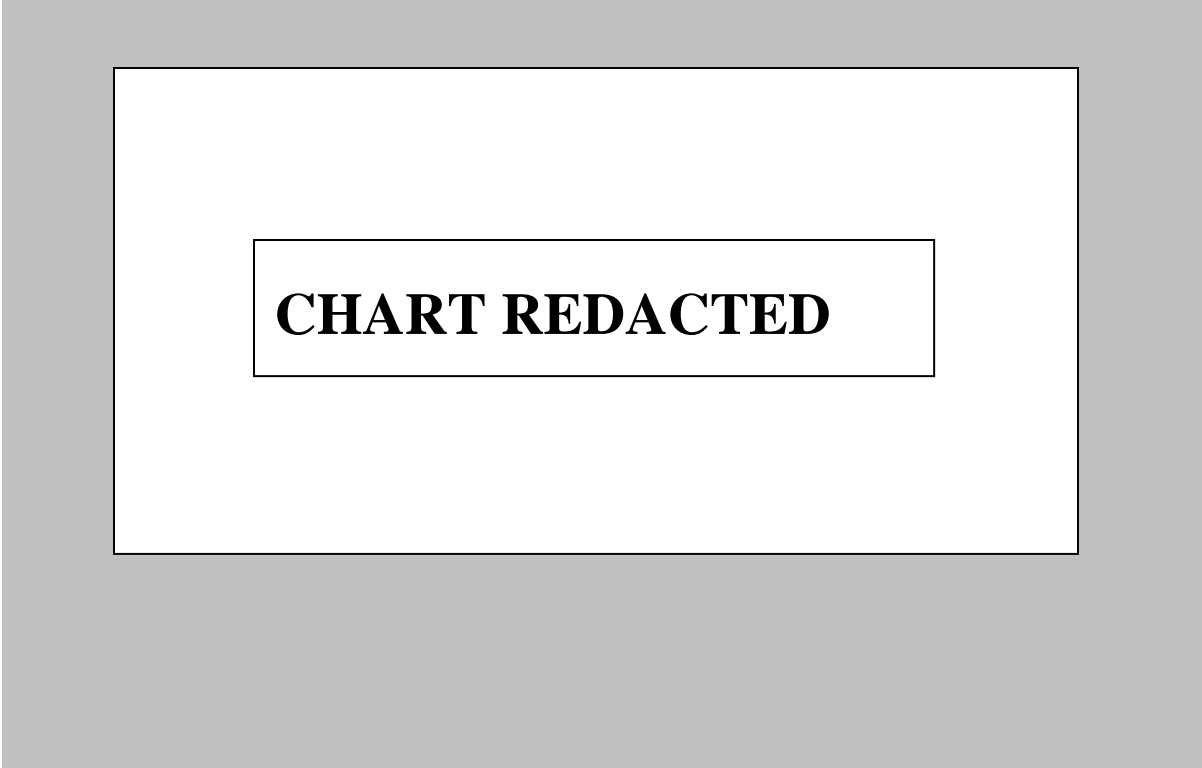
3

4 **END CONFIDENTIAL**** The graph shows that between 2000 and 2006,
5 miscellaneous revenues ****BEGIN CONFIDENTIAL** XXXXXXXXXXXXXXXXXXXX
6 XX
7 XX
8 XXXXXXXX **END CONFIDENTIAL****

9 During the same six year period interstate revenues ****BEGIN CONFIDENTIAL** XX
10 XX **END CONFIDENTIAL****
11 as shown by the following graph.

12

1 **BEGIN CONFIDENTIAL

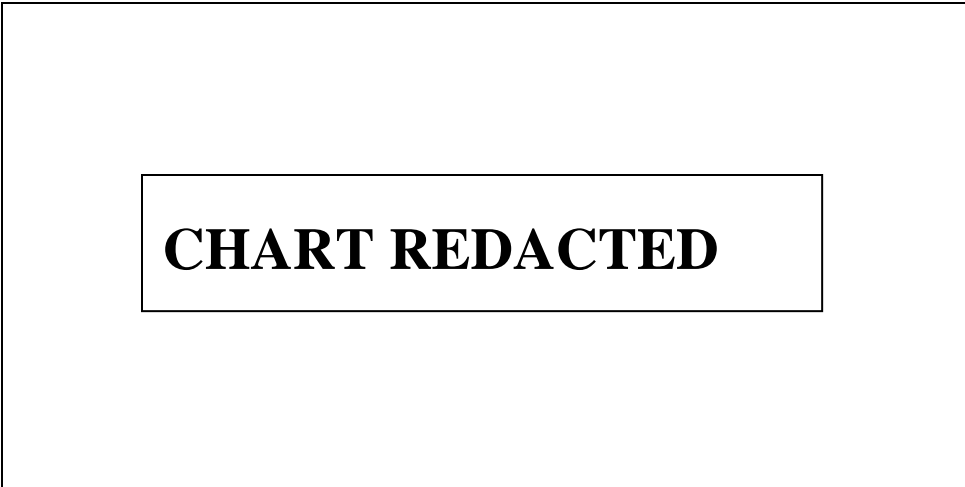


2

3 END CONFIDENTIAL** Between 2000 and 2006 interstate revenues **BEGIN
4 CONFIDENTIAL XX
5 XX
6 XXXXXXXXXXXXXXXXXXXX. END CONFIDENTIAL**

7 The components of the interstate revenue change between 2000 and 2006 are shown
8 on the following graph.

1 ****BEGIN CONFIDENTIAL**

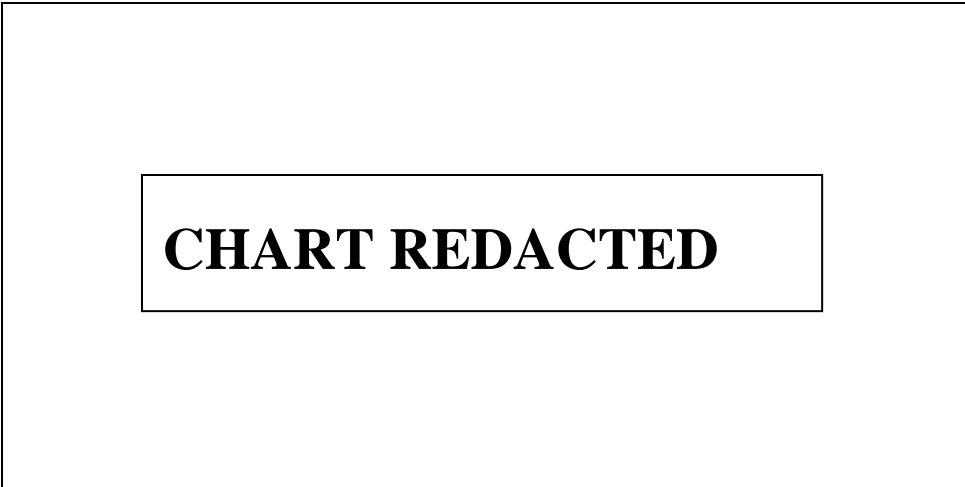


2

3 **END CONFIDENTIAL**** The graph reveals that between 2000 and 2006, interstate
4 miscellaneous revenues ****BEGIN CONFIDENTIAL** XXXXXXXXXXXXXXXXXXXX
5 XX
6 XXXXXXXXXXXXXXXXXXXXXXXXXXXX **END CONFIDENTIAL****

7 The following graph charts the change in intrastate revenues.

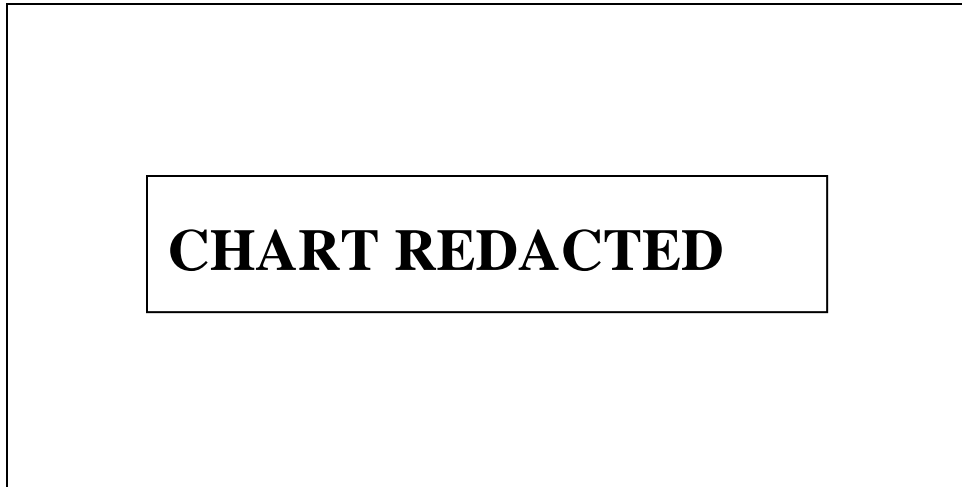
1 **BEGIN CONFIDENTIAL



2

3 END CONFIDENTIAL** The graph shows that Washington intrastate operating
4 revenues peaked **BEGIN CONFIDENTIAL XXXXXXXXXXXXXXXXXXXXXXXX
5 XXXXXXXXXXXXXXXXXXXXXXXXXX. END CONFIDENTIAL**

1 The components of the intrastate revenue change between 2000 and 2006 are shown
2 on the following graph. ****BEGIN CONFIDENTIAL**



3
4 **END CONFIDENTIAL**** Over the six year period, Qwest experienced an ****BEGIN**
5 **CONFIDENTIAL** XXX
6 XXX
7 XXX
8 XXX
9 XXXXXXXXXXXXXXXXXXXXXXX **END CONFIDENTIAL****

1 **Q. DOES YOUR ANALYSIS SUPPORT THE CONCLUSION THAT THERE**
2 **HAS BEEN A SHIFT OF REVENUES FROM THE INTRASTATE**
3 **JURISDICTION TO THE INTERSTATE JURISDICTION SINCE 2000?**

4 A. No. The analysis shows that interstate revenues have remained relatively stable while
5 intrastate revenues have plummeted. ****BEGIN CONFIDENTIAL XXXXXXXXXXXX**
6 **XX**
7 **XX**
8 **XX**
9 **XX**
10 **XX**
11 **XX**
12 **XX**
13 **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. END CONFIDENTIAL****

14 **Q. MS. STRAIN SUGGESTS THAT REVENUE SHIFTS HAVE OCCURRED**
15 **BECAUSE THE FCC CHANGED THE JURISDICTION OF REVENUES**
16 **FROM CERTAIN SERVICES AFTER THE SEPARATIONS FREEZE**
17 **BEGAN.² DO YOU AGREE?**

18 A. Ms. Strain cites special access and DSL as examples.³ I do not agree that the FCC
19 has changed the jurisdictional assignment of either of these services since the
20 Separations Freeze began.

21 There are two categories of access service: switched and special. Switched access
22 services share the local switch to route originating and terminating interstate toll
23 calls. Special access services, by contrast, generally provide a dedicated path

² Testimony of Paula M. Strain, page 14, lines 4 through 16.

³ Testimony of Paula M. Strain, page 14, lines 7 and 8.

1 between an end user and an IXC's point of presence. The special access category
2 includes a wide variety of facilities and services, such as wideband data, video, and
3 program audio services.⁴ DSL is a special access service.

4 The jurisdiction of special access is determined under the mixed-use facilities rule
5 which was introduced in a proceeding involving the re-examination of the separations
6 treatment of "mixed-use" special access lines.⁵ Specifically, in the *MTS/WATS*
7 *Market Structure Order*, the FCC adopted the Joint Board's recommendation that
8 "mixed-use" special access lines (*i.e.*, lines carrying both intrastate and interstate
9 traffic) are subject to the FCC jurisdiction where it is not possible to separate the uses
10 of the special access lines by jurisdiction.⁶ The FCC found that special access lines
11 carrying more than *de minimis* amounts of interstate traffic to private line systems
12 should be assigned to the interstate jurisdiction.⁷ According to the FCC, interstate
13 traffic is deemed *de minimis* when it amounts to ten percent or less of the total traffic
14 on a special access line.⁸ The FCC established the mixed-use-facilities rule in 1989
15 and made it effective January 28, 1990, more than eleven years before the Separations
16 Freeze.⁹

⁴ See Investigation of Access and Divestiture Related Tariffs, CC Docket No. 83-1145, Phase I and Phase II, Part I, FCC 85-70, 57 Rad. Reg. 2d 1459, 1465 (Com. Car. Bur. 1985).

⁵ MTS and WATS Market Structure, Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, 4 FCC Rcd 5660 (1989) (*MTS/WATS Market Structure Separations Order*).

⁶ *Id.*

⁷ *Id.* at 5660, 5661. A private line service is a service for communications between specified locations for a continuous period or for regularly recurring periods at stated hours. 47 C.F.R. Pt 36, App. For example, high volume voice telephony customers purchase private line services as a means of obtaining direct access to interexchange carrier (IXC) networks.

⁸ *Id.* at 5660.

⁹ *Id.* at 5661 (¶9)

1 The FCC first addressed the jurisdictional treatment of DSL service in 1998 when
2 DSL service was in its infancy.¹⁰ In an order released October 30, 1998 the FCC
3 found that DSL service is subject to federal jurisdiction under the FCC mixed-use-
4 facilities rule¹¹ and properly tariffed as an interstate service.¹² Consequently, it would
5 be wrong to conclude that the FCC changed the jurisdictional assignment of DSL
6 services after the Separations Freeze became effective or after calendar year 2000
7 which is the year upon which Category Relationships are based during the Freeze.

8 Qwest's interstate revenues from special access and DSL have grown since the
9 Separations Freeze took effect in 2001. But that growth cannot be properly ascribed
10 to changes made by the FCC to the jurisdictional designation of services after the
11 Separations Freeze went into effect. The jurisdictional assignment of special access
12 and DSL revenues was established well before the Freeze. The growth of these
13 revenues is attributable to customer demand.

14 **Q. WHAT HAS BEEN THE GROWTH IN INTERSTATE SPECIAL ACCESS**
15 **AND DSL REVENUES IN WASHINGTON?**

16 A. The following graph charts interstate special access revenues that Ms. Strain
17 evaluated.

18

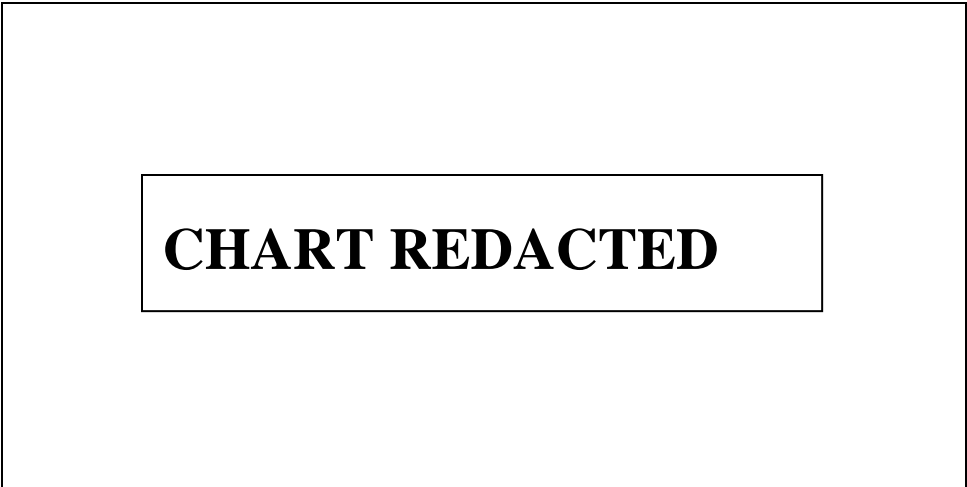
¹⁰ "In this Order, we conclude our investigation of a new access offering filed by GTE that GTE calls its DSL Solutions-ADSL Service ("ADSL service"). We find that this offering, which permits Internet Service Providers (ISPs) to provide their end user customers with high-speed access to the Internet, is an interstate service and is properly tariffed at the federal level."

FCC 98-292, Memorandum Opinion and Order in CC Docket No. 98-79 released October 30, 1998. *See also* FCC 98-317 released November 30, 1998

¹¹ "[W]e conclude that GTE's ADSL service is subject to federal jurisdiction under the Commission's mixed-use facilities rule" *Id.* ¶26

¹² "We agree that GTE's DSL Solutions-ADSL service offering is an interstate service that is properly tariffed at the federal level." *Id.* ¶16

1 ****BEGIN CONFIDENTIAL**



2

3 END CONFIDENTIAL** The graph shows that the portion of interstate special
4 access revenues from DSL has grown. However, the growth in total interstate special
5 access revenues since the separations freeze began in 2001 is ****BEGIN**
6 CONFIDENTIAL XXXXXXXXXXXXXXXXXXXXXXXXXXXX. END
7 CONFIDENTIAL**

1 **B. DSL and Special Access Adjustments**

2 **Q. MS. STRAIN PROPOSES TWO ADJUSTMENTS TO REMOVE OPERATING**
3 **EXPENSES AND INVESTMENT FOR DSL AND SPECIAL ACCESS FROM**
4 **THE INTRASTATE RESULTS OF OPERATIONS.¹³ DO YOU AGREE WITH**
5 **THESE ADJUSTMENTS?**

6 A. No. Ms. Strain makes both adjustments in response to the revenue shifts about which
7 she testifies. Both adjustments are in direct contravention of the FCC’s separations
8 rules. The FCC preempts the field of Separations. These adjustments—like the
9 adjustment that was the subject of *Hawaiian Telephone Company v. Public Utilities*
10 *Commission of State of Hawaii*, 827 F.2d 1264—are “a fairly transparent and
11 improper attempt to circumvent the FCC mandate.”

12 **C. Adjustments to Impute Revenues**

13 **Q. MS. STRAIN PROPOSES AN ADJUSTMENT TO IMPUTE REVENUES**
14 **EQUAL TO THE DIFFERENCE BETWEEN WHOLESALE RATES AND**
15 **FULL RETAIL RATES FOR DS1S AND DS3S AND UNBUNDLED DARK**
16 **FIBER¹⁴ DO YOU AGREE WITH THIS IMPUTATION?**

17 A. For the limited purpose of assessing the maximum revenues that Qwest could
18 generate as a result of charging retail rates instead of wholesale rates for these
19 particular services, the adjustment may be appropriate. However, the imputation does
20 not satisfy the requirements for a pro-forma adjustment to earnings. Specifically, the
21 facts are not known and measurable. The adjustment is purely speculative. The rate
22 changes may or may not occur and the revenues from the rate changes may or may

¹³ Testimony of Paula M. Strain, page 14, line 21 to page 15, line 2 and Exhibit PMS-4C

¹⁴ Testimony of Paula M. Strain, page 15, lines 15 to 19 and .Exhibit PMS-4C

1 not be derived. Certainly the adjustment is not appropriate for a measurement of
2 Qwest's 2005 earnings.

3 **Q. MS. STRAIN ALSO PROPOSES AN ADJUSTMENT TO IMPUTE**
4 **REVENUES EQUAL TO A TWO DOLLAR PER MONTH INCREASE IN**
5 **QWEST'S BASIC RESIDENTIAL SERVICE RATE.¹⁵ DO YOU AGREE**
6 **WITH THIS IMPUTATION?**

7 A. For purposes of assessing the absolute maximum possible revenues that Qwest could
8 generate during the AFOR as a result of increasing its basic residential rate 50 cents
9 per month each year during the first four years of the AFOR, the adjustment may be
10 appropriate. For purposes of assessing Qwest's actual financial performance in 2005,
11 it is not appropriate.

12 For ratemaking purposes it is not correct. It includes four years' of annual rate
13 increases of 50 cents per month (the maximum possible). But it does not include the
14 mitigating effect of four years of continuing access line losses.

15 **Q. DOES THIS CONCLUDE YOUR TESTIMONY CONCERNING**
16 **ADJUSTMENTS TO QWEST'S EARNINGS PROPOSED BY STAFF?**

17 A. Yes.

¹⁵ Testimony of Paula M. Strain, page 15, line 20 to 22.