BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE INVESTIGATION OF WHETHER QWEST CORPORATION IS IN COMPLIANCE WITH THE INVESTMENT REQUIREMENTS OF ITS AMENDED ALTERNATIVE FORM OF REGULATION PLAN	))))))	**Case No. 04-00237-UT**

FINAL ORDER

THIS MATTER comes before the New Mexico Public Regulation Commission ("Commission" or "NMPRC") upon the Commission's investigation of whether Qwest Corporation ("Qwest" or "Company") is in compliance with the investment requirements of its Alternative Form of Regulation plan ("AFOR"), as approved by the Commission's Final Order of March 8, 2001, in Utility Case Nos. 3215, et al. A public hearing on this matter was conducted by the Commission on December 15 and 16, 2004, and on January 4 and 5, 2005. The Commission, having considered all of the evidence admitted at the hearing, the record and the pleadings in this case, and arguments of counsel, and being fully apprised of the premises, announced an oral decision in this case during its regular open meeting on March 8, 2005, pursuant to 17.1.2.39.A(1) NMAC. Consistent with that rule, the Commission now enters the following as its Final Order in this proceeding.

I. STATEMENT OF THE CASE

On July 15, 2004, the Commission began this docket by entering an Order Commencing Investigation. The scope of the investigation was the following inquiry: "[W]hether Qwest is and will remain in compliance with its AFOR investment obligations, and what, if any remedial measures are

necessary to ensure Qwest's compliance with its AFOR investment obligations through the term of the AFOR." Id., p. 5, ¶ A.

In the July 2004 Order, the Commission also found that Motions to Intervene filed by the Citizens for Integrity and Transparency in Utility Matters ("CITUM") and the Department of Defense and all other Federal Executive Agencies ("DOD/FEA") were approved pursuant to 17.1.2.26.D(1) NMAC.[1] The Commission also appointed Peter E. Springer as Hearing Examiner to preside over procedural and discovery matters.

On July 23, 2004, the Hearing Examiner issued an Order setting a Prehearing Conference for July 29, 2004.

On July 29, 2004, a prehearing conference was conducted by the Hearing Examiner and attended by representatives of the Commission's Utility Division Staff ("Staff"), NMIPA, CITUM, the American Association for Retired Persons ["AARP"], the AG, and Qwest. Attending telephonically were AT&T, MCI, GSD, and DOD/FEA.

The Hearing Examiner issued a Procedural Order on July 30, 2004, that scheduled a public hearing for December 8, 2004. The Order set deadlines for motions to intervene by August 20, 2004; Qwest direct testimony by September 24, 2004; testimony from Staff and Intervenors by October 22, 2004; and any rebuttal testimony by November 19, 2004. Qwest was to publish notice in the Albuquerque *Journal* by August 6, 2004 and send notice to all entities on the Telecommunications Service List and all other persons entitled to notice

[1] The Attorney General of New Mexico ("AG"), the New Mexico General Services Department ("GSD"), MCI and the New Mexico Internet Professionals Association ("NMIPA") had previously intervened in case or cases 3812 or 03-00353-UT and were deemed parties in the instant case.

specified within the AFOR. The Protective Order adopted in Case Nos. 3812 and 03-00353-UT was deemed applicable to the instant case.

On August 9, 2004, an Affidavit of Publication was filed stating that the Notice had been published in the Albuquerque *Journal* on August 4, 2004.

On August 24, 2004, the Commission entered an Order Denying Request regarding CITUM's Request for An Independent Audit of Qwest's AFOR Reporting. That Request had been filed in Case Nos. 3812 and 03-00353-UT prior to the commencement of this Case No. 04-00237-UT.[2]

Staff filed a Notice of Staff Objection to Content of Qwest Annual AFOR Report for Period 3, and Request for Finding Good Cause and Issuing Bench Requests, on August 30, 2004. On that same date, GSD filed its Objection to Qwest Annual AFOR Report for Period 3.

On September 21, 2004, the Commission entered an Order Modifying Investigation. That Order expanded the scope of the investigation "to encompass consideration of whether the inclusion of Qwest's investment in wireless infrastructure in New Mexico, and the mode of such investment, in its overall AFOR investment commitment is permissible under the AFOR." Id., p. 3, ¶ A. That Order also provided that "Qwest shall have the burden of showing that its proposed inclusion of the Company's investment in wireless infrastructure in New Mexico, and the mode of such investment, in its overall AFOR investment commitment is permissible under the AFOR." Id., p. 3, ¶ B.

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[2] The Commission found that pleadings advocating the investigation that had since been docketed in the instant case were already pending in those cases by the time the Request was filed, and that the relief sought in the Request related to the subject matter of this case. Accordingly, the Commission concluded that this case was the proper forum for consideration and disposition of the Request. Id., p. 2, ¶ 2.

On September 23, 2004, in response to Qwest's Motion for Extension of time filed that same day, the Hearing Examiner reset Qwest's deadline for the filing of its direct testimony from September 24, 2004 until October 12, 2004.

Qwest filed the direct testimony of Nita Taylor, M. Lynn Norsworthy, and Rachel Torrence on September 24, 2004.

On October 12, 2004, Qwest filed the supplemental testimony of M. Lynn Norsworthy and Nita A. Taylor, and the Company's Responses to Bench Requests regarding Qwest's reporting of investments in wireless networks.

On October 12, 2004, Qwest filed an unopposed Motion asking for an extension of time in which to respond to CITUM's Motion to Compel. The Hearing Examiner granted this Motion on the following day.

On October 15, 2004, the Hearing Examiner entered an Order Rescheduling the Hearing to December 15, 2004

On October 19, 2004, the Hearing Examiner responded to Qwest's Motion for Further [four-day] Extension to Respond to CITUM's Motion to Compel by ordering Qwest to provide any response to the Discovery on or before October 22, 2004.

Staff filed the direct testimony of Susan Oberlander and Lee L. Selwyn on October 22, 2004. On that same date, GSD filed the direct testimony of John Martinez; and CITUM filed the direct testimony of David Mittle.

On October 25, 2004, in response to Qwest's Motion for its Third Extension of Time to Respond to Motion to Compel, the Hearing Examiner ordered that Qwest "shall provide any response to the Discovery Motion within

two business days after CITUM notifies Qwest of a CITUM decision to pursue the Discovery Motion."

In response to Qwest's Motion of November 17, the Hearing Examiner on November 18, 2004, set a scheduling conference to take place on November 22, 2004.

On November 19, 2004, Rebuttal Testimony was filed as follows: Rachel Torrence, M. Lynn Norsworthy, Harry M. Shooshan, and Nita A. Taylor on behalf of Qwest; Sidney L. Morrison on behalf of the AG. On that same date, Staff filed the Supplemental Testimony of Susan E. Oberlander.

On November 24, 2004, the Hearing Examiner ordered that all motions pertaining to the hearing be filed by December 1 and responses to such motions be filed by December 8.

On December 1, 2004, the Commission entered an Order Designating (and substituting) James C. Martin as the Hearing Examiner in this case for discovery and procedural matters. That Order also provided that the Hearing Examiner's authority included "the consideration of all motions pertaining to the December 15, 2004 hearing, scheduling and presiding over a hearing regarding such motions, and making recommendations to the Commission concerning such motions." On that same date, Hearing Examiner Martin reset the deadline for prehearing motions to noon on December 2, 2004 with responses due no later than noon on December 9, 2004. Prehearing motions were set for hearing on December 13, 2004, with the hearing on the merits to begin, as previously scheduled, on December 15, 2004.

On December 1, 2004, Qwest filed Qwest Corporation's Motion in the Alternative to Strike Testimony [of Sidney L. Morrison on behalf of the AG] or Extend the Procedural Schedule. At the same time, Qwest also filed a Motion to Cancel Oral Presentation Concerning JR-21 For Third Quarter 2004.

The following were filed on December 2, 2004: CITUM's Motion to Strike Portions of Qwest Direct and Rebuttal Testimony and Motion in Limine; Staff's and Intervenors' Joint Motion for Partial Summary Judgment, together with a Memorandum Brief in Support of its Motion; and Staff's Motion Challenging the Confidential Designation [by Qwest] of certain data requests and other responses to discovery.

On December 8, 2004, Qwest filed its Responses in opposition to Staff's Motion Challenging Confidential Designation, to the Joint Motion for Summary Judgment, and to CITUM's Motion to Strike. Qwest also filed a Motion to Modify Procedural Order To Move Hearing Date.

On December 9, 2004, the AG filed her Response in opposition to Qwest's Motion to alternatively strike the testimony or continue the hearing set for December 15, 2004.

On December 10, 2004, Staff filed its Response in opposition to Qwest's Motion to extend the hearing date.

On December 10 and 13, 2004, the Commission received correspondence from CITUM and DOD respectively concerning scheduling of the hearing; CITUM filed its Response to Qwest's Motion to Modify Procedural Order on December 13, 2004.

A hearing on Prehearing Motions took place on December 13, 2004, with Hearing Examiner James C. Martin presiding. Commissioner E. Shirley Baca and Commissioner-Elect Jason Marks were present and participated in the proceedings. Roy Stephenson appeared for Staff; George Baker Thomson, Jr. appeared for Qwest; Judith Ann Moore appeared for the Attorney General; Richard Levin appeared telephonically for GSD; Bruce Throne appeared for NMIPA; David Mittle appeared for CITUM; and Stephen Melnikoff appeared telephonically for DOD/FEA.

On December 14, 2004, the Commission entered its Order on Prehearing Motions as follows:

a. Qwest's Motion to Modify Procedural Order to Move Hearing Date was denied in part and granted in part. The Commission ordered the hearing to begin as scheduled December 15 with the testimony of Qwest witnesses, M. Lynn Norsworthy, Rachel Torrence, Nita A. Taylor and Harry M. Shooshan; additionally, Staff was to present the testimony of its witness, Lee L. Selwyn. After the presentation of these witnesses, the Commission reserved the right to recess the hearing and reconvene on January 3 or 4, 2005.

b. Staff and Intervenors' Joint Motion for Partial Summary Judgment was denied.

c. CITUM's Motion to Strike Portions of Qwest Corporation's Direct and Rebuttal Testimony was denied.

d. Qwest's Motion in the Alternative to Strike Testimony or Extend the Procedural Schedule was denied with the condition that Qwest may

present an oral response to the AG's rebuttal witness [Sidney Morrison] or furnish a pre-filed written response.

e. Staff's Motion Challenging Confidential Designation was granted in part and denied in part. The confidential designation of page 3 of Confidential Attachment SO-1 to the Supplemental Testimony of Staff witness Susan E. Oberlander was removed.

f. Qwest's Motion to Cancel Oral Presentation Concerning JR-21 for Third Quarter 2004 was granted.

The Commission convened the hearing on the merits as scheduled on December 15, 2004, with Chairman Herb H. Hughes and Commissioners David W. King, Jerome D. Block, Lynda M. Lovejoy and E. Shirley Baca presiding. Commissioners-Elect Jason Marks and Ben R. Lujan were present and participated. James C. Martin was present as Hearing Examiner and Special Assistant General Counsel. The following persons entered appearances in this proceeding.

For Qwest

George Baker Thomson, Jr., Esq., and Thomas W. Olson, Esq.

For the Attorney General

Judith Ann Moore, Assistant Attorney General

For GSD:

Richard H. Levin, Esq.

For DOD/FEA

Stephen S. Melnikoff, Esq.

For NMIPA

Bruce C. Throne, Esq.

For CITUM

David Mittle, Esq.

For Utility Division Staff

Roy Stephenson, Esq., and Jane Yee, Esq.

The Commission received the opening statements of the parties and public comments from J.D. Bullington, Vice President for Government Affairs, Association of Commerce and Industry of New Mexico; Judy McMullan, President, Communications Workers of America, Local 711- Albuquerque; Mary Ann Granoff, Regional Vice-President of Zianet and Chairman of Public Affairs for the New Mexico Internet Professionals Association; Carolyn Fudge, Assistant City Attorney, City of Albuquerque; Warren Salomon, AARP; and Michael Orchan, Director of Science and Technology, New Mexico Economic Development Department.

On the first day of the hearing, the Commission heard the testimony of Qwest witnesses Harry M. Shooshan; M. Lynn Norsworthy; Nita A. Taylor; and Rachel Torrence.

On day two of the hearing, the Commission proceeded with the remainder of the testimony of Qwest witness Rachel Torrence. The Commission concluded day two of the hearing on the merits with the testimony of Staff witness Lee L. Selwyn. The hearing was then recessed until January 4, 2005.

On January 4, 2005, the Commission reconvened the hearing. Chairman Ben R. Lujan and Commissioners Jason Marks, David W. King, and E. Shirley Baca presided. James C. Martin was present as Hearing Examiner

and Special Assistant General Counsel. Appearances for the parties were the same as set out above for the December sessions.

The Commission heard the telephonic testimony of Staff witness Lee L. Selwyn; AG witness Sidney L. Morrison; and CITUM witness David Mittle.

The Commission held the fourth and final day of the hearing on January 5, 2005, during which the testimony of GSD witness John Martinez and Staff witness Susan Oberlander was presented.

At the conclusion of the hearing, the Commissioners ordered that:

i) Responses to bench requests made by the Commission during the hearing must be filed by January 26, 2005;

ii) The parties must simultaneously file their briefs-in-chief by February 4, 2005; and

iii) Simultaneous reply briefs are due by February 18, 2005.

On January 26, 2005, Qwest filed its Response to Commission's Bench Requests, and GSD filed its Response to Qwest's Response to Bench Requests.

The parties filed their briefs-in-chief and their reply briefs by the required times.

On March 7, 2005, Qwest filed its Request for Notice of Substance of Nonparty Expert Advice and Opportunity to Respond.

II. BACKGROUND

A. Qwest's AFOR

As explained in the Commission's Final Order of March 8, 2001, in Utility Case Nos. 3215, et al. ("AFOR Final Order"), 2001 WL 849469,[3] the AFOR "had

[3] The Commission takes administrative notice of the Final Order and the record in Case Nos. 3215, et al., in accordance with 17.1.2.37.D(1) NMAC.

its genesis in the convergence of two developments." First was the passage of House Bill 400 (NM Laws 2000, Ch. 102; codified as NMSA 1978, §§ 63-9A-2, 63-9A-8.2 and 63-9A-8.3). Among other things, HB 400 directed the Commission "to eliminate rate of return regulation of incumbent telecommunications carriers with more than fifty thousand access lines and implement an alternative form of regulation that includes reasonable price caps for basic residence and business local exchange services." Section 63-9A-8.2(C). The second development was the merger of Qwest and U S WEST. AFOR Final Order, p. 8.

Qwest's AFOR was submitted as part of a contested Stipulation and was approved as provided by the AFOR Final Order. The AFOR became effective upon the date of approval for a term of five years from that date. AFOR Final Order, p. 75, ¶ D; AFOR (Ex. B to AFOR Final Order), § IV.C. The AFOR set the terms and conditions of regulation applicable to Qwest's retail services in New Mexico during the term of the AFOR. AFOR Final Order, p. 13.

The AFOR's broad array of terms is summarized at pp. 13-19 of the AFOR Final Order. For the proceeding at hand, the most pertinent provisions of the AFOR are as follows:

Section V: The AFOR established the going in prices for 1FR (residence basic exchange service) at $10.66 and 1FB (business basic exchange service) at $34.37 during the term of the Plan. This maintained the 1FR and 1FB rates at the levels ordered by the Commission in Utility Case No. 3007. On the condition that Qwest met its average yearly investment and other specified service commitments, including the deployment of digital subscriber line

services ("DSL") and integrated services digital network services ("ISDN"), the grooming of loops to allow any carrier to provide DSL, and the clearing of existing high cost held orders, the 1FR price cap was eligible for an increase to $12.25 30 days after Qwest submitted its annual compliance report for Period 1, which ended June 30, 2002, and to $13.50 after the end of Period 2 (June 30, 2003).

Section VIII: Qwest was obligated to invest not less than $788 million over the term of the AFOR, under various terms and timeframes. The AFOR itself stated Qwest's commitment this way:

> Qwest commits to devote a substantial budget to infrastructure investment, with the goal of achieving the purposes of this Plan. Specifically, Qwest will make capital expenditures of not less than $788 million over the term of this Plan. This level of investment is necessary to meet the commitments made in this Plan to increase Qwest's investment and improve its service quality in New Mexico. Section VIII.A.1, p. 10 (footnote omitted).

In the footnote to this provision, the AFOR made it clear that the capital expenditures constituting the $788 million commitment were to be measured by Qwest's Jurisdictional Report 21—Summary of Construction ("JR-21"). Id., n.3. As Qwest witness Norsworthy testified in the present case, this reporting requirement and measurement standard was proposed by the stipulating parties and ordered by the Commission precisely because it was a known, objective standard already undertaken by Qwest, and therefore required no additional data gathering, compilation, or interpretation. Qwest Ex. 2 (Norsworthy Direct), p. 13. *See also*, Qwest Ex. 7 (Taylor Supp. Direct), p. 6

("Qwest acknowledges that the agreed upon measurement of its investment is the JR-21 report,...")

Attachment A to the AFOR plan described the anticipated investment projects and time frames. Included within this investment was the commitment to deploy DSL within 6 months of the effective date of the Plan in the following wire centers: Taos, Farmington main, Roswell main, Gallup main and Alamogordo. Further, within 18 months of the effective date of the Plan, Qwest was committed to deploy ISDN in five of ten identified wire centers, and within 24 months of the effective date of the Plan, Qwest was to deploy ISDN in the five remaining wire centers. Another component of Qwest's investment commitment to advanced services was an agreement to groom loops capable of providing DSL in the wire centers where Qwest deploys DSL.

Section X: This section includes what came to be known as the "reopener" provision, which provides that,

> If during the term of the Plan the Commission determines the benefits and credits provided in this Plan do not provide sufficient incentives to Qwest to meet the quality of service standards or investment commitments contained in the Plan, the Commission may, after public notice and opportunity for hearing, modify the Plan to ensure future compliance with service standards or investment commitments. Section X.B.5.e, p. 42.

The AFOR Final Order (at pp. 19-23) discussed this and a related reopener provision at length. An integral part of that discussion was the Commission's finding that "upon Commission approval of the AFOR or any other stipulated plan, it becomes an order of the Commission." Id., p. 20. The parties, including Qwest, agreed. Id., pp. 19-20. Because the AFOR is an order

of the Commission, said Qwest, "'the Commission may use all of its available authority to enforce that order.'" Id., p. 20 (citation omitted). The parties also agreed that, as a Commission order, the AFOR "'is subject to the Commission's continuing jurisdiction.'" Id. (citation omitted).

After that discussion the Commission concluded that,

> we are charged with continuing regulatory oversight of the AFOR, including matters pertaining to its implementation and enforcement, to Qwest's compliance with the AFOR and this Order, and to any changes of facts or circumstances that may affect the AFOR and the public interest in how it is, or should be, implemented. If necessary, we may review any aspect of the AFOR either upon the Commission's own motion or upon the application or complaint of any interested person. If circumstances warrant, we may, after notice and hearing, change any aspect of the AFOR as the public interest may require. Id., p. 23.

B. The Origins of This Case

Most of the concerns that later became the principal issues in this case were first raised in what became Case No. 03-00353-UT.[4] The occasion was Qwest's filing of its Annual Compliance Report for Period 2[5] and notice of substantial compliance, and the Company's Notice Regarding Second 1FR Price Cap Increase. Staff expressed concern about what it characterized as a decline in Qwest's annual investment levels to pre-AFOR levels. Staff also questioned the reliability of the investment data on the JR-21 form in light of possible audit adjustments and future restatements of financial information. Both Staff and the AG urged that any Commission approval of the proposed second price cap increase for Qwest's 1FR rate be made conditional and subject to refunds or

[4] The Commission takes administrative notice of the Commission Orders and case records in this and the other precursor cases described herein, in accordance with 17.1.2.37.D(1) NMAC.
[5] AFOR Period 2 extended from July 1, 2002, through June 30, 2003. AFOR § IX.A.1.a.

rebate. Staff and the AG agreed that the Commission should determine the appropriate compliance period for measuring Qwest's average annual AFOR investment commitment. Order on Second Proposed Increase of Qwest's 1FR Price Cap, p.3; entered in Case Nos. 3812 and 03-00353-UT on September 9, 2003.

The conditions proposed by Staff and the AG concerning the second raising of the 1FR price cap were uncontested. The Commission agreed to increase the 1FR price cap subject to refunds and cancellation[6] contingent upon Qwest being able to show that the various investigations involving its financial restatements have been completed, and that these investigations have not materially impacted the investment data in the Company's Annual Compliance Reports. This approval was also subject to refunds and cancellation if it was later found that Qwest was not in substantial compliance with the Commission's determination of the appropriate compliance period for measuring Qwest's average annual investment commitment under the AFOR, and the investment amount required for that period. The Commission also approved Staff's recommendation that, commencing with the fourth quarter of calendar year 2003, Qwest be directed to file JR-21 forms quarterly for the remainder of its AFOR term. Order on Second Proposed Increase of Qwest's 1FR Price Cap, p. 7.

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[6] Qwest's first proposed increase of its 1FR price cap had been approved a year before in Case No. 3812. That approval was subject to refunds and cancellation if Qwest failed to timely file a required audit, or if the audit revealed that the investment data on which Qwest relied to support its rate increase is invalid or does not otherwise support a finding that Qwest has substantially complied with its investment commitments as set out in AFOR § V.A.1.a, or if Qwest's financial restatement causes changes to the figures in its Jurisdictional Report 21 forms for 2000 and 2001 that are material to Qwest's compliance with its AFOR investment commitments. Order on Proposed Increase of Qwest's 1FR Price Cap, p. 4; entered on September 3, 2002.

Lastly, that Order directed that briefs be filed addressing what compliance period is appropriate for measuring Qwest's average annual investment commitment under the AFOR. Id., pp 7-8.

After receiving and evaluating those briefs, the Commission issued its Order on AFOR Compliance Period, and Related Matters, in Case Nos. 3812 and 03-00353-UT on December 18, 2003. In that Order, the Commission agreed with Qwest that for the purpose of determining whether the Company is eligible for the 1FR price cap increases after Periods 1 and 2, the compliance period for Period 1 would include investments of over $126 million made during 2000, and investments made between January 1, 2001, and June 30, 2002. The compliance period for Period 2 included investments made between July 1, 2002, and June 30, 2003.[7] For the remaining periods of the AFOR, the average annual period for the determination of Qwest's investment commitment will correspond to Periods 3, 4 and 5 as defined in the AFOR.[8] Id., pp. 6 and 8.

The parties agreed, and the Commission so ordered, that Qwest had an obligation to invest an average of $157.6 million per year for each period during the term of the AFOR. Id., pp. 4 and 8. However, both the AG and Staff continued to articulate their concerns about what they claimed were Qwest's declining investment levels. The AG argued that Qwest had invested only $68.1 million between July 1, 2002 and June 30, 2003, "thus raising the question whether the infrastructure may deteriorate from lack of adequate continuing

[7] In the AFOR, Period 1 is defined as the 12-month period commencing on July 1, 2001. Period 2 is defined as the 12-month period commencing on July 1, 2002. See, respectively, AFOR §§ IX.A.1.a and IX.A.1.b, p. 10.

[8] Period 3 is defined as the 12-month period commencing on July 1, 2003. Period 4 is defined as the 12-month period commencing on July 1, 2004. Period 5 commences on July 1, 2005, and terminates five years after the effective date of the AFOR plan, i.e., on March 8, 2006. See, AFOR §§ IX.A.1.c through IX.A.1.e, p. 10.

investment" (quoting from the AG's Brief, p. 7). Staff pointed to Qwest's declining investment levels with concern because after the second rate increase the AFOR contained no express incentives to ensure that Qwest meet its $788 million investment commitment. Staff said it might recommend that the Commission take other measures to ensure that Qwest fulfills its total AFOR investment commitment. Id., pp. 3-4.

The Commission noted that its previous Orders on Qwest's price cap increases recognized that Qwest was being required to undertake financial restatements for some or all of the relevant reporting periods, and that such restatements may affect the investment data in the Company's Annual Compliance Reports. As a result, Qwest was required to show that it has completed the investigations[9] involving its financial restatements, and that those investigations had not materially impacted its AFOR investment data. At the time of the issuance of the Order on AFOR Compliance Period, and Related Matters, no relevant details from Qwest's financial restatements had yet been filed, nor had the pending SEC and DOJ investigations been completed, and, as Staff stated, these investigations could result in further changes to Qwest's investment numbers. Id., p. 7.

In view of the considerations just set out, the Commission required Qwest, Staff and the AG, and permitted other interested persons, to file statements or briefs addressing the following:

> i) Whether the Company's restatement of revenues, and the SEC and DOJ investigations, have caused or may cause material changes to the investment figures contained in its annual compliance reports and, if so, how;

[9] Those investigations included pending U.S. Securities and Exchange Commission ("SEC") and U.S. Department of Justice ("DOJ") investigations.

> ii) Whether the conditions set out in the Commission's two Orders that make both 1FR increases subject to refunds and cancellation should be removed;
> iii) Whether the Commission should reopen the AFOR pursuant to § X.B.5.e to add additional incentives, or otherwise modify the AFOR, to compel Qwest to comply with its $788 million total investment commitment over the term of the AFOR; and
> iv) Whether and, if so, what types of further proceedings may be necessary regarding any of the above issues.

Id., pp. 8-9.

This briefing was later stayed by the Commission's Order Granting Motion to Stay Proceedings, entered in Case Nos. 03-00353-UT and 3812 on January 27, 2004. Qwest had filed a Motion to Stay Proceedings for Sixty Days or, in the Alternative, to Extend All Procedural Deadlines by Sixty Days, which was opposed by GSD and Staff. The Commission ordered that all proceedings in those cases be temporarily stayed for a period ending on March 29, 2004. Qwest, Staff, the AG, GSD and other interested parties were directed to engage in good faith discussions with respect to issues related to Qwest's AFOR investment commitment—including those identified in the Commission's Order on AFOR Compliance Period, and Related Matters—and how those issues might be resolved. The discussions were to be subject to the protections afforded by 17.1.2.19.D NMAC and Rule 11-408 NMRA, and Hearing Examiner William J. Herrmann was appointed to act as facilitator for the discussions. The parties were required to file a joint status report, or separate status reports, on the discussions by no later than April 2, 2004. Id., pp. 3-4.

Nonetheless, this "time out" proved unsuccessful. Two status reports were filed on the April 2 deadline. One was a Joint Status Report by Staff, the AG, AT&T, MCI, GSD, AARP, NMIPA and DOD/FEA. The other was by Qwest.

The parties to the Joint Status Report wrote that Staff and various interested parties participated in settlement discussions with Qwest for eight consecutive weeks, but the results were inconclusive and no settlement was reached. The joint reporters did not rule out the possibility of a future settlement, but did not think that a continuation of current talks would lead to a settlement. The Report said that information that had been publicly provided by Qwest indicated that the rate and amount of Qwest's New Mexico investments was declining, and expressed concern that Qwest may therefore not be able to satisfy its AFOR investment obligation of $788 million. Thus, these parties requested that the Commission reschedule the briefs and discovery process required by its Order on AFOR Compliance Period, and Related Matters. Order Reinstating and Rescheduling Hearings, entered April 20, 2004, in Case Nos. 03-00353-UT and 3812, p. 2.

Qwest agreed that these discussions took place and that no settlement resulted. The Company said that it "has appropriately alerted the Commission that the investment objective perceived three years ago does not appear to synchronize with current circumstances" (quoting from Qwest's Status Report, p. 6). Even so, Qwest insisted that "there is simply no need at this time for a formal proceeding regarding the AFOR investment obligations" because there are no unmet service commitments and "no breakdowns or failures in the AFOR that the Commission need investigate" (quoting from Qwest's Status Report, p. 7). Order Reinstating and Rescheduling Hearings, pp. 2-3.

After reviewing these reports, the Commission found that Qwest and the other parties appeared to agree about the decline in Qwest's AFOR investment,

but that there was disagreement about the extent of the decline. Moreover, Qwest and the other parties disagreed about the possible consequences of this decline, and whether the Commission should undertake any further proceedings thereon. For these reasons, and for the reasons set out in the Order on AFOR Compliance Period, and Related Matters, the Commission reinstated and rescheduled the briefing and discovery process originally established for those cases. Id., p. 3.

After considering the resulting briefs, the Commission ordered the investigation in this Case No. 04-00237-UT.

III. DISCUSSION

The central issue of this case is whether Qwest is, and will be upon the expiration of the AFOR, in compliance with its commitment to invest $788 million in New Mexico over the life of the AFOR. The evidence of record indicates that Qwest will not be in compliance with this commitment. If the current trend in the Company's investment expenditures continues, there will be a significant shortfall of around $200 million, and possibly more, by the time the AFOR ends on March 8, 2006. This prospective shortfall requires us to address this matter now and to put a remedial process in place right away.

A. Qwest's $788 Million Investment Commitment

Qwest has acknowledged at least since April, 2004 that it will likely fall short of its $788 million commitment.[10] Concerns in that regard were brought up by Staff and the AG before that time. *See* above. Nevertheless, Qwest resisted any inquiry into that matter up to the time the instant case was

[10] That acknowledgement continued in Qwest's testimony in this case. *See*, e.g., Qwest Ex. 6 (Taylor Direct), p. 7 ("Qwest will not likely invest $788 million during the term of the plan.")

docketed. Nor did the Company propose any revisions to the AFOR or any other remedial measures until this case was underway.

Qwest now argues that it is currently in substantial compliance with its AFOR investment commitment.[11] Whether Qwest will remain in compliance with its AFOR investment obligations, says the Company, requires re-examination of those obligations in light of developments and events that occurred after the AFOR and the AFOR Final Order were approved by the Commission. Qwest asserts that this is due to what it claims were the unforeseen and extraordinary changes in the telecommunications industry in the period since the AFOR hearings that have substantially reduced the need for landline infrastructure investment in New Mexico.

Qwest argues that it is meeting or exceeding its other AFOR commitments and there is no evidence that such success will not continue. Any Commission assessment of Qwest's compliance with its investment obligations, the Company says, should take into account telecommunications investment by affiliated and subsidiary Qwest companies as well as uncapitalized expenditures directly related to AFOR investment and projects. Qwest states that these additional investment categories include the following, which should be added to the categories now comprising the JR-21:

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[11] Pursuant to the Commission's Order on AFOR Compliance Period, and Related Matters, Qwest's cumulative investment obligation by the end of AFOR Period 3 was $472.8 million. Qwest's reported amount of investment, not including proposed additional categories, was $427.8 million, or slightly over 90% of the required amount. Qwest Ex. 8 (Taylor Rebuttal), p. 6; Staff Ex. 2 (Oberlander Direct), p. 17. Qwest claims that Valor Telecommunications of New Mexico reported attainment of approximately 94% of its investment benchmark at the end of its most recent AFOR reporting period, which Staff found to be in "substantial" compliance. Staff's testimony, however, was that Valor was in compliance. Transcript, Jan. 5, 2005 (Oberlander), pp. 116-117.

i) An additional $46 million of intrastate capitalized software investment by Qwest;[12]

ii) An additional $26 million in intrastate wireless service investment by Qwest affiliate Qwest Wireless ("QW");

iii) An additional $2 million in New Mexico-specific investment by Qwest long-distance affiliate Qwest Communications Corporation ("QCC");[13]

iv) Certain other non-capitalized expenses not quantified by Qwest in their direct testimony.

Qwest's Brief-in-Chief, pp. 7, 25-26 and 28.

In addition to these proposals, Qwest urges the Commission to reform the investment commitment by directing Staff and willing interested parties to work with Qwest along these lines in light of what the Company claims are the significant, unanticipated changes since the AFOR was adopted. Qwest does not offer an alternative figure to the present $788 million investment requirement. Similarly, while disputing the end-of-term investment shortfall projected by Staff, Qwest claims an inability to estimate what its New Mexico investments would be for the relatively brief period between the hearing and the end of the AFOR term.[14] 1 Tr. (Norsworthy), pp. 146-149.[15]

The parties have proposed different punitive measures. These proposals are described beginning at page 45 of this order. Qwest opposes what it terms as the punitive enforcement measures advocated by Staff and intervening

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[12] This proposal was first introduced in the rebuttal testimony of Qwest witness Norsworthy. *See* Qwest Ex. 4 (Norsworthy Rebuttal), pp. 9-12.

[13] Qwest asks the Commission to include QCC investment as a component of the Company's AFOR investment beginning in 2004. This is because until 2004, QCC's records were not maintained so as to permit precise identification of its New Mexico investment. Qwest Ex. 2 (Norsworthy Direct), pp. 32-33; Qwest Ex. 3 (Norsworthy Supplemental Direct), pp. 11-12.

[14] When the testimony in question was given, on December 15, 2004, approximately fifteen months of the AFOR's term remained. At the same time, Qwest's witness admitted that when the Company entered into the AFOR agreement, it was making projections over the entire five-year AFOR term. 1 Tr. (Norsworthy), p. 147.

[15] Transcript citations herein correspond to the day of the hearing on the merits. For example, because December 15, 2004, was day 1, it will be cited as "1 Tr. __."

parties as premature, excessive, unnecessary, and not in the public interest. These enforcement measures, Qwest asserts, are not detailed enough to act on, and no legal authority exists in the record to date for many of the recommended measures. Qwest also argues that the record does not permit the Commission to craft a lawful, proportionate penalty in this proceeding because it is not known what harm, if any, or the extent of the violation, if any, that might exist at the end of the AFOR term.

All of the other parties dispute Qwest's assessment of the situation. For example, NMIPA argues that the only context in which the phrase "substantial compliance" appears in the AFOR is with respect to the price cap increases Qwest was allowed to implement. NMIPA points out that Qwest's average annual investment requirement in the AFOR and the Final Order is simply Qwest's total minimum $788 million investment requirement divided by the five-year term of the AFOR, or $157.6 million annually. The other parties argue that Qwest is not in compliance with its investment obligation because it is approximately $45 million, or 10%, short of what it was expected to have invested in its New Mexico wireline network by the end of AFOR Period 3. According to Staff's estimates, at Qwest's current investment rate the final deficit will be between $188 and $194 million (assuming the Commission does not allow "non-JR-21" expenditures to count towards Qwest's commitment). Staff Ex. 3 (Oberlander Supplemental), p. 3 (citations omitted).

Staff and the other parties generally disagree with counting the additional investments and expenses proposed by Qwest as part of the Company's investment commitment because they are not part of Qwest's JR-21

Report and they were not considered by any party during the negotiations that led to Qwest's AFOR. With respect to the investments of Qwest's affiliates, the parties argue that these are essentially investments made by other companies that were not part of the AFOR and thus should not be included in Qwest's fulfillment of its investment obligation. The parties suggest that crediting QCC's investment towards Qwest's AFOR obligation would run afoul of the structural separation required by Section 271 of the federal Telecommunications Act of 1996.[16] The parties also argue that expenses should continue to be excluded because the AFOR investment obligation was not determined based on a historical baseline of Qwest's annual expenses, but only on its historical annual capital investment. The total AFOR obligation, the parties claim, undoubtedly would have been significantly larger if Qwest's expenses had also been included.

When Qwest and other parties first proposed the AFOR, Qwest's support for all facets of the AFOR, including the $788 million investment commitment, was unstinting and unqualified. As the Commission noted in the AFOR Final Order (pp. 8-9), in the wake of the merger of Qwest and U S WEST, "the new Qwest management stated its willingness to invest in this state more than its predecessor, and began an initiative to resolve a number of pending regulatory controversies and to work toward a comprehensive solution to the service problems that Qwest had inherited in New Mexico." The increased investment was to be made manifest by Qwest's $788 million commitment. The resolution of regulatory controversies was carried out by the AFOR's settlement of eight

[16] 47 U.S.C. § 271. The Communications Act of 1934 was amended by the Telecommunications Act of 1996—Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. § 151, *et seq.*

outstanding Commission cases. *See*, AFOR Final Order, pp. 53-73, for a description of these cases and a discussion of the respective settlements.

In the AFOR proceeding, Qwest's witnesses identified a number of benefits the Company would receive from approval of the AFOR.[17] Qwest's senior witness, Charles Ward,[18] testified that a major benefit would be the "measure of stability and predictability" that Qwest would receive from the AFOR plan, so that it could execute its business plan. The AFOR also helped Qwest identify "the significant risks" that the Company faces. Quoted and cited in Staff Ex. 2 (Oberlander Direct), p. 12. Mr. Ward testified that "the balance reached in the AFOR is the best that could be reached under the circumstances presented in the existing cases and under the rulemakings proposed by the Commission [at that time]." AFOR Final Order, p. 10 (citations omitted).

Qwest witness John Badal[19] stated that the AFOR allowed the Company "to resolve a number of pending regulatory issues in order for Qwest to invest, to improve service quality and to have an opportunity for success in New Mexico." The AFOR, said Mr. Badal, also provided Qwest the benefits of streamlined regulation, addressed the issues of competitive parity, and ended rate of return regulation. Quoted and cited in Staff Ex. 2 (Oberlander Direct), pp. 12-13. Mr. Badal testified that "the Amended AFOR provides a means to create a regulatory environment in New Mexico that encourages investment, provides incentives for new service deployment, promotes competition,

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[17] In the hearing on pre-hearing motions, there was no objection to or disagreement with the Hearing Examiner's conclusion that the testimony and the record in the original AFOR case constitutes the best evidence of the parties' understandings of what the AFOR means, what benefits the AFOR would afford, etc. Transcript, December 13, 2004, pp. 74-75.

[18] Mr. Ward was the Regional Vice President for Qwest's Eastern Region. AFOR Final Order, p. 9.

[19] Mr. Badal was Qwest's Vice President and General Manager for the State of New Mexico. AFOR Final Order, p. 10.

enhances service quality, and furthers the policy initiatives of the federal Telecommunications Act of 1996 and HB 400." AFOR Final Order, p. 10 (citation omitted).

Mr. Ward recognized the nature of Qwest's investment commitment:

> If opportunities arise elsewhere, if the investment package for New Mexico does not realize gains, or if competition increases the company's exposure to cover its costs of investment, Qwest will be unable to change the amount invested in the state.

Quoted and cited in Staff Ex. 2 (Oberlander Direct), p. 14.

Mr. Ward summed up by declaring that,

> Qwest needs assurance that the risks to its shareholders will not be increased still more. The balancing of interests in the AFOR plan was achieved in a careful and deliberate way. To increase the burdens on one side or the other would disrupt and destroy the balance that the parties have reached.

Quoted and cited in Staff Ex. 2 (Oberlander Direct), p. 13.

The record in this case shows that these benefits have not diminished over time. Investment in telecommunications infrastructure is an especially important,[20] if not crucial, factor in stimulating business activity, economic development and job creation throughout all sectors of New Mexico's economy. Staff Ex. 1 (Selwyn Direct), pp. 14-21. Conversely, insufficient or inadequate telecommunications infrastructure could threaten this State's economic well-being. For example, repeated telephone and Internet outages at military facilities served by Qwest could lead to DOD/FEA pullbacks. Id., p. 20.

[20] The importance of such investment has long been recognized by the New Mexico Legislature. *See*, e.g., NMSA 1978, § 63-9A-2 (2000) ("It is further the intent of the legislature that the encouragement of competition in the provision of public telecommunications services will result in greater investment in the telecommunications infrastructure in the state, improved service quality and operations and lower prices for such services").

Moreover, while admitting that Qwest has successfully resolved many of the critical inadequacies in the Company's infrastructure that serves federal installations and offices, DOD/FEA continues to insist that the Qwest infrastructure serving both the Los Alamos National Laboratory and White Sands Missile Range are inadequate. Reply Statement of DOD/FEA, pp. 2-3, and nn.6 and 7.

Other claims of service deficiencies were made in comments submitted by the City of Santa Fe via letters from Mayor Larry A. Delgado dated December 14, 2004, and December 23, 2004. Mayor Delgado wrote of City residents unable to get DSL, outages during wet weather due to aged infrastructure, service quality problems with leased Qwest circuits supporting the Municipal Airport's emergency response plan, and delays in new service installation because of a lack of Qwest facilities. 2 Tr., pp. 2-4.

There is no shortage of ways in which Qwest could improve its New Mexico network. For example, Qwest acknowledges that economic development could be enhanced by equipping more central offices with redundant diversely routed interoffice fiber because certain types of businesses will not consider locating without such service. 2 Tr. (Torrence), pp. 22-25.[21] Additionally, about one third of business and residential locations within Qwest's New Mexico service area still cannot get DSL because there is no DSL equipment in their serving central office or no remote terminal to serve their location. 2 Tr. (Torrence), pp. 35 and 41. Qwest admits that the availability of high speed DSL is also a factor in economic development because many businesses would not

[21] Offices without redundant diversely routed interoffice fiber are vulnerable to a total loss of service with a single accidental cut. Id.

consider locating someplace where they would not have access to some form of high-speed Internet. 2 Tr. (Torrence), pp. 42-43.

Unquestionably, in a state with the size and geographic diversity of New Mexico, with growing populations both concentrated and scattered, and featuring a variety of harsh weather during all seasons, maintaining and expanding this State's telecommunications infrastructure requires ongoing effort and investment. This includes among other things the rehabilitation of local distribution facilities prone to failure,[22] the completion of diverse routing of fiber for all Qwest central offices, and the continuing expansion of DSL deployment. Notwithstanding Qwest's claims to the contrary, the Company has not come close to exhausting investment opportunities in New Mexico.

Qwest appears to have recognized both the need and the opportunity for constant investment in New Mexico when it agreed in the AFOR to a 25% increase over the pre-AFOR investment of U S WEST. 1 Tr., pp. 107-108. Even so, after a strong start during Period 1, Qwest's level of investments has been on an increasingly downward curve. In Period 1, Qwest invested $275.2 million, or 174% of its average annual investment requirement of $157.6 million.[23] After Period 2, Qwest's cumulative investment total was $343.3 million, or about 108% of the required cumulative amount. The actual amount invested during Period 2, $68.1 million, was down sharply. The investment amount for Period 3, $85.4 million, was an increase over the Period 2 investment, but still fell well short of the average requirement. The cumulative

[22] The AG's witness testified about the need for updating, repairing or replacing Qwest's outside plant network. AG Ex. 2 (Morrison Rebuttal), pp. 8-12.

[23] As mentioned above, the compliance period for Period 1 was longer than the other four Periods. It included investments made between January 1, 2001, and June 30, 2002, plus certain other investments made during the year 2000. *See* Order on AFOR Compliance Period, and Related Matters.

investment amount after Period 3 was $427.8 million, about 90% of the cumulative investment target of $472.8 million. Staff Ex. 2 (Oberlander Direct), pp. 17-18.

If Qwest's first two quarterly reports for Period 4 are any indication, the Company is now investing at a rate of approximately $19.5 million a quarter. If continued, that would amount to almost $78 million for Period 4, and approximately $58 million for Period 5.[24] In that event, the total investment at the end of the AFOR would be around $564 million—a shortfall of about $224 million.[25]

Although the amount of Qwest's prospective investment shortfall is still uncertain, it is uncontested on this record that Qwest is heading for a shortfall by the end of the AFOR. That any shortfall in Qwest's promised investment is a serious matter cannot be doubted. We are effectively being asked in this case to decide whether any shortfall should be permitted.

As noted above, the parties to the original AFOR case recognized that, upon approval by the Commission, the AFOR or any other stipulated plan becomes an order of the Commission.[26] As such, "'the Commission may use all of its available authority to enforce that order.'" AFOR Final Order, p. 20 (citation omitted). This principle is not at issue. The authority to interpret and enforce a regulatory instrument contemplates interpreting that instrument in

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[24] Period 5 runs for slightly more than eight months, or not quite three calendar quarters.

[25] These amounts include only those investment categories currently reported in the JR-21. Whether, as Qwest contends, additional categories toward its investment commitment should be allowed will be considered below.

[26] *See*, e.g., **Cajun Electric Power Cooperative, Inc. v. Federal Energy Regulatory Commission**, 924 F.2d 1132, 1135 (DC Cir. 1991) ("Any agreement that must be filed and approved by an agency loses its status as a strictly private contract and takes on a public interest gloss.").

light of the circumstances giving rise to it. The exercise of that authority falls within the Commission's "unique area of expertise." *See*, e.g., **E.spire Communications v. New Mexico Public Regulation Commission**, 392 F.3d. 1204, 1207-1208 (10th Cir. 2004).

Also not in question is the Commission's ability to do what it did in the AFOR Final Order, namely, to adopt a contested stipulation by making "an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will resolve the subject of the proceeding in a way that is just and reasonable." **Attorney General v. Public Service Commission**, 111 N.M. 636, 640, 808 P.2d 606, 610 (1991) (citations omitted). The justness and reasonableness of the Commission's resolution of the AFOR case was not challenged at the time, but Qwest appears to be doing so now, well after the fact, even though it was a proponent of that resolution.

Understandably, changing a Commission order is not something that can or should be done lightly. This is especially so when, as here, the Commission's resolution of the matter rested on a proposal made by most of the parties that was designed as a delicate balance of the interests and circumstances in play,[27] and that was later accepted by all once the Commission had made its decision. Qwest is proposing that it be relieved from fulfilling its AFOR investment commitment, contrary to the balance achieved by the AFOR. This ignores the public interest in that balance and is inconsistent with the rest of the

[27] The AFOR Final Order (p. 59) concluded that "the Amended AFOR provides a just and reasonable balancing of interests, including those of the public as well as the parties to this proceeding."

circumstances that led to the adoption of the AFOR.[28] As the Company's testimony in the original AFOR case shows, Qwest was keenly aware at that time of how well the AFOR's balancing of interests served the public interest. Qwest has not shown that those circumstances have changed in any material way since the AFOR Final Order.

For example, although Qwest represents that the demand for wireline services has fallen off sharply since the beginning of the AFOR,[29] as demonstrated by the reduction in Qwest's "Switched Access Line" count in New Mexico, the record suggests otherwise. During the hearings the Attorney General introduced an exhibit[30] that showed that while Qwest's Switched Access Line counts in New Mexico had fallen by approximately 6% since the AFOR,[31] these losses were accompanied by a 51% increase in "Special Access Lines" resulting in a 5.5% increase in "Total Access Lines" during the time period in question.[32] Thus, Qwest's argument that there has been a significant decrease in the demand for wireline service in New Mexico is not supported by the record. Furthermore, given that Qwest's operations in New Mexico have seen the smallest decrease in "Switched Access Lines" and the largest increase

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[28] For example, the AFOR Final Order (p. 45) found that one of the public policy bases for the passage of HB 400 was "increasing investment into the network infrastructure." Circumstances include the settlement in the AFOR case (No. 3215, et al.) of eight other cases then pending against Qwest.

[29] *See*, e.g., Qwest Ex. 9 (Torrence Direct), pp. 32-33.

[30] AG Ex. 1; 2 Tr., p. 123.

[31] Qwest's company-wide access line loss for the same time period was approximately 19% or more than 3 times that of New Mexico.

[32] AG Ex. 1 covers the time period between 2000 and 2003. The Commission produced similar calculations using the most recent ARMIS (http://www.fcc.gov/wcb/eafs/) data available (this database was accessed on April 9, 2005). The Commission's comparison of Qwest-New Mexico versus the 13 "Other" Qwest states indicates that between 2000 and 2004 Qwest's New Mexico operations have seen: a 10.61% decrease in Switched Access Lines as compared to a 24.27% decrease elsewhere; a 62.41% increase in Special Access Lines as compared to a 30.70% increase elsewhere; and a 4.22% increase in Total Access Lines as opposed to a 9.75% decrease elsewhere.

in "Total Access Lines" of any Qwest territory,[33] claims that Qwest-New Mexico is somehow disadvantaged, or less receptive to investment as compared to Qwest's other service territories, also ring hollow.

Nor has Qwest explained why New Mexico needs less, not more, investment in its telecommunications infrastructure. Qwest contends that it need not invest the $788 million because its quality of service now meets or exceeds the benchmarks established elsewhere in the AFOR. Qwest's Brief-in-Chief, p. 19. It also avers that in light of the downturn in the telecommunications sector of the economy, it should not be required to fulfill its initial commitment. Qwest's Brief-in-Chief, p. 17-18 and 23. There is no support in either the AFOR Final Order or the AFOR for the proposition that Qwest's investment obligation is tied to other AFOR provisions or is contingent on or qualified by any other AFOR requirements. The Company's investment commitment is independent of Qwest's other obligations under the AFOR and, as the Company itself admits, the state of its financial affairs. *See* Qwest Ex. 4 (Norsworthy Rebuttal), p. 12 ("revenues and profits, in and of themselves, are not the issue in this case and are outside the scope of the AFOR Agreement"). Even if financial hardship or distress had been a recognized contingency in the AFOR, Qwest does not claim that the Company can simply no longer afford to meet its investment commitment. 1 Tr. (Shooshan), pp. 79-80. Moreover, Qwest's confidential response to the Bench Request issued on December 15, 2004, suggests that the cash provided by Qwest's operating activities in New

[33] We note that only one other Qwest state, Wyoming, has seen an increase in "Total Access Lines" between 2000 and 2004.

Mexico for the year ending December 31, 2003 was more than Qwest is obligated to invest annually under the AFOR.

In view of the foregoing, and given Qwest's notable reluctance to ask for "relief" from its investment requirement until this case (which was initiated over Qwest's objections)[34] and its recent $8.9 billion bid on MCI ("Qwest, Refusing to Accept No, Raises MCI Bid," New York Times, April 1, 2005),[35] the credibility of any claims of financial distress would not be high.

The AFOR Final Order and the AFOR also do not support Qwest's claim that there is a "substantial compliance" standard regarding its investment commitment that, argues Qwest, could be met by an investment of less than $788 million. The only contexts in which that phrase appears in the AFOR are in connection with the two price cap increases that Qwest was allowed to seek (AFOR § V.A.1.b and c, p. 6; and § IX.G.4, p. 22), and with service quality standards (Id., § X.B.5.d, p. 42). This was essentially admitted by Qwest's witnesses, who also agreed that substantial compliance is a concept that was suggested only by Qwest in this proceeding. 1 Tr. (Taylor), p. 220; 2 Tr. (Torrence), pp. 8-9.

In sum, Qwest has not demonstrated why it should not be held to its commitment to invest $788 million in New Mexico under the terms and

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[34] Qwest could have applied at any time for Commission review of any genuine financial tribulations material to the AFOR under the procedure established in the AFOR Final Order. *See* Id., p. 23. Some of the other parties fault Qwest for not doing so until it filed testimony (instead of pleadings) in this case. While that position may have merit, we do not consider or rule on it in this case because of the overriding public interest in, and the importance of, the issues associated with Qwest's investment commitment, and the concomitant need for a Commission decision on those issues.

[35] Qwest's initial bid on MCI was $8 billion, followed by a first revised bid of $8.45 billion. Id. *See also,* letter of March 31, 2005, from Richard C. Notebaert, Chairman and Chief Executive Officer of Qwest Communications International, Inc., to the MCI Board of Directors (Qwest press release); and letter of March 28, 2005, from Richard C. Notebaert to the MCI Board of Directors, SEC File No. 001-10415.

timeframes contained in the AFOR. The importance of that commitment cannot be overstated. The Company's best efforts should be dedicated to meeting that commitment by the end of the AFOR.

We now consider whether investment categories other than those comprising the JR-21 should be counted toward Qwest's investment commitment. In this case Qwest has requested that the Commission give the Company credit for expensed items and for investments made by Qwest affiliates, neither of which are part of Qwest's JR-21 Report. For Period three, Qwest is requesting recognition of approximately $26 million of investment by QW, $46 million in software expenses, $2 million of investment by QCC (Qwest's Long Distance affiliate) and other unquantified expenses related to AFOR projects such as deloading loops and general network maintenance. Qwest claims that allowing these additional expenses and the investments of its affiliates to count towards Qwest's investment obligation removes any doubt regarding its compliance with its AFOR investment obligation through Period 3. Qwest also seeks recognition of these items for the remainder of the AFOR.

B. Qwest's Investment in Wireless Infrastructure

We first examine Qwest's wireless investments. Staff and the other parties that have taken a position on this issue oppose recognition of wireless investments. This opposition stems from claims that wireless investments were not a part of the AFOR negotiations and are not part of Qwest's JR-21. The parties also argue that this is an investment made by a company that was not included in the AFOR, and thus should not be included in Qwest's overall investment requirement.

To begin with, we can find no language in the AFOR Final Order or in the AFOR itself that refers to investment by Qwest, or any of its affiliates, in wireless infrastructure. Additionally, Qwest has not pointed to anything in the record of the original AFOR case (No. 3215, *et al.*) concerning wireless investment. Qwest has also admitted that it "did not consider wireless" with respect to the AFOR, and called it "an oversight on our part." 1 Tr. (Taylor), pp. 185-186.

It is undisputed that Qwest did not include any wireless investment in its JR-21 reports prior to the AFOR Final Order, or in any of its AFOR reports until after Period 3.[36] The Company's proposal for the inclusion of wireless investment in its AFOR investment commitment came only after this case was already underway.

Qwest was a party to the AFOR, which expressly stated in its very first line that "[t]his Plan establishes the regulatory framework under which Qwest Corporation will provide retail telecommunications services in New Mexico." AFOR § 1, p. 1. QW was neither a party to, nor mentioned by, the AFOR. One of Staff's witnesses asserts, and we agree, that this Commission has no jurisdiction over QW's investments or the prudence thereof. Staff Ex. 1 (Selwyn Direct), p. 40. Qwest agrees that the Commission lacks jurisdiction in this area, and claims that the Commission also has no jurisdiction to regulate other parts of Qwest's wireless service.[37] *See*, e.g., 1 Tr. (Taylor), p. 168. Regardless,

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[36] *See* Order Modifying Investigation (issued in the instant case on September 21, 2004), p. 1 (citing Qwest's Annual AFOR Compliance Report for Period 3).

[37] Among other things, the federal Telecommunications Act provides that "no State or local government shall have any authority to regulate the entry of or the rates charged by any commercial mobile service or any private mobile service, except that this paragraph shall not prohibit a State from regulating the other terms and conditions of commercial mobile services." 47 U.S.C. § 332 (c)(3)(A). The extent of this Commission's jurisdiction over wireless carriers

there is no state regulatory oversight or framework with respect to Qwest's wireless investments.

From the foregoing it is readily apparent that all the investment goals and projects stated or referred to in the AFOR were wireline projects. The wireless investment by Qwest's affiliate, QW, was not contemplated or permitted by the AFOR, and has not been part of any AFOR apparatus that benefits Qwest's customers.

For these reasons we find that Qwest has not met its burden of showing that its proposed inclusion of the Company's investment in wireless infrastructure in New Mexico, and the mode of such investment, in its overall AFOR investment commitment is permissible under the AFOR. Qwest has failed as well to demonstrate why inclusion of its wireless investment is otherwise in the public interest. Accordingly, the Company's wireless investment should not count towards Qwest's fulfillment of its $788 million investment obligation.

We further note that both Congress and the FCC have established law and regulations that are designed to prevent regulated services from providing support or a subsidy to non-universal service or competitive services. For example, 47 U.S.C. § 254(k) of the Federal Telecommunications Act states that "the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities." The 1996 Act also

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under this and other applicable law has been argued in pending NMPRC Case No. 3567. We do not consider, and express no opinion on, that question in the instant case.

prescribed structural and nonstructural safeguards that were intended to protect ratepayers, consumers, and competitors against the effects of potential improper cost allocation and discrimination.[38] Raising local rates in exchange for Qwest increasing its investment in unregulated activities would have been inconsistent with the spirit of the federal law and federal cost allocation rules.

C. QCC Capital Expenditures

According to Qwest, its long distance affiliate, QCC, did not maintain records that permitted precise identification of its New Mexico investment until 2004. Since then, QCC's records have been maintained to identify New Mexico-specific investment. Beginning with 2004, Qwest asks the Commission to include QCC investment as part of Qwest's overall AFOR investment. Qwest testifies that through the first eight months of 2004, QCC's New Mexico investment totaled approximately $2 million. Qwest's Brief-in-Chief, p. 25 (*see also* the testimony cited therein).

The other parties oppose the inclusion of QCC's investment in the overall AFOR investment. They argue that, as with QW, QCC was not a part of the AFOR, was neither mentioned nor contemplated by it, and its investment is outside the scope of the AFOR. The AG observes that the $788 million investment figure was derived by determining an incremental amount over and above the average of the 1995-1999 spending of U S WEST. However, since QCC was a part of Qwest, not U S WEST, before the Qwest/U S WEST merger, QCC's investment could not have been part of the U S WEST baseline, and

[38] *See*, for example, In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, FCC 96-490, Released: December 24, 1996.

should not be included now. AG's Brief-in-Chief, pp. 7-8 (*see also* the record citations therein).

Staff points out that as a condition of Qwest's entry into the interstate long distance market, QCC is an affiliated entity separated from Qwest. 47 U.S.C. § 272(a)(1) and (2). Under that section of the Telecommunications Act, Qwest and QCC are required to maintain separate books, records and accounts. 47 U.S.C. § 272(b)(2).[39] Qwest, says Staff, has provided no assurances that any inclusion of QCC investment for Qwest AFOR purposes would not violate the structural separation requirements between it and QCC. Staff's Post-Hearing Brief, p. 24. Along these same lines, Staff states that subsuming QCC's investments within the AFOR "may raise significant concerns over the statutory prohibition against cross-subsidization of unregulated affiliates. NMSA 1978, § 63-9A-8(C)." Id.

As addressed at pp. 36-37 and immediately above, and given the record in this case, the concerns raised by the subject federal prohibitions caution against permitting the QCC investment that Qwest seeks. In any event, it is undisputed that QCC's investments were not included in the AFOR (and, indeed, could not even have been sufficiently identified for that purpose until 2004), and were only brought up for the first time in this case. For these reasons, the QCC investments should not be permitted to count towards Qwest's AFOR investment commitment.

D. Previously Expensed Software

[39] Qwest and QCC are also required to operate independently from each other; to have separate officers, directors and employees; to obtain credit in a way that would shield Qwest's assets from any default by QCC; and to conduct all transactions between Qwest and QCC on an arm's length basis and in writing. 47 U.S.C. § 272(b)(1), (3), (4) and (5).

Citing generally accepted accounting principles, and specifically, the American Institute of Certified Public Accountants Statement of Position 98-1 ("SOP 98-1"), Qwest asks that the AFOR be amended to allow an amount of capitalized software investment that was previously expensed. Qwest says that SOP 98-1 requires capitalization of costs of software developed or acquired for internal use, and has been adopted by the FCC. Qwest avers that its management reporting, including annual reports to this Commission, is consistent with SOP 98-1 in that it reflects capitalization of software costs. The Company says that the $46 million that Qwest seeks to add to its JR-21 represents the intrastate portion of its capitalized software investment. The interstate portion, states Qwest, is already included in its JR-21. Qwest's Brief-in-Chief, p. 7 (*see also*, the record citations therein).

Qwest admits that the Company opposed the capitalization of these costs when the issue came up in one of the cases that the AFOR settled (i.e., Utility Case No. 3008), while Staff and the AG supported the SOP 98-1 position. That case was settled without a Commission determination on whether these costs should be capitalized or expensed. "Qwest determined at the time that in the absence of a definitive ruling, it would continue to expense the costs for intrastate ratemaking purposes." Qwest Ex. 4 (Norsworthy Rebuttal), pp. 8-9. Staff and GSD maintain that Qwest had argued for continued treatment of the software as an expense in the early proceedings because that treatment was to Qwest's benefit in the rate of return environment. Staff's Post-Hearing Brief, p. 23, and Staff's Reply Brief, p. 15; GSD's Initial Brief, p. 13, and GSD's Reply Brief, p. 11.

Qwest now says that it has changed its mind because of the desirability of standardizing its accounting and reporting practices and conforming them to FCC requirements. Id., p. 10. Both Staff and GSD question the timing of Qwest's proposal. GSD argues that in view "of the size of this expense which Qwest seeks to convert into an AFOR investment, it is more than a little suspicious that Qwest did not bring it forward until it was clear that Qwest was not meeting its AFOR investment obligation." GSD's Brief, p. 13. Staff echoes GSD's sentiment, and points out that this issue was brought up for the first time in Qwest witness Norsworthy's rebuttal testimony, which Staff contends raises due process questions because no other party had the opportunity to offer testimony on this point. Staff's Post-Hearing Brief, p. 23. This issue presents something of a conundrum. On the one side, none of the parties dispute Qwest's reading of SOP 98-1, or the proposition that qualified intrastate software expenses could ordinarily be credited as an AFOR investment. On the other side, the parties protest that Qwest's proposal is too late and too little. The AG and GSD maintain that rate consequences flowed from the Commission's balancing of interests in the AFOR, including the settlements of Case Nos. 3007 and 3008. The rates that were set as the residential and business rates in the AFOR, the AG and GSD argue, resulted at least in part from the positions advocated in those cases, including Qwest's support of expensing its software costs. Reclassifying those costs as investments now, they say, would require a reopening of the AFOR and a readjustment and a rebalancing of Qwest's investment and rates retroactively. GSD's Brief, p. 14; AG's Brief-in-Chief, p. 9.

The record in this case is silent on whether the software expenses in question existed during the baseline period and, if so, how much those expenses were. The record also does not tell us what are Qwest's current New Mexico software expenses.

To determine these remaining issues, we will give Qwest an opportunity, in the docket we create below, to establish what its expenses were, if any, for intrastate software during the AFOR baseline period. Expenditures incrementally higher than the baseline intrastate expenses can be included in the JR-21 for AFOR investment purposes, on the grounds that such incremental increases are consistent with the AFOR's objective of increased investment. For example, if Qwest was spending $20 million per annum on software during the baseline period, and today is spending $30 million per annum, $10 million per annum of incremental expenditures could be credited toward the $788 million.

E. Loop Grooming Expenses

Qwest claims that it has incurred substantial expenses in meeting the "mass grooming" obligation specifically required by Section VIII.D of the AFOR.[40] Qwest asserts that while these expenditures are not capitalized according to generally accepted accounting principles ("GAAP") they are directly related to its infrastructure investments so they should be counted towards its investment commitment. Qwest's Brief-in-Chief, p.33.

[40] Section VIII.D of the AFOR requires Qwest to "groom loops" that are shorter than 18 kilo feet in 18 specific wire centers within 12 months of the effective date of the AFOR agreement. Grooming loops is the process of removing load coils (a/k/a: deloading) and bridge tap (unused cable sections) that impede the provision of DSL service on a given loop. 2 Tr. (Torrence), p. 17.

The AG notes that the AFOR plan specifically states that Qwest will make capital expenditures to meet its investment commitment, as measured by the JR-21 report, and that the average 1995-1999 baseline investment used to determine Qwest's investment commitment did not include expenses. The AG believes these reasons are sufficient to exclude such expenditures. AG's Brief-in-Chief, p 10. Similarly, Staff points out that even a lay understanding of the term "invest" draws a bright distinction between capital and expenses, as between parts and labor. Staff Reply Brief, p. 14. Staff also argues that the only "evidence" Qwest has offered is the testimony of a network engineer, not an accountant, that, in her opinion, these expenses should be credited as capital expenditures against the investment commitment since they are necessary to accomplish certain projects required by the AFOR.[41] Staff's Post-Hearing Brief, p. 24.

However, the AG does not object to the inclusion of loop grooming expenses in the 18 wire centers where Qwest offered DSL service within 12 months of the effective date of the AFOR because this particular loop grooming was specifically recognized by the Commission as being within the total investment commitment contained in the AFOR. AG's Brief-in-Chief, p 10 (citing AFOR Final Order, p. 46). CITUM argues that to the extent the AFOR provides for Qwest to count loop grooming expenses towards its investment requirement, CITUM does not oppose Qwest being allowed to do so. CITUM Brief, p. 11.

Staff and GSD disagree with Qwest, CITUM, and the AG regarding the inclusion of grooming expenses. Staff argues that counting expenses as capital

[41] 4 Tr. (Torrence), , pp. 7, 13-15, and 64; Qwest Ex. 9 (Torrence Direct), p. 20.

expenditures finds no support in GAAP, which was in place and well known to Qwest at the time the AFOR was negotiated and the projects agreed to by Qwest. Staff Brief-in-Chief , p. 25. GSD agrees with Staff's arguments and adds that Qwest acknowledges that grooming loops does not involve capital investment,[42] but instead involves removing previous investment from the network. Furthermore, GSD argues that the bridged taps and load coils that deloading removes from the network were installed to enable and enhance voice services, and thus, by removing this equipment the loops become less suitable for regular voice service. GSD Brief-in-Chief, pp. 9, 14-15.

GSD maintains that because the AFOR investment obligation was determined based only upon a historical baseline of Qwest's annual capital investment, the total AFOR obligation undoubtedly would have been significantly larger if Qwest's expenses had been included. According to GSD, Qwest now seeks to unbalance the equation by crediting expenses to an investment-only obligation. Thus, GSD argues that in order to be fair to ratepayers, if the Commission were to give Qwest credit for expenses, it would then have to give ratepayers the same credit and increase the overall AFOR obligation commensurately. Id.

The parties disagree over the extent to which the record contains evidence regarding Qwest's pre-AFOR loop grooming expenses. For example, while the AG claims the record indicates that there was no DSL in New Mexico until the AFOR so there would be no loop grooming costs during the baseline

[42] GSD cites 2 Tr. (Torrence), pp. 16-17.

investment period,[43] Staff claims that loop grooming did occur during that time period. AG's Brief-in-Chief, p 10; Staff Post-Hearing Brief, p. 25.

According to GSD, its preliminary review of Qwest's confidential ATT A-1 showed entries for DSL services equipment as well as entries for DSL loop deloading or conditioning. GSD argues that to the extent that Qwest has previously reported any deloading or conditioning labor expenses on its JR-21 forms these entries should be stricken. GSD Reply Brief, pp. 14-15.

We conclude that non-capitalized load coil expenses incurred by Qwest during the term of the AFOR should be considered for inclusion towards Qwest's investment commitment because such expenditures are consistent with Qwest's AFOR obligations and provide customers with long term benefits by enabling the provision of broadband services. AFOR § VIII.D. The record in this case, however, is not clear on whether the loop grooming expenses existed during the baseline period and, if so, how much those expenses were. The record also does not indicate whether Qwest is claiming additional mass grooming expenses pursuant to AFOR § VIII.D.6. Thus, to determine these remaining issues, we will give Qwest an opportunity, in the docket we create below, to establish what its expenses were, if any, for loop grooming during the AFOR baseline period and for additional mass grooming. Expenditures incrementally higher than the baseline New Mexico expenses can be included in the JR-21 for AFOR investment purposes. For example, if Qwest was spending $10 million per annum on loop grooming during the baseline period, and today is spending $15 million per annum, $5 million per annum of incremental expenditures could be credited toward Qwest's investment commitment.

[43] Citing 3 Tr. (Mittle), pp. 107-108.

F. Prospective Remedies

The record convinces us that Qwest may not meet its $788 million investment commitment by the end of the AFOR without a strong incentive to do so. Accordingly, we conclude that a refund of any investment shortfall to all of Qwest's New Mexico customers will serve both as an incentive to Qwest and as a means to maintain the balance that was struck by the AFOR.

1. Is Remedial Action Needed?

Staff asserts that the rapidly declining rate of investment and the lack of Qwest assurances to the contrary suggest that Qwest will not invest the full $788 million absent a strong incentive.[44] Thus, Staff recommends that the Commission immediately issue an order confirming that Qwest is to abide by the terms of the AFOR and that Qwest is unequivocally obliged to invest the full amount of $788 million by the end of the AFOR or return the unexpended portion to its customers. Staff Post-Hearing Brief, p. 20. Staff avers that without some such incentive, there is a real and immediate threat of irreparable harm to the public interest, the telecommunications network infrastructure, and the economic development of the state. Id., p. 5.

Staff's general position that remedial measures are necessary to ensure Qwest's compliance is shared by CITUM, NMIPA, GSD, and the AG. For example, CITUM argues that if the Commission does not impose remedial measures on Qwest the telecommunications infrastructure in New Mexico will be unable to provide for economic development, rural education, or telemedicine in the future.[45] CITUM also suggests that Qwest never intended to

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[44] This argument was also made by GSD.
[45] CITUM cites Staff Exhibit 1 (Selwyn Direct), pp. 12-25.

meet its investment commitment because Qwest never booked its commitment as a contingent liability[46] even though it booked a similar but much smaller rural extension fund liability.[47] CITUM avers that because there is a direct relationship between investment and service quality, remedial measures need to be imposed today to preserve and strengthen the network for tomorrow. CITUM Opening Brief, p. 3.

NMIPA believes that ordering remedies and sanctions is necessary to ensure compliance due to the substantial nature of Qwest's violations of the Final Order, the potential harm to the State and the public interest from those violations, and also because the Commission's administrative fining authority is limited to a maximum of $25,000. NMIPA Brief-in-Chief, pp. 22-27.

The AG adds that while it is true that the record does not demonstrate what harm particular customers have suffered, in terms of network capability or availability of services due to Qwest's investment shortfall, it is also true that ratepayers are not receiving the full intended benefits contemplated by the AFOR investment obligation. The AG claims it is undeniable that the AFOR was a package deal, and thus, remedial measures are necessary to restore the balance it established. AG's Brief-in-Chief, pp. 13-14.

In an oral bench request[48] the Commission ordered Qwest to provide documentation identifying the infrastructure investment projects Qwest intends to complete if ordered to do so by the Commission. GSD refers to Qwest's response as "contemptuous" for its lack of detail and assurances that the projects would actually be completed. GSD argues that Qwest's response

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[46] Citing 1Tr. (Norsworthy), p. 102.
[47] Citing 1Tr. (Norsworthy), p. 131.
[48] 4 Tr., p. 195.

indicates that Qwest has no intention of completing its obligation under any circumstances and proves that the Commission must take immediate action to force Qwest's compliance. GSD Brief, p. 17.

Qwest claims that consideration of remedial actions at this point, such as those that have been recommended by Staff, the AG, GSD, NMIPA, and CITUM, is premature and unnecessary, and the actions themselves are excessive, lack essential detail and are unsupported by law. For example, Qwest maintains that any punishment ordered by the Commission must be proportionate to the nature and severity of the violation and to the extent of the harm it has caused, and must consider any mitigating and aggravating circumstances. Thus, Qwest argues, because the term of the AFOR has not expired the Commission cannot determine the nature and extent of a violation or the resulting harm, nor can the Commission assess mitigating or aggravating circumstances. Qwest contends that the punitive measures proposed by the parties are excessive in light of Qwest's assertion that it has met and frequently surpassed its service quality obligations and its obligations to deploy broadband services. Qwest's Brief-in-Chief, pp. 38-40.

CITUM argues that it is axiomatic the Commission has the authority to impose remedial measures because the AFOR contains a provision that allows the commission to create incentives if Qwest not meeting investment obligations. CITUM's Opening Brief, p. 9.

As noted above, Qwest is proposing that it simply be relieved from fulfilling its AFOR investment commitment. This ignores the public interest in sustaining the balance achieved by the AFOR and is inconsistent with the

totality of circumstances that led to the adoption of the AFOR. As has been previously discussed, Qwest's testimony in the original AFOR case shows that the Company was acutely aware at that time of how well the AFOR's balancing of interests served the public interest.[49] The Commission has no intention of upsetting this balance and repeats its declaration that Qwest's best efforts should be dedicated to meeting its investment commitment by the end of the current AFOR. To this end the Commission has concluded that in the event it is determined at the end of the current AFOR agreement that Qwest has invested less than 100% of its investment requirement, the Commission will impose remedial measures upon Qwest that are commensurate with the investment shortfall. Obviously, if it is determined that Qwest has met its investment commitment there will be no need for remedial actions regarding that issue.

The AFOR explicitly states that the Commission retains the authority to modify the AFOR in order to provide Qwest with additional incentives.[50] The Commission hereby creates the "additional incentives" discussed in the AFOR by making it absolutely clear to Qwest that in the event that there is an investment shortfall Qwest will be required, as provided by this Order, to return any investment shortfall to its customers in New Mexico.

Qwest has not demonstrated why it should not be held to its commitment to invest in New Mexico under the terms and timeframes contained in the AFOR. Qwest has also failed to demonstrate why requiring the Company to meet the AFOR investment commitment to which it agreed would

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[49] *See* above, pp. 24-26.
[50] *See* AFOR § X.5.e.

be punitive. Furthermore, we agree with Staff that the proposed remedial measures involving refunds to ratepayers are not punitive as they merely make the State of New Mexico whole by enforcing the investment obligation originally ordered by the Commission. We now consider whether any of the other measures recommended are appropriate in light of the circumstances of this case.

2. Recommended Remedies

Staff maintains that because Qwest's revenue comes from its ratepayers the ratepayers should be the beneficiaries of any difference between the actual and the promised investment. According to Staff's proposal Qwest would be required to credit to its customers any unexpended balance of the $788 million that exists on March 8, 2006. Staff would have Qwest provide these credits to all of its retail customers. These credits would be allocated according to the number of lines each customer has. Staff claims its plan for remedial action is transparent and self-executing, requiring no additional regulatory burden while establishing a genuine incentive for the company to invest in a timely way. Staff Post-Hearing Brief, p. 5.

Like Staff, GSD recommends that the Commission require Qwest to pay the shortfall to its customers. However, contrary to Staff, GSD suggests that the payment should be made to customers based on a ratio of the individual customer's monthly recurring charge payments to Qwest for wireline services, excluding toll calling, as a proportion of the total Qwest monthly recurring charge receipts from all of Qwest's New Mexico customers for wireline services for the same month, less toll calling, multiplied by the total amount to be

refunded. GSD argues that its refund/credit proposal is more efficient than Staff's proposal because the refund would be proportionate to the financial burden of Qwest's New Mexico customers. However, if its plan is deemed too difficult to administrate the GSD is not opposed to Staff's recommended approach, based on a reasonable determination of line counts, as an alternative basis for refunds. GSD's Brief, pp. 19-20.

According to CITUM, the preferred remedial measure would be for the Commission to immediately freeze all earnings and dividends of Qwest New Mexico and bar them from being transferred out of State.[51] If Qwest fails to freeze its dividends, CITUM recommends that the Commission seek an order of contempt and enforcement in a district court.[52] If Qwest fails to invest $788 million by March 2006, CITUM avers that the under investment should be garnished from Qwest New Mexico's frozen dividends, placed in a specific account, and spent on improving the telecommunications infrastructure of New Mexico. CITUM's Opening Brief, p. 10.

NMIPA believes that if Qwest fails to invest the minimum of $788 million by March 8, 2006, it should be required to deposit the remaining, unspent balance of that requirement in an interest-bearing "Qwest investment escrow account," to be established by the Commission. NMIPA suggests that the Commission then solicit input from all interested parties as to how Qwest should be ordered to invest that remaining amount in its wireline network infrastructure in accordance with the stated objectives of the Final Order and the AFOR. The Commission would subsequently order Qwest to implement that

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[51] CITUM Ex. 3 (Mittle Direct), p. 7.
[52] Citing NMSA 1978, § 63-7-1.1(H).

investment and supervise disbursements of the funds in that escrow account in accordance with its orders. Finally, NMIPA believes the Commission should attempt to prevent Qwest from causing further potential and irreparable harm to the State and its consumers by ordering that Qwest will be subject to suspension or revocation of its certificate of public convenience and necessity, further credits to customers and, in addition, fines and other penalties deemed appropriate by the Commission if it fails to satisfy its $788 million investment requirement by March 7, 2006. NMIPA's Brief-in-Chief, pp. 24-26.

The AG recommends that the Commission consider an immediate reduction of either the current 1FR rate or the price cap increases allowed in the AFOR by the 10% shortfall that currently exists. However, if the shortfall percent increases during the remaining term of the AFOR, the AG recommends an additional 1FR reduction, calculated by applying the incremental shortfall percent to either the 1FR rate or to the price cap increases. According to the AG's plan, if the shortfall percent decreases during the final year, Qwest will essentially earn back the difference between the immediate 10% reduction and the final shortfall percent. The AG maintains that such a scheme is within the authority of the Commission, administratively simple with low implementation costs, and gets immediate benefit to consumers. AG's Brief-in-Chief, p. 13.

NMIPA responds that the AG's customer credit allocation approach is not reasonable or equitable because it would provide no benefits or remedy at all for any of Qwest's other customers that take services other than "basic residential service." NMIPA maintains that Qwest's other customers depend on Qwest's investment in its landline network in New Mexico and were harmed, to an even

greater extent, by Qwest's AFOR investment violations.[53] Instead, NMIPA recommends that the Commission adopt a credit allocation method which equitably distributes any remedial credits ordered by the Commission to all Qwest retail customers purchasing landline services, and which also considers and appropriately factors in the fact that the harm resulting from those Qwest investment requirement violations has not affected, and does not affect customers on a simple, proportionate retail "line count" basis. NIMPA believes that Staff's proposed method of allocating any Commission-ordered credit to retail customers on the basis of Qwest's retail "line count" is more reasonable and equitable than the AG's credit allocation proposal, but thinks Staff's proposal could be more equitable. NMIPA recommends that, before the Commission orders Qwest to implement any remedial retail customer credits as a result of this investigation, the Commission solicit further input from Staff and the other parties regarding the implementation of and adjustments to Staff's credit allocation proposal. NMIPA's Response Brief, pp. 20-21.

In addition to claiming that no remedies are needed with respect to its AFOR investment commitment, Qwest argues that the majority of the recommended remedies are outside the Commission's authority. For example, Qwest claims that although CITUM recommends freezing earnings and dividends and barring them from being transferred out of state, and garnishing any investment shortfall from those frozen funds at the end of the AFOR term, there is no discussion on whether the Commission has such powers and from where they derive. Qwest also maintains that CITUM's proposal fails to discuss

[53] NMIPA notes that these "other" retail customers include schools, hospitals, State, federal and local governmental authorities, small businesses and larger business.

the due process requirements to support such a "taking" of corporate funds by an administrative agency of the state government, or the Commission's authority to accept and control funds and spend or direct spending of such funds in light of the guidelines in NMSA 1978, § 6-10-3. Qwest avers that there is no evidence that freezing its dividends is necessary to preserve Qwest's ability to meet its service or investment obligations and there is no statutory authority in New Mexico to freeze dividends as a punitive measure.

Qwest argues that NMIPA's recommendation that the Commission establish a "Qwest investment escrow account" is clearly contrary to the dictates of § 6-10-3.[54] Furthermore, Qwest maintains that NMIPA's legal analysis advocating that the Commission has statutory authority to establish such an account, breaks down quickly as they cite NMSA 1978, §§ 8-8-4 and 67-7-1.1, both of which contain language conditioning the Commission's powers respectively by enjoining the Commission from "issuing orders not inconsistent with law" and having only "all other powers provided by law". Qwest Reply Brief, p. 21.

Qwest acknowledges that New Mexico statutes permit the Commission to impose certain specified administrative penalties, or to seek enforcement of the AFOR in court. However, Qwest argues that because the Commission has only the powers granted to it by the Legislature, the Commission cannot impose the kinds of penalties and remedial measures proposed by Staff and GSD, which

[54] NMSA 1978, § 6-10-3 states that "All public money in the custody or under the control of any state official or agency obtained or received by any official or agency from any source, ... shall be paid into the state treasury. It is the duty of every official or person in charge of any state agency receiving any money in cash or by check, draft or otherwise for or on behalf of the state or any agency thereof from any source, ... to forthwith and before the close of the next succeeding business day after the receipt of the money to deliver or remit it to the state treasurer." (Internal citations omitted.)

ask the Commission to require Qwest to pay the balance of the unspent investment commitment to ratepayers, because there is no statutory authority for the Commission to order such a payment as a penalty or to order payment of a penalty to ratepayers, rather than the State. Qwest Reply Brief, p. 15.

Qwest claims that the remedy proposed by the AG must be rejected because AFOR prescribes only two circumstances under which retail rates may be reduced[55] and subject to these two exceptions, which Qwest asserts are not applicable to this discussion, the AFOR provides that "the Commission will not require Qwest to decrease the price for any retail telecommunications service."[56] Moreover, Qwest avers that irrespective of the limitation established in the AFOR, the Commission is not authorized to reduce rates as a penal measure. According to Qwest, because the AG's recommendation to reduce Qwest's rates is based only on Qwest's failure to meet the AFOR investment obligation, it is a punitive recommendation that, like the recommendations of Staff and other intervenors, is outside the Commission's authority. Qwest Reply Brief, pp. 17-18 and 22-23.

We agree with Qwest that it is premature at this point to impose penalties for violations that have yet to, and may not, occur. If violations of the AFOR Final Order are found to have occurred before or after the expiration of the current AFOR, sanctions may then be considered. Because we do not adopt at this time the penalties and other sanctions recommended by the parties in

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[55] Qwest cites Section V.A.3 (requiring a reduction to intrastate carrier common line charge effective January 1, 2003) and Section X.B.4 (requiring certain specified reductions in the 1FR price cap should Qwest fail to meet specified service quality standards for two consecutive periods).

[56] Qwest cites AFOR Section XI.G.1.

this case, we need not consider or decide at this time whether those recommendations lie within our authority.

Nonetheless, the record well establishes that now is hardly too soon to take other steps to ensure that both the letter and the spirit of the AFOR are followed. A process must be in place before the end of the AFOR that both provides Qwest an opportunity to come into compliance with its investment commitment and provides the Commission with a vehicle to oversee Qwest's efforts in that regard. Postponing possible remedial action until after the term of the current AFOR will only have the effect of closing the stable door after the horse has galloped off into the distance.

Indisputably, the best outcome for both Qwest and its New Mexico customers would be for the Company to invest every penny of its $788 million AFOR commitment by the time March 8, 2006 comes around. That commitment was, after all, designed to benefit those customers. If that commitment falls short, it is only fair, and consistent with the balance wrought by the AFOR, that Qwest make up for that shortfall in a way that benefits its customers and conserves the AFOR's balance. Living up to a voluntary commitment, and a Commission Order, is not a penalty.

Although the parties have devoted much briefing space to customer refunds and other possible remedies in the event of an investment shortfall, virtually no testimony addressed how any such remedies should work. The details of a possible refund to all of Qwest's customers, and related matters, therefore must still be considered.

For these reasons, we are creating a new docket to address matters relative to Qwest's AFOR investment commitment and any other unfinished AFOR business.

G. Case No. 05-00094-UT

This Final Order is initiating a new AFOR implementation and enforcement docket, Case No. 05-00094-UT, to consider remaining or ongoing AFOR information and issues. Foremost among these is Qwest's compliance with its AFOR investment commitment and related matters identified in this Final Order. Additionally, all reports required by the AFOR or other Commission Order will henceforth be filed in this docket. Since pending Case Nos. 3812 and 03-00353-UT were established to deal with issues arising from the AFOR Final Order, and due to the relatedness of those issues with the others that will be considered in Case No. 05-00094-UT, those cases will be consolidated with that one.

Qwest filed a compliance audit report for AFOR Period 1 as a part of Case No. 3812.[57] In the instant case, GSD claims that on the basis of its preliminary analysis of Qwest Confidential ATT-1 to the Company's response to Commission Bench Requests, it believes that Qwest has reported "numerous items which are clearly not proper for inclusion as New Mexico AFOR investment, and others which are highly questionable." GSD's Reply Brief, p. 5; *see also*, Confidential Attachment A to NMGSD Reply Brief. Without deciding GSD's or similar claims, we think that an audit would clear up any doubts about the accuracy and reliability of Qwest's reporting of its AFOR investments. Consequently, and as provided by this Order, an independent audit of Qwest's AFOR investments

[57] *See*, e.g., Order Granting Requested Relief entered in that case on March 11, 2003.

through Period 4 will be conducted as a part of the docket in Case No. 05-00094-UT as provided by this Order. Should the Commission find it necessary, there will be an independent audit of Qwest's AFOR investments for Period 5.

These and the other matters to be included in Case No. 05-00094-UT are set out below.

H. Qwest's Motion Concerning "Nonparty" Advice

Qwest filed a Request for Notice of Substance of Nonparty Expert Advice and Opportunity to Respond on March 7, 2005, regarding Dr. David Gabel's participation in this case. Qwest alleges that Dr. Gabel appeared before the Commission in closed session "as a nonparty expert to provide advice on an issue or issues concerning Case No. 04-00237-UT." Id., p. 1. Citing Commission Rule (sic) 1.1.3.9.D NMAC, Qwest asks that the Commission notify the parties of the substance of Dr. Gabel's advice, and provide Qwest and the other parties a reasonable opportunity to respond. No responses to this Request were filed.

Dr. Gabel is a longtime Commission consultant who is under contract to assist the Commission in his areas of expertise, *viz.*, applicable regulatory law, telecommunications and economics. After the hearings in this case, Dr. Gabel was asked to assist the Commission in its deliberations on this case. In that capacity, he reviewed the record in this case and furnished assistance and advice to the Commission and its Special Assistant General Counsel on matters of record during Commission deliberations in closed sessions at working sessions that were noticed and scheduled for, and took place on, March 1 and March 3, 2005.

A previous Commission Order in another case is directly on point. Based on that Order and the circumstances in the instant case, the Commission finds that Qwest's Request should be denied.

In its Order in Utility Case No. 3269, issued on September 18, 2001, the Commission denied a Request by the AG[58] that is identical to the one Qwest filed in the case at hand. There, the AG was also asking for the disclosure of the Commission's communications with David Gabel. As Qwest is doing here, the AG premised her Request on her characterization of Dr. Gabel as a "nonparty expert" under NMSA 1978, § 8-8-17(C)(4). The Commission's Order pointed out that § 8-8-17(C)(2) permits the Commission to engage in *ex parte* communications with "advisory staff" absent the disclosure and response requirements claimed by the AG. The Commission found that, unlike the term "nonparty expert," "advisory staff" is a term that "is spelled out in detail in the PRC Act." Order, p. 3. Quoting the relevant section of the Public Regulation Commission Act (NMSA 1978, § 8-8-13)[59] in its entirety, the Commission found that Dr. Gabel's relationship with the Commission fell squarely within the

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[58] Qwest was a party to that case and, like the other parties thereto, did not respond to the AG's Request. Order, p. 1, n.1.

[59] The complete statute reads as follows.

A. The chief of staff may hire, with the consent of the commission, advisory staff with expertise in regulatory law, engineering, economics and other professional or technical disciplines to advise the commission on any matter before the commission. The chief of staff may hire on a temporary, term or contract basis such other experts or staff as the commission requires for a particular case.

B. Advisory staff shall:
(1) analyze case records;
(2) analyze recommended decisions;
(3) advise the commission on policy issues;
(4) assist the commission in the development of rules;
(5) assist the commission in writing final orders; and
(6) perform such other duties as required by the chief of staff.

definition of advisory staff. For these reasons, the Commission denied the AG's Motion.

Qwest's Request in the current case does not mention the Commission Order in Case No. 3269, nor does it cite any statutory authority for the relief it seeks. The only authority referred to is 1.1.3.9.D NMAC. This reference is incorrect, but seems to be an attempt to cite a provision of the Commission's rule on *ex parte* communications, i.e., 1.2.3.9.D NMAC. That provision relates to nonparty experts. The more relevant provision of that rule is 1.2.3.7.B(1)(a) NMAC, which tracks the PRC Act by declaring that, "ex parte communications do not include: statements made by commissioners, hearing examiners, or advisory staff that are limited to providing publicly available information about a pending adjudication or rulemaking after the record has been closed." Advisory staff is defined in the rule at 1.2.3.7.A NMAC. Here, as in Case No. 3269, Dr. Gabel is performing the functions of advisory staff as defined by both statute and rule.

For the reasons set out above and in the Order In Case No. 3269, Qwest's Request regarding Dr. Gabel should be denied.

THE COMMISSION FINDS AND CONCLUDES:

1. The Statement of the Case, the Background, the Discussion, and all findings and conclusions stated therein or elsewhere in this Order, whether or not separately stated, numbered or designated as findings or conclusions, are hereby adopted as Findings and Conclusions of the Commission.

2. The Commission has jurisdiction over the parties and subject matter of this case.

3. Qwest Corporation is a Colorado corporation that provides telecommunications services, including local exchange telephone service, in areas throughout New Mexico. As such, Qwest is affected with the public interest (NMSA 1978 § 63-9A-5), and is subject to regulation by this Commission pursuant to N.M. Const., Art. XI, § 2; NMSA 1978, § 63-7-1.1, and the New Mexico Telecommunications Act, NMSA 1978, §§ 63-9A-1, *et seq.*

4. Qwest's commitment in its AFOR to invest $788 million is independent of its other AFOR commitments and stands on its own. Qwest provided no persuasive evidence or argument, and did not otherwise meet its burden, as to why the Company's investment commitment should be waived or reduced.

5. The current trend in Qwest's level of investment expenditures strongly suggests that there will be a major shortfall at the end of the AFOR period unless the Commission addresses the matter now.

6. Qwest must invest $788 million over the life of the AFOR plan. If Qwest fails to satisfy its commitment the shortfall must be credited or refunded to Qwest's customers.

7. Any such credit or refund should be given to both business and residential customers. How credits or refunds should be determined and passed on to Qwest's customers will be addressed in Case No. 05-00094-UT.

8. Qwest's request to add investments or expenses attributed to QW or QCC to its current authorized JR-21 categories should be denied.

9. Qwest's request to add investments or expenses attributable to previously expensed computer software, and to non-capitalized loop grooming

expenses, to its current authorized JR-21 categories should be permitted to the extent provided by this Order.

10. In the event that Qwest is not in compliance with its AFOR investment commitment at the end of AFOR Period 4, the Commission will consider whether to begin credits or refunds to Qwest's customers in the amount of the shortfall at the end of Period 4.

11. In the event that Qwest is not in compliance with its total $788 million AFOR investment commitment at the end of AFOR Period 5, the Commission will require credits or refunds to Qwest's customers in the amount of the shortfall at the end of Period 5.

12. A new implementation and enforcement docket, i.e., Case No. 05-00094-UT, should be created and commenced to consider remaining or ongoing AFOR information and issues as provided by this Order.

13. Pending Case Nos. 3812 and 03-00353-UT should be consolidated with Case No. 05-00094-UT, and those pending dockets should be closed.

14. Due, proper and legally sufficient notice has been given of this Case No. 04-00237-UT.

IT IS THEREFORE ORDERED:

A. Qwest shall invest $788 million over the life of the AFOR plan. If Qwest fails to satisfy its commitment the shortfall shall be credited or refunded to Qwest's customers as provided by this Order.

B. Any such credit or refund shall be given to both business and residential customers. How credits or refunds should be determined and passed on to Qwest's customers shall be addressed in Case No. 05-00094-UT.

C. Qwest's request to add investments or expenses attributed to QW or QCC to its current authorized JR-21 categories is denied.

D. Qwest's request to add investments or expenses attributable to previously expensed computer software, and to non-capitalized loop grooming expenses, to its current authorized JR-21 categories is granted to the extent provided by this Order.

E. In the event that Qwest is not in compliance with its AFOR investment commitment at the end of AFOR Period 4, the Commission shall consider in Case No. 05-00094-UT whether to begin credits or refunds to Qwest's customers in the amount of the shortfall at the end of Period 4.

F. In the event that Qwest is not in compliance with its total $788 million AFOR investment commitment at the end of AFOR Period 5, the Commission shall require credits or refunds to Qwest's customers in the amount of the shortfall at the end of Period 5. Any proceedings in this regard shall take place in Case No. 05-00094-UT unless otherwise ordered by the Commission.

G. Case No. 05-00094-UT is hereby created and commenced for the purpose of Commission consideration of remaining or ongoing AFOR information and issues. In addition to the matters described at ¶¶ B, E and F, above, the following shall be considered in this new docket:

i) Starting by no later than May 20, 2005, and within twenty (20) days of the end of each regular calendar quarter thereafter, Qwest shall file in this docket reports detailing by project and amount how it will comply with its AFOR investment commitment for the remaining duration of the AFOR. Objections or protests to this report may be filed by interested persons no later than twenty (20) days after the report is filed.

ii) Qwest shall file its quarterly JR-21 reports, and all other reports required by the AFOR or other related Commission Order, in this new docket.

iii) Any objections or protests to such reports permitted by the AFOR or other related Commission Order shall be filed in this new docket.

iv) By no later than when its next JR-21 report is due, Qwest shall file in this new docket a report containing a breakout of all its intrastate computer software expenses, and all of its interstate computer software expenses, for the baseline period and for AFOR Period 1 through the present. Objections or protests to this report may be filed by interested persons no later than twenty (20) days after the report is filed.

v) Any new or pending AFOR compliance issues, including but not limited to those relative to Qwest's AFOR investment commitment.

vi) There shall be an independent audit of Qwest's AFOR investments through Period 4. The audit shall cover the elements of the JR-21 Reports and any related matters that the Commission may determine. Qwest shall issue requests for proposals that address issues raised in this Order. Qwest shall select the company to conduct the audit by July 1, 2005, and shall notify the Commission by that date. The Commission may reject that choice by so notifying Qwest by July 29, 2005. The total cost of the audit shall be paid by Qwest and shall not exceed $250,000. The cost of the audit shall be credited toward Qwest's AFOR investment commitment. The audit report shall be filed with the Commission by no later than December 16, 2005.

vii) Should the Commission find it necessary, there will be an independent audit of Qwest's AFOR investments for Period 5.

viii) The Commission may consider requiring Qwest to post a bond in the amount of any investment shortfall after the end of Period 5.

ix) Any other matters pertaining to the implementation and enforcement of the AFOR.

H. All pleadings, papers and other filings in Case No. 05-00094-UT shall, along with the case number, contain the following caption:

IN THE MATTER OF THE IMPLEMENTATION)
AND ENFORCEMENT OF QWEST)
CORPORATION'S AMENDED ALTERNATIVE)

FORM OF REGULATION PLAN.)
)

I. Utility Case No. 3812 and Case No. 03-00353-UT are hereby consolidated with Case No. 05-00094-UT. Copies of this Order shall be placed in the official case files for Case Nos. 3812 and 03-00353-UT.

J. Qwest's Request for Notice of Substance of Nonparty Expert Advice and Opportunity to Respond is denied.

K. In accordance with 17.1.2.37.D NMAC, the Commission has taken administrative notice of all Commission orders, rules, decisions, records, transcripts and other relevant materials in all Commission proceedings cited in this Order.

L. Any outstanding matter in this Case No. 04-00237-UT not specifically ruled on during the hearing or in this Order is disposed of consistent with this Final Order.

M. Copies of this Order shall be mailed to all persons listed on the attached official Certificate of Service for this case. This Order shall be posted on the Commission's web site (www.nmprc.state.nm.us) as soon as possible.

N. This Order is effective immediately, *nunc pro tunc* to March 8, 2005.

O. This Docket is closed.