BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of Qwest's Petition to be Regulated Under an Alternative Form of Regulation Pursuant to RCW 80.36.135	Docket No. UT-061625 **JOINT NARRATIVE OF QWEST AND COMMISSION STAFF SUPPORTING SETTLEMENT AGREEMENT**

I. INTRODUCTION

1 Pursuant to WAC 480-07-740(2), this Narrative Supporting Settlement Agreement ("Narrative") summarizes the Settlement Agreement ("Settlement Agreement" or "Agreement") that is being filed concurrently with this Narrative. It is not intended to modify any terms of the Settlement Agreement.

2 WAC 480-07-740(2) requires that when filing a proposed settlement agreement, "parties must also file supporting documentation sufficient to demonstrate to the Commission that the proposal is consistent with law and the public interest and that it is appropriate for adoption." Parties may present a narrative, as the Parties are doing here – WAC 480-07-740(2)(a) states that the supporting documentation should include a narrative outlining the scope of the underlying dispute; the scope of the settlement and its principal aspects; a statement of parties' views about why the proposal satisfies both their interests and the public interest; and a summary of legal points that bear on the proposed settlement.

3 The Parties to the Settlement Agreement are Qwest; Commission Staff ("Staff"); Integra

Telecom of Washington, Inc., Time Warner Telecom of Washington, LLC, Covad Communications Company, and XO Communications Services, Inc. (collectively, "Joint CLECs"); Northwest Public Communications Council ("NPCC"); WeBTEC; and, the Department of Defense on behalf of the consumer interest of the Department of Defense and all other Federal Executive Agencies ("DOD") (Joint CLECs, NPCC, WeBTEC, and DOD are also collectively referred to as "Intervenors"). The Parties agree that the Settlement Agreement is in the public interest. The Parties understand that the Settlement Agreement is subject to Commission approval.

4 This document represents the joint narrative of Qwest and the Commission's Staff in support of the multi-party settlement; other settling parties may file separately.

II. DISCUSSION

A. Scope of the Underlying Dispute

5 This docket concerns a Petition by Qwest Corporation ("Qwest") to be regulated under an alternative form of regulation ("AFOR") pursuant to RCW 80.36.135. On October 20, 2006, Qwest filed a petition with the Washington Utilities and Transportation Commission ("Commission") asking for approval of an alternative form of regulation ("AFOR"). Qwest asked that under the AFOR plan it be treated as if it were competitively classified, subject to certain exceptions and certain transition period requirements. The Intervenors herein were granted intervention in the proceeding. In accordance with the procedural schedule, all parties have had the opportunity to file testimony in this proceeding, and hearings are scheduled to begin on March 12, 2007.

6 The disputes between the Parties generally concerned whether the AFOR is in the public interest, whether the AFOR plan meets the statutory criteria for granting an AFOR, and whether the AFOR appropriated included and excluded certain services from regulation under

the AFOR.

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B. The Scope of the Settlement and Its Principal Aspects

8 **Scope and Term of the AFOR.** The Parties have agreed upon the term of the AFOR, as well as a process for review at the end of the plan. For the 4-year period of the AFOR, the parties agree that Qwest should be treated as if it were competitively classified subject to certain exceptions and certain transition period requirements under the AFOR plan. **Appendix A** to the AFOR plan provides an overview of specific waivers of regulatory requirements that will be granted, granted in part, denied, or not affected. In the AFOR, Qwest agrees to be bound by the provisions of RCW 80.36.330(3), and the Commission's implementing regulations, in connection with below-cost pricing.

9 **DS-1 and DS-3 Provisions.** In order to address concerns raised by the Intervenors, Qwest has expressly agreed that if the Commission determines, after an appropriate proceeding, to revoke the previously-granted competitive classification for Qwest's DS-1 or DS-3 private line services, Qwest will not contend that the provisions of this AFOR nonetheless require those services to be treated as competitively classified.

10 **DSL Deployment.** Qwest will implement a plan for broadband infrastructure development in which it will deploy high speed Internet (DSL) services in its Washington wire centers where it currently does not offer DSL.[1]

11 **Wholesale Services Exception.** The AFOR does not address the Commission's authority to regulate Qwest's wholesale obligation under the Telecommunications Act of 1996, nor does it address existing carrier-to-carrier service quality requirements, including service quality

[1] The Qwest Washington wire centers in which Qwest does not currently offer its high speed Internet (DSL) services are Easton, Elk, Northport, Pateros, Roy, Springdale, and Waitsburg.

standards or performance measures for interconnection and appropriate enforcement or remedial provisions in the event Qwest fails to meet service quality standard or performance measures.

12 **Service Quality Reporting.** The Parties have agreed upon a level of service quality reporting consistent with the 'Class A' company reporting requirements in WAC 480-120-439 (1). Qwest will continue filing customer service guarantee reports in accordance with the Seventeenth Supplemental Order in Docket No. UT-991358, albeit <u>semi-annually</u> rather than monthly.

13 **Excepted Services.** The following services will remain in Qwest's tariff for the duration of the AFOR: Standalone Residential Exchange Services (complete list in the AFOR); Washington Telephone Assistance Program; Tribal Lifeline; Link-up Programs; Basic and Enhanced Universal Emergency Number Service – 911; Interconnection Service; Resale Service; Access Service; Payphone Services. The one free call allowance for directory assistance service on residential lines is not excepted from the AFOR, but the free calls from hospitals and for those who cannot use the printed directory are maintained in the tariff.

14 **Chapters 80.08, 80.12, and 80.16 RCW.** Qwest will continue to file: <u>annual</u> reports of affiliated interest transactions; cash transfer filings (subject to an exception below); transfer of property transactions that are greater than <u>five percent</u> of its rate base, or involving the sale of one or more entire exchanges, or involving the merger or acquisition of Qwest Corporation; and, access charge and universal service reporting per WAC 480-120-399. Qwest agrees that it will abide by RCW 80.08.030 regarding the use of funds. Qwest agrees to bound by the parts of WAC 480-120-369 and WAC 480-120-395 that are currently being challenged in the Court of Appeals of the State of Washington Division II pending a final decision on that appeal (either by that court or by the Supreme Court should either party pursue the action further). If

the decision is in Qwest's favor the rules will not apply to Qwest. If the decision is in the Commission's favor, Qwest agrees to be bound by the rules.

Transition Period Requirements:

15 The following requirements will apply during a 4 year transition period:

16 **Protection for the 1FR Rate.** The standalone residential exchange service recurring rate is capped at $13.50 during the transition period. Qwest may increase the current rate by $1.00 during the transition period if it maintains and augments the Customer Service Guarantee Programs as described in the AFOR. The augments include the addition of two service quality metrics and customer remedies in connection with provisioning and repair.

17 **Deaveraging.** Qwest agrees not to geographically de-average the non-recurring and monthly recurring rates for these services. This provision does not modify or restrict Qwest's ability to enter into individual contracts for service that specify rates other than state-wide average rates.

18 **Financial Reporting.** Qwest will keep its books of accounts in accordance with WAC 480-120-355. The accounting method that Qwest commits to use is the same accounting method that it uses to maintain its books for FCC reporting purposes (MR Books). The parties have agreed upon a process to follow when Qwest informs the FCC of its intention to follow a new accounting standard or if the FCC changes accounting methods used in 47 CFR Part 32.

19 In addition, unlike competitively classified companies, which file an annual report in accordance with WAC 480-120-382, Qwest shall continue to file an annual report in accordance WAC 480-120-385(1). Qwest has agreed to file an annual report of Washington intrastate regulated results of operations which shall be based on Qwest's MR Books and shall include the following adjustments:

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a) a directory revenue credit in the amount specified by the settlement agreement the Commission approved in the Dex case;
b) a credit to its depreciation reserve required for prior sale of rural exchanges;
c) a credit to its depreciation reserve for sharing under a prior AFOR; and
d) a standing adjustment reflecting the difference in rate base between its MR Books and its Washington Jurisdictional Books of Account (JR Books) on the date of transition from JR books to MR Books.

Qwest shall also maintain the capability of calculating the following Commission Basis Adjustments that it included in its quarterly financial reports to the Commission for 2006:

e) Pension Asset
f) Post-Retirement Benefits
g) Disallowed Plant
h) Interest Synchronizations
i) End-of-Period Deferred Income Tax

C. Why the Proposal Satisfies both the Parties' Interests and the Public Interest

21 The proposed Settlement Agreement and revised AFOR satisfy Qwest's interests and the public interest. The Settlement allows Qwest to bring its revised plan of AFOR expeditiously before the Commission, and to avoid the risk and expense of litigating with the settling parties. The compromises Qwest has reached with the other parties address the public interest concerns they raised in their testimony and petitions to intervene and strengthen the AFOR plan, while still giving Qwest pricing and other regulatory flexibility to allow it to compete more effectively in a market where many of its competitors are not subject to any Commission regulatory requirements at all.

22 The Commission's Staff is persuaded that the plan for AFOR agreed to by the settling parties provides a measured, moderate and precise tool for adjusting regulation in response to changes in technology and the structure of the telecommunications industry. The plan retains Commission regulation of service quality, improves the customer service guarantee, leaves

essential programs and public service offerings in tariff, but allows the company pricing flexibility and streamlined reporting similar to competitive companies. It addresses the intent and provisions of the AFOR statute. Accordingly, Staff concludes that the plan is in the public interest and urges its adoption by the Commission.

D. Summary of Legal Points that Bear on the Proposed Settlement

23 In Qwest's testimony in this case, as well as in its initial petition, Qwest presented argument and evidence as to why its original AFOR plan was in the public interest and met the statutory criteria in RCW 80.36.135. Qwest believes its initial filing was sufficiently supported by the evidence that the Commission could have approved the AFOR plan as filed. The revised plan presented in the Settlement represents a movement by Qwest toward the Staff position, and also addresses concerns raised by Public Counsel, though Public Counsel is not a party to the Agreement. The changes only enhance the extent to which the AFOR is consistent with the public interest.

24 RCW 80.36.135(2) specifically directs the Commission to consider both the public policy goals declared in RCW 80.36.300, as well as the six specific factors in subsection (2).

1. The Goals of RCW 80.36.300

25 The stated public policy goals of the State of Washington, as set forth in RCW 80.36.300, are as follows: (1) Preserve affordable universal telecommunications service; (2) Maintain and advance the efficiency and availability of telecommunications service; (3) Ensure that customers pay only reasonable charges for telecommunications service; (4) Ensure that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of regulated telecommunications companies; (5) Promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state; and (6) Permit flexible regulation of competitive telecommunications companies and services.

26 Qwest and Staff believe that the revised AFOR plan is consistent with each of these goals. The plan includes a provision that continues to treat the recurring and non-recurring charges for basic stand-alone residential flat-rated local exchange service (1FR) and measured local exchange service (1MR) as tariffed services. A price increase for these services is limited to $1.00 during the term of the AFOR, so long as Qwest maintains and augments certain service quality measures and customer remedies. This is a reduction from Qwest's original request of $0.50 per year for each of four years of the plan. The 1FR is currently priced at $12.50 per month and would not increase to more than $13.50 after four years. Qwest and Staff believe that this proposal preserves affordable universal telecommunications service, consistent with policy goal (1). Further, Qwest and Staff's testimony supports the conclusion that the increase will not cause the company's earnings to exceed the authorized rate of return.

27 Policy goal (2) is to maintain and advance the efficiency and availability of telecommunications service, and policy goal (3) is to ensure that customers pay only reasonable charges for telecommunications service. These goals parallel goals set forth in RCW 80.36.135(2) and are discussed below.

28 Policy goal (4) is to ensure that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of regulated telecommunications companies. Qwest's rates for its noncompetitively classified (i.e., tariffed) services were set by the Commission in the most recent rate case, or are offered under tariffs that have been submitted to and reviewed by the Commission. The Commission has either affirmatively approved those rates, or has determined that it will take no action on them, thereby allowing them to become effective. There is nothing in the AFOR plan that would allow Qwest to begin extracting profits from its tariffed services to support its competitive service offerings. Pursuant to the settlement, Qwest will be bound by the provisions of RCW 80.36.330(3), and the Commission's implementing regulations, which guard against below-cost pricing. Finally, Qwest has committed to retain

tariffs for certain services as set forth in the AFOR, which should fully address this issue.

29 Policy goal (5) is to promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state. The revised AFOR contains a provision for DSL deployment to every wire center in the state. Additional deployment of broadband capability enhances subscribers' ability to obtain telecommunications and information services, and this aspect of the AFOR therefore furthers this goal.

30 Policy goal (6) is to permit the flexible regulation of competitive telecommunications companies and services. The revised AFOR is not inconsistent with that goal, as it does not change the way the Commission regulates competitive companies and services.

2. The Specific Factors under Subsection (2) of RCW 80.36.135

31 Under RCW 80.36.135(2), the Commission is further directed to consider whether the AFOR will: (a) Facilitate the broad deployment of technological improvements and advanced telecommunications services to underserved areas or underserved customer classes; (b) Improve the efficiency of the regulatory process; (c) Preserve or enhance the development of effective competition and protect against the exercise of market power during its development; (d) Preserve or enhance service quality and protect against the degradation of the quality or availability of efficient telecommunications services; (e) Provide for rates and charges that are fair, just, reasonable, sufficient, and not unduly discriminatory or preferential; and (f) Not unduly or unreasonably prejudice or disadvantage any particular customer class.

32 It is important to note that the statute does not require that the Commission make an affirmative finding that the AFOR will meet or enhance each of these considerations. Rather, the Commission is directed to consider whether the AFOR will further the considerations. This suggests that the Commission could still approve an AFOR that is neutral with regard to

one or more of the considerations. Nevertheless, Qwest and the Commission's Staff believe that the revised AFOR plan is consistent with each of these considerations and improves upon traditional regulation in a number of important respects. There is no impediment to the Commission approving the plan under RCW 80.36.135(3).

33 The first consideration is whether the plan will "facilitate the broad deployment of technological improvements and advanced telecommunications services to underserved areas or underserved customer classes. . . ." The revised AFOR contains a provision for DSL deployment in the state. Additional deployment of broadband capability enhances subscribers' ability to obtain advanced telecommunications and information services, and this aspect of the AFOR therefore furthers this goal. In addition, The revised AFOR includes a provision that it will not geographically de-average its rates for the services that will be treated as competitively classified services if the AFOR is approved. This means that rural customers will receive the benefit of any price changes for those services made by the company to compete in the competitive urban markets.

34 The second consideration is whether the AFOR will improve the efficiency of the regulatory process. Qwest and Staff believe that it will. The AFOR streamlines many reporting processes for Qwest, while continuing to provide the Commission information it needs to discharge its regulatory duties.

35 The third consideration is whether the AFOR will preserve or enhance the development of effective competition and protect against the exercise of market power during its development. Qwest and Staff believe that the plan preserves competition by maintaining the status quo for all of the market-opening and wholesale provisions under the Telecommunications Act of 1996. Competition will be the best discipline to constrain Qwest from exercising market power. In addition, the plan's requirement that Qwest not deaverage its rates provides

protection against local exercise of market power in isolated areas, and the requirement that the company remain subject to the bar on pricing below cost that applies to competitively classified companies provides a safeguard against market-wide exercise if competition ceases to constrain the company.

36 The fourth consideration is whether the AFOR will preserve or enhance service quality and protect against the degradation of the quality or availability of efficient telecommunications services. Qwest explained in its initial petition why it believes that service quality will not be negatively impacted by the AFOR. The revised AFOR plan contains additional service quality commitments that substantially strengthen the Commission's basis for finding that service quality will be preserved or enhanced. In the revised AFOR Qwest has committed to retain the Customer Service Guarantee Program in its tariff, and has further committed to add three provisions associated with provisioning, repair, and network reliability.

37 The fifth consideration is whether the AFOR will provide for rates and charges that are fair, just, reasonable, sufficient, and not unduly discriminatory or preferential. Qwest and Staff believe that the combination of safeguards in the AFOR plan, including the 1FR and the 1MR price cap, de-averaging prohibition, service quality rules and guarantee program incentives, plus the emergence of a price-constraining competitive market described in testimony will assure that prices remain fair, just and reasonable. This conclusion is supported by comparison of current and proposed rates to other affordable rates, analysis of TELRIC cost based rates, rural versus urban economies of scale, and a solid review of Qwest's results of operations and its rate of return performed by Staff. Qwest and Staff believe that the Commission does not need to perform a fully contested rate case to determine whether the plan will provide fair, just and reasonable rates during the term of the AFOR. For purposes of the AFOR, it is appropriate and sufficient for the Commission to review objective, verifiable evidence, as provided by testimony in this case.

38 The final consideration is whether the AFOR will not unduly or unreasonably prejudice or disadvantage any particular customer class. In answer to this consideration, Qwest and Staff submit that a discriminatory pricing scheme is only feasible when the producer has sufficient market power to be able to create separate classes of customers between which it will discriminate. With the growth of competition, it is unlikely that Qwest could maintain a discriminatory scheme because customers will find that Qwest does not have the market power to prevent them from moving to another provider. As a fallback, the AFOR plan protects customers who may be subject to vestiges of market power by placing basic services under full Commission oversight. In addition, all of Qwest's business customers who are currently subscribed to business services in non-competitively classified wire centers will continue to be treated at parity with customers in competitively classified wire centers. This offers assurances that no customer classes will be unduly or unreasonably prejudiced or disadvantaged.

III. CONCLUSION

39 The Settlement Agreement and revised AFOR are consistent with the public interest and should be expeditiously approved by the Commission.

40 DATED this 6th day of March, 2007.

QWEST CORPORATION

per telephone authorization

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