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 QWEST'S REPLY BRIEF IN RESPONSE TO THE OPENING BRIEF OF PUBLIC COUNSEL

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I. INTRODUCTION

1 Pursuant to the procedural schedule in this matter, Qwest Corporation ("Qwest") hereby submits its Reply Brief in response to Public Counsel's Opening Brief. Public Counsel's Brief is similar to its AFOR proposal in that Public Counsel argues for more regulation than Qwest currently faces as a fully regulated company, and for additional regulatory requirements. Contrary to Public Counsel's arguments, the Settlement AFOR meets the statutory requirements, and is otherwise consistent with the public interest.

2 In paragraph 3 of its Initial Brief, Public Counsel lists as bullet points the aspects of the Settlement AFOR that Public Counsel claims are defects in the plan. Qwest's response to these contentions is presented in the same format, and is also discussed in more detail in specific sections of this Reply Brief applicable to the specific points.

- Public Counsel's position: While claiming to maintain protections for basic customers, it allows an increase of $1 per month in the basic rate with no evidence that the new rate is fair, just, and reasonable.

  Qwest response: This is simply not true – it is not necessary to conduct a full rate case to determine if rates are reasonable. The testimony establishes that Qwest is not currently earning at its last authorized rate of return. This is true even with a $2 increase, and the Settlement AFOR provides for no more than a $1 increase. Other evidence also supports a conclusion that local service rates will remain fair, just and reasonable under the AFOR: Dr. Taylor's testimony regarding the affordability of local service; Staff's testimony that the service does not cover cost, that it may not offer Qwest a chance to invest in new plant, and that the rate is lower than other companies in the industry; Public Counsel's testimony that rates at or above the level requested in the AFOR are within a reasonable range; and, the price points for service offerings from intermodal competitors.

- Public Counsel's position: It does not preserve customers' ability to purchase features on an à la carte basis if they prefer not to buy bundles.

  Qwest response: Customers may currently purchase features in packages or a la carte, and the AFOR does not change this. Customers have the same ability to purchase features after the AFOR as before, though Qwest will have additional

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flexibility after the AFOR is effective. Under current regulation Qwest may file to grandfather and remove services, and in the future the market will dictate and control how Qwest offers services, to the benefit of consumers. Ultimately, Public Counsel just wants more regulation.

- Public Counsel's position: The plan allows unlimited price increases for residential features, as well as for any bundled service.

  Qwest response: The plan allows for pricing flexibility for features and bundles subject to a moratorium on de-averaging, as well as protection for certain public interest features – approval of the AFOR recognizes that the market will dictate the price levels for these services, and that competition exists for them.

- Public Counsel's position: It does not require any notice to customers about the availability of stand-alone and à la carte services, or about the change to AFOR regulation.

  Qwest's response: Qwest has already made notice to customers regarding the AFOR. Requiring notice of the availability of standalone and a la carte features is unnecessary. It is in Qwest's interest to provide accurate information to its customers about available services. Public Counsel's proposal is simply a request for more regulation.

- Public Counsel's position: It does not require continued provision of DSL on a stand-alone basis.

  Qwest's response: Stand-alone DSL is not currently required of Qwest and the AFOR does not change the status quo – Qwest has indicated that it has no intention of discontinuing this (interstate) service, but a condition is clearly beyond the regulatory scope of a state AFOR. Public Counsel asks the Commission to exceed its jurisdiction to impose this requirement.

- Public Counsel's position: The plan unfairly gives DS-1 and DS-3 services special treatment in the event their competitive classification is revoked.

  Qwest's response: The AFOR is the result of a balanced settlement agreement and this provision is key to some of the intervening parties. It does not unfairly discriminate against any customer class and seeks to provide a fair hearing for carrier-to-carrier issues. The unique nature of these services and the CLECs' arguments in connection with availability of those services makes it reasonable to carve them out – such a distinction does not apply to the other services that Public Counsel would attempt to sweep into this provision.

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- Public Counsel's position: The broadband infrastructure plan contains a commitment to benefit only a minimal number of customers and a questionable aspirational target of a statewide average which the company is already close to meeting. It does nothing to address underserved classes of customers.

  Qwest response: The AFOR would deploy broadband to currently unserved areas and customers. Public Counsel's proposals, while much more costly to Qwest, are not demonstrably superior, and in any event would exceed the Commission's jurisdiction to require.

- Public Counsels position: The plan does not include a service quality plan to preserve or enhance quality by creating incentives for maintaining investment and providing good service quality.

  Qwest response: This is not true. Qwest has incentive, driven by the market and by compliance objectives, to provide good service and comply with Commission rules and its CSGP. The Settlement AFOR is more than the status quo, adding service quality components to the CSGP as well as a commitment to maintain the CSGP in Qwest's Washington tariffs. Public Counsel's proposal is just a recommendation for more regulation.

- Public Counsel's position: The AFOR adopts minor improvements to the Customer Service Guarantee program which affect few people and cost Qwest little to provide.

  Qwest's response: This is not a defect in the AFOR. The settlement AFOR maintains existing service quality compliance and reporting and adds additional provisions – this certainly satisfies the statutory goals and requirements. Public Counsel's proposal is just a recommendation for more regulation.

- Public Counsel's position: With exceptions for mergers and sales of exchanges, the plan exempts Qwest from reporting transfers of property worth up to $78 million, exposing ratepayers to significant risk of loss.

  Qwest response: There is not a significant risk of loss. The plan preserves Commission oversight and approval for large transactions. Public Counsel presented no evidence that it or any other public interest group has ever taken an interest in or challenged any transaction that is less than the threshold. The Commission will still have visibility through annual reporting and Staff believes that is sufficient. Public Counsel's proposal does not materially streamline the regulatory process.

- Public Counsel's position: It eliminates the current allowance of one free directory assistance call per month.

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Qwest's response: The plan allows Qwest the flexibility to change or eliminate the free call, consistent with the Commission's previous competitive classification of directory assistance, and consistent with how directory assistance is regulated for every other company in the state.

- Public Counsel's position: The plan purports to limit geographic deaveraging, but creates a loophole which allows deaveraging for any services sold under contract, including residential services.

  Qwest's response: The AFOR does not create a loophole. Qwest will continue to provide the stand-alone 1FR under tariff at a statewide regulated rate, but will be free to contract with its customers in connection with offerings for packages and features – just like any other service provider offering services that have been competitively classified.

- Public Counsel's position: The procedures for reviewing the performance at the end of the term are vague and incomplete. Neither the process to be used, the Commission's options, or the parties' rights are clear.

  Qwest response: This is not true. All of the other parties in this case have agreed to the general procedures for review at the end of the AFOR – it would be presumptive and imprudent to attempt to dictate procedures at this time. The AFOR leaves the details about the review at the discretion of the Commission, and does not foreclose any party from arguing, at that time, about what procedures are necessary or appropriate.

II. COMPETITION IN THE RESIDENTIAL MARKET

3 It is clear that Public Counsel is focused on the residential market.[1] The AFOR has very little to no impact on business and wholesale customers, and Public Counsel has conceded that residential services sold as part of a package or bundle are subject to effective competition. However, Public Counsel also claims that there is a separate market for stand-alone residential services and that that market is not competitive. For example, at paragraph 12, Public Counsel uses the phrase "lack of competition in the stand-alone residential market" in an improper attempt to narrow the definition of the "market" at issue in this proceeding. In

[1] PC Brief ¶¶ 10-26

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Washington, it is accurate that there are two significant "markets" for Qwest's retail services: the residential market and the business market. Public Counsel errs in its attempt to define a "market" as one consisting only of residential customers purchasing only Qwest residential access lines and nothing else. This is an incorrect means of defining a "market."

4 Public Counsel claims that Qwest is the dominant carrier in its residential market,[2] stating that Qwest has 75% of the residential market, wireless has 8%, and cable 3.5%. In fact, these "share" percentages are not meaningful since they are significantly incomplete. For example, Public Counsel estimates cable telephony "share" at only 3.5%, but was apparently not aware of the fact, discussed at page 16 of Mr. Teitzel's rebuttal testimony, that the FCC's reported cable telephony line quantities exclude lines served via VoIP technology. Since the FCC does not presently require VoIP-based providers to report in-service quantities at all (and no VoIP provider has voluntarily disclosed such quantities at the individual state level), a significant and increasing segment of the market is missing from Public Counsel's estimates[3].

5 In addition, Public Counsel uses outdated statistics to estimate the number of wireless customers who have "cut the cord" (have completely disconnected wireline service in favor of wireless service), and ignores the fact that the statistics relied upon exclude customers who have removed an additional line in favor of wireless but still retain a primary wireline access line.[4] In contrast, at page 5 of his rebuttal testimony, Mr. Teitzel presented data showing the decline in ILEC "connection shares" in Washington from 58% in 12/2000 to 32% in 6/2006, reflecting the rapid increase of other forms of competition.

6 In fact, neither Public Counsel nor Qwest has the data specific to Qwest's service territory to

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2 Public Counsel Brief ¶ 13

3 Exhibit 16C, Teitzel Rebuttal, page 16

4 Exhibit 11C, Teitzel Direct, page 15

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accurately calculate "share" of Qwest versus each of the alternative forms of competition now available in the market, since much of this data is associated with deregulated competitors and is not publicly available. Since the competitive telecommunications market is no longer defined as being Qwest versus CLECs, the meaningfulness of "share" values has been eroded.

7 At paragraph 14 of its Opening Brief, Public Counsel asserts that Qwest's HHI is 5658 – 3 times the HHI threshold of 1800 often used as an indicator of highly concentrated markets. Public Counsel's HHI calculations are based on seriously flawed "share" estimates, as discussed above. In addition, as described at pages 12 and 13 of Dr. Taylor's rebuttal testimony, it is not necessary to calculate an HHI to determine if a market is effectively competitive. He states: "In contrast to the merger setting, in assessing market power in telecommunications markets, there is no corresponding need to measure market concentration*, per se*. To determine whether a firm has significant market power, we need to know the degree to which customers would substitute away from its services in the face of a significant non-transitory increase in price above the competitive level. That exercise does not require an all-or-nothing assignment of firms or services to the market for all purposes but rather focuses only on the ability of substitutes (in aggregate) to constrain its prices to competitive market levels. In the current case, we need only to ascertain whether substitutes for Qwest's residential services (in aggregate) constrain its prices; we do not need to determine, for example, whether wireless or VoIP services are in the same antitrust market as wireline local exchange service." The uncontroverted evidence in this case shows that cable and wireless providers offer services that many consumers consider to be substitutes for bundled services and for second lines. And, though Public Counsel contests the issue, there can be no reasonable doubt that these services are substitutes for the primary line as well.

8 Competition in Washington, as it is throughout the country, is continually evolving, with

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increasing fractions of the customer base finding non-traditional and differentiated telecommunications services to be substitutes for Qwest's services. As this Commission correctly observed:

> The very purpose of competition, as envisioned in the 1996 Telecommunications Act and our own statutes, is to allow for differentiation in the market: different providers, different services, different customer groups, different technologies, and different niches. It is expected, therefore, that as competition develops, there will also develop a continuum of services and providers that, to a greater or lesser degree, compete with one another. The argument that a service cannot be considered an alternative because it is not a complete and perfect substitute is just as misplaced as the argument that a service must be fully counted as an "alternative," even if it is only partially a substitute. Such an "all or nothing" approach does not comport with the real world. But it is not fatal if a company fails to conduct an exhaustive collection and analysis of data on all possible forms of competition, if that data will not alter the outcome of the case. Rather, the evidence presented and reliance upon it should be commensurate with its relevance to the critical questions in the case.[5]"

In other words, this Commission has properly recognized that alternative telecommunications services need not be considered to be substitutes by 100% of Qwest's customers to be considered viable (and price constraining) telecommunications competition.

9 At paragraphs 15-16 of its Brief, Public Counsel asserts that Qwest has market power because it believed it could raise the 1FR rate by $2 over four years. Public Counsel also notes past increases to the subscriber line charge. The flaw in this argument is simple – market power is evidenced only by the ability to sustain a price increase to rates set in a *competitive market*. Public Counsel further agreed that rate increases in a market, standing alone, were not evidence of market power. Dr. Loube testified that prices go up and down in a competitive market. Public Counsel also agreed that the 1FR rates were *not* set by a competitive market – so Qwest's ability to sustain a price increase to those rates may simply mean that they are

[5] In the Matter of the Petition of Qwest Corporation For Competitive Classification of Basic Business Exchange Telecommunications Services (UT-030614), Order No. 17, Order Granting Competitive Classification, December 22, 2003 at ¶ 51.

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priced too low at present levels and that an increase will promote competition. It may also be the case that Qwest is not able to sustain such an increase in the market – but that is a question for the market to determine.

10 Public Counsel asserts, at paragraphs 18-23, that the residential market has three segments, and further states that PC and Qwest agree on market segments – stand alone; stand-alone with a la carte features; and bundles or packages. This is incorrect, since Public Counsel simply (and improperly) subdivides Qwest's – and only Qwest's – existing customer base into three groupings and defined them to be "market segments." These groupings entirely ignore services customers purchase from non-Qwest service providers and are nothing more than subsets of the larger residential telecommunications market.

11 As discussed at page 7 of Dr. Taylor's rebuttal testimony "in economics, one must examine consumers' substitution possibilities to define the market and not simply cite differences in the characteristics of the service."[6] This is the crux of the issue. Public Counsel suggests that Qwest possesses a virtual monopoly for services provided to Qwest customers who purchase nothing more than a Qwest residential access line, and that these customers have absolutely no alternatives other than Qwest to satisfy their communications needs.

12 This premise presumes that 100% of Qwest "stand-alone" residential access line customers subscribe to and use no telecommunications service other than the Qwest access line (e.g.: use no long distance service, subscribe to no wireless service, subscribe to no broadband internet service, etc), and further, that this group of customers does not have the choice of subscribing to such services. None of these assumptions was established as fact on the record in this case. Rather, Public Counsel simply cites to Qwest's records of "stand alone" residential lines

[6] Exhibit 66.

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purchased by Qwest's customers in an economically inappropriate attempt to narrowly define the market for residential exchange service, including any accompanying features.

13 This issue was specifically addressed in Public Counsel's cross examination of Mr. Teitzel (see transcript starting at page 346), as follows:

> Q. Sure, let's start at line 16. Well, let me back up a minute and maybe provide some context for this, and then we can go to the specific line number. But basically wouldn't you agree that the residential market that we're discussing here and you address in your testimony in this section can be divided into three different components, there are, number one, the customers who buy stand alone residential service with nothing else, just plain old fashioned stand alone residential service, that's one segment, correct?
> A. I will agree with that. I may have a qualifier in a moment, but proceed.
> Q. Okay. At the other end of the spectrum, if you will, you have customers who purchase packages or bundled services, correct, from Qwest?
> A. Correct.
> Q. In the middle, if you will, there is a group of customers who buy stand alone residential service and one or more features from Qwest, correct?
> A. That would be correct, and I would agree with those three classifications as customers of Qwest in terms of categories of services they would buy from the company, but I would not agree that a stand alone 1FR customer, for example, may be simply stand alone. Some proportion of those customers very likely are buying other services from other vendors, such as broadband from Comcast, Verizon wireless service, a variety of other services. But in terms of your categorization of Qwest's market around what services buy from Qwest, very narrowly I would agree with your definitions.
> Q. Well, and we're talking about the customers for residential telephone service, local exchange service, that's the three different groups are different components of the residential local service market, correct?
> A. Once again, I would agree with you as far as it goes, but I would not agree that those customers don't have other options available to them. What was just described is very strictly focused on the wireline telecommunications market, and some of those customers buy nothing but a line from the telecom provider, some buy a package or bundle, some buy a la carte features.

14 This exchange on the record clarifies that what Public Counsel portrays as a distinct "market" is nothing more than a subset of the residential telecommunications market, and that all communications alternatives reasonably available to this subset of customers must be

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considered when assessing competition in this subset of the market.

15 Public Counsel ignores the fact that virtually every corner of Qwest's service territory in Washington is served by at least one wireless carrier. Additionally, the FCC's data shows that 99% of the zip codes in Washington are served by at least one broadband internet service provider.[7] These facts mean that wireless and/or VoIP telecommunications service alternatives exist for virtually all of Qwest's residential customers.

16 Public Counsel ignores the fact that a variety of alternative communications services are available to Qwest's residential subscribers--even those who now subscribe to only a Qwest residential line or a Qwest residential line plus a single optional feature.

17 As described at page 18 of Exhibit 11C, a "stand-alone" Qwest residential customer pays $18.34 for a 1FR (line rate of $12.50 plus an End User Common Line Charge of $5.84). If, for example, the customer opts for Caller ID (one of Qwest's most popular features) plus a 1FR line, the total price becomes $29.99. Even though many alternative services include other benefits (such as unlimited long distance, additional calling features, etc), these services are available at very attractive prices. For example, Comcast has offered its Comcast Digital Voice service at a promotional rate of $24.99. Various wireless carriers also offer very attractive pricing: T-Mobile, Sprint and Alltel all offer $29.99 monthly plan rates and Cricket offers a $30.00 plan rate in Spokane.[8] Many VoIP providers also offer very attractively-priced telecommunications services: Vonage offers a $24.99 rate, Sunrocket's "Annual Edition" plan is priced at $16.58 (Teitzel direct, page 18).[9] AT&T's CallVantage product is priced at $19.99 and the Verizon VoiceWing 500 Service is priced at $19.95.[10]

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7 Exhibit 11C, p. 22.

8 Exhibit 11C, p. 18

9 Exhibit 11C, pp. 18-25.

10 Exhibit 16C, p. 30.

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18 For a service to be considered a reasonable alternative to Qwest's residential service, it is not necessary that the service be priced the same as Qwest's residential service, only that it be within reasonable range of Qwest's prices. Even before taking into account the various mandatory taxes and fees paid by Qwest's customers (many of which are not applicable to wireless and VoIP services), as well as long distance charges, it is clear that variety of very reasonably-priced competitive alternatives are available to Qwest's residential customers.

19 In the settlement agreement reached between Qwest and all other parties in this docket, with the exception of Public Counsel, Qwest has agreed to cap the 1FR rate (which is currently $12.50 and has remained at that level for approximately a decade) at $13.50 for the four year life of the AFOR plan. At page 30 of his rebuttal testimony, Dr. Taylor explains that the Qwest 1FR rate has declined in real terms by 0.65 percent per year since the time the rate was set at $12.50, and concludes that, even were the price to be increased to $14.50 (a price higher than the level to which Qwest has committed), "taking household income into account strongly suggests that residential basic exchange service will be more affordable under Qwest's proposal than it was in 1998 when the Commission presumably found a $12.50 basic exchange rate to be affordable." In other words, even if the Commission disregards the clear evidence of competition in the residential market, Qwest's commitment to maintain the 1FR price at $13.50 for the duration of the AFOR means the "stand-alone" residential access line subscriber is protected by the price cap (as well as by the effects of competition).

20 Public Counsel argues at paragraphs 22-23 of its Brief that the market for standalone and a la carte services is not effectively competitive. Public Counsel selectively cites price points in an effort to claim that there is not effective competition for standalone 1FR, and cites to Bench Request 8 (Exhibit 169C) to argue that the stand-alone 'market' is 350,000 residential accounts, and that stand-alone plus features (not in packages) is the largest segment.

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21 While Public Counsel's citations to data supplied by Qwest in response to Bench Request 8 are accurate, the conclusions drawn from this data are both incorrect and incomplete. First, Public Counsel ignores the fact that the Washington Telephone Assistance Plan ("WTAP") plan is available to a significant number of Washington residential customers who meet certain qualifications for such assistance. This plan ensures the 1FR price for qualifying customers remains at $8.00 per month, regardless of whether the Qwest 1FR price is increased. It is logical that a subset of the "stand-alone" 1FR customer base is eligible for this plan and is thus insulated from any potential 1FR rate change, and the pool of constituents for which Public Counsel purports to advocate is thereby reduced from the number identified in Qwest's bench request response.

22 Second, Qwest has earlier in this Reply Brief identified price points for alternative services that are well within a reasonable range of Qwest's 1FR rate. Since it is not necessary for a competitive service to be priced precisely at, or lower than, the comparable Qwest service, the fact that a number of competitive services are available at attractive rates shows that competition exists for all of Qwest's residential services. Public Counsel mischaracterizes and takes out of context Mr. Teitzel's testimony regarding the effect of this type of purchase on the differential between Qwest's and a competitor's prices. While Public Counsel cites selectively to page 351 of the transcript at lines 14 - 18 in an attempt to show that competitive alternatives are not attractive to such customers, the full text of Public Counsel's question and Mr. Teitzel's answer is as follows:

> Q. And at line 6 you say that this customer by purchasing this one feature does reduce the differential between their own cost and that of an offering perhaps from a competitor, correct?
> A. That's correct. If I could give you an example of that, we have talked about the fact that the Qwest 1FR is about $18.30, and you add the end user common line charge to it, if the customer were to buy voice

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> messaging for approximately $10, then they're talking about a net price of those two things added together is something in the range of $28. And the point is, if you're talking about a $28 price comparison to a $24 VoIP offer or $29 wireless offer, suddenly the numbers look pretty compelling to the customer, and that was the message here.

23 Rather than saying in his response that Qwest customers purchasing a la carte features are not attracted to competitive alternatives (or that the pricing differential between Qwest's service and a competitor's is only reduced but not eliminated), Mr. Teitzel said the inverse: certain competitive services may actually be priced lower than the combination of a 1FR line and an a la carte feature and such alternatives are therefore highly attractive to customers.

24 Public Counsel next argues that it is key to note that only half of the customers have broadband services, focusing on the half that do not have such access.[11] This is a "glass half empty" argument, whereas Qwest views the case as one where the glass is half full, and increasing every day. It is significant to note that approximately half of Washington households *do* have broadband internet access, since this segment now is clearly subject to price-constraining competition. VoIP service is simply an incremental purchase decision once the customer has invested in broadband for internet access purposes. It is equally important to note several key facts identified at page 5 of Mr. Teitzel's rebuttal testimony: High Speed Internet lines in Washington have increased from 195,628 in December of 2000 to 1,575,375 in June of 2006, an increase of <u>over 700%</u>. In addition, in the first six months of 2006 <u>alone</u>, the number of high speed lines in Washington increased by <u>well over 300,000.</u> As stated at page 10 of Mr. Teitzel's rebuttal testimony, the base of broadband internet subscribers in Washington is large and "continues to inexorably increase." This is an important factor for the Commission to consider: it is not only the static (and significant)

[11] PC Brief ¶ 24.

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number of Washington households with broadband internet access, it is the fact that this significant number is on an ever-increasing upward trend.

25 Finally, Public Counsel's claim that customers must purchase cable modem to obtain VoIP service is incorrect.[12] A new non-Comcast subscriber can purchase Comcast Digital Voice ("CDV") service from Comcast without also subscribing to Comcast broadband internet service. While this Comcast service is not "stand-alone" telephone service as defined by Public Counsel (includes a range of features and unlimited long distance), it is important to note that the subscriber need not also subscribe to Comcast broadband internet service to obtain CDV service, and it is also important to note that Comcast regularly runs promotional offers for this service at very attractive price points that are within reasonable range of Qwest's stand-alone 1FR rate of $18.34 (including the End User Common Line charge), and is even more attractive to 1FR customers whom also subscribe to a la carte features or packages.[13] From this perspective, Comcast's CDV service is clearly a competitive substitute for Qwest's 1FR service.

III. COMPARISON OF SETTLEMENT AFOR TO AFORS IN OTHER STATES

26 Although Public Counsel admits that the Commission is not bound by regulatory decisions in other states, it nonetheless provides a review of AFORs in several other Qwest states.[14] Apparently, Public Counsel's purpose in its comparison of Qwest AFORs is to selectively point out to the Commission that these AFORs variously include more onerous regulatory requirements than are currently included in the Settlement AFOR.

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[12] Tr. 378 (Teitzel). Q. Do you know whether cable modem service is required to be purchased as a separate item from Comcast in order for a customer to order digital voice from Comcast?
A. I think Comcast will sell their Comcast digital voice to a non-Comcast broadband subscriber.

[13] Exhibit 11C, p. 25

[14] PC Brief, pp. 12-20.

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27 It is no surprise that Public Counsel's comparison does not include any information about, or reference to, other states where regulation is currently far less than would be allowed under the Settlement AFOR. For example, Mr. Teitzel's direct testimony provides information about two sweeping deregulation decisions by the New York Public Service Commission ("NYPSC") and California Public Utility Commission ("CPUC") based on their determination that the major incumbent local exchange companies ("ILEC") were facing pervasive competition by intramodal as well as intermodal competitors. To establish the relevance of the NYPSC and CPUC orders to this AFOR proceeding, Mr. Teitzel provided the following matrix which compares competitive data for the major ILECs in each of the states (footnotes omitted):

	New York: Verizon	California: SBC/AT&T	Washington Qwest
% Switched Access Line Loss: 2000-2005	25%	21%	24%
% Decline in Switched Access MOU: 2001-2004	30.5%	25.3%	29.5%
CLEC Market Share Statewide: 12/2005	31%	13%	14%
Wireless Subscribers Exceed Combined ILEC and CLEC Lines in the State?	Yes	Yes	Yes
% of Total Population With Cell Phones (Statewide): 12/2005	70%	66%	66%
% Households With DSL or Cable Modem: 12/2004	33%	35%	32%
% Increase in Broadband Lines: 2000-2004	365%	415%	355%

28 Even though the data indicate that the competitive situation in the three states is remarkably similar, the regulatory relief that Qwest is seeking in the Settlement AFOR is far less that what has already been granted in New York and California. Specifically, the NYPSC and CPUC found as follows:

> New York
>
> "After an extensive examination of telecommunications competition in the state, the New York Public Service Commission ("NYPSC") issued an order on April 11, 2006

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finding that intramodal and intermodal competition is now sufficient to justify classifying as competitive, without price restrictions, all of Verizon New York and Frontier Telephone of Rochester retail services except stand-alone residential basic service. For residential basic service, the NYPSC established a cap of $23.00 and allowed increases of no more than $2.00 to the monthly rates during the first year and $2.00 in the following year. With regard to metrics of service quality, the NYPSC acknowledged that competitive forces should now be sufficient to ensure high quality of service, and established a separate rulemaking to define relaxed metrics that provide parity of measurement of all telecommunications providers, both intramodal and intermodal."[15]

California

"The CPUC's rulemaking order was effective August 24, 2006 and was a broad examination of competition and regulation in the service territories of local exchange carriers, including AT&T, Verizon, SureWest and Frontier. Similar to the findings of the NYPSC . . . the CPUC found that, in view of the status of intramodal and intermodal competition, it should forbear from regulation of all retail residential and business telecommunications services offered by these carriers, with the sole exception of specific residential local exchange service rates, which were frozen at current levels until January 1, 2009 - after which this price cap is eliminated - pending a review in a separate proceeding of the relationship between the availability of essential "lifeline" services to universal service funding."[16]

29 Furthermore, in Exhibit 68 Mr. Reynolds states that in "[m]any of Qwest's fourteen states, and in other states in the country, laws have been recently changed, or are in the process of being changed, to reflect the competitive telecommunications market and incorporate the goals that are expressed in this testimony."[17] In Qwest's territory, regulatory flexibility legislation has been enacted in seven of its states.[18] In virtually all of these states, the regulatory flexibility afforded through legislation exceeds what would be granted by approving the Settlement AFOR. Consequently, when all the evidence is evaluated regarding comparisons to other states' levels of regulatory flexibility, both in and outside Qwest's

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15 Exhibit 11C, pp. 35-36

16 *Id*., p. 38

17 Exhibit 68, Reynolds Direct, p. 6, footnote 3.

18 Idaho – HB 224; Iowa – HF 277; Utah – SB 108; Nebraska – LB 835; North Dakota – SB 2216; South Dakota – TC 03-057

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region, the Settlement AFOR represents a modest proposal that is far from overreaching given the competitive environment that is its genesis.

IV. PUBLIC COUNSEL'S AFOR PROPOSAL

30 In this section of this Reply Brief, Qwest will respond to Public Counsel's proposed AFOR with arguments in rebuttal to the plan, and/or with references to Qwest's Opening Brief where the issue has already been discussed

A. Term and Effective Date

31 The parties agree that the AFOR should have a four year term. The Settlement AFOR allows that term to be extended, which may be appropriate and will likely be decided during the six-month review period.

B. Pricing Flexibility

32 Public Counsel claims that its plan gives Qwest pricing flexibility.[19] But in Qwest's view the plan is more restrictive than current regulation, from the perspective that Qwest is now free to file requests for changes/increases in its tariffed rates. Public Counsel would freeze the 1FR and effectively cap rates for features and bundles, even though Public Counsel agrees that the market for bundles is effectively competitive. As discussed in Qwest's Opening Brief, the Settlement AFOR provides Qwest with the necessary pricing flexibility, while offering certainty and capped rates for purchasers of the stand-alone line.

33 Public Counsel's conditions include the requirement to continue to offer standalone features (PC Brief ¶ 48); a cap on the price for features (¶ 49); a freeze on the rate for Caller ID (¶ 50); a limitation so that there is no de-averaging of any service (¶ 51), and a limitation on the price

[19] PC Brief ¶¶ 46-47.

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of bundled services (¶ 52).

34 These issues are addressed in Qwest's Opening Brief at paragraphs 56-57, 67, 68, and 71-73. In each case, it is safe to say, that Public Counsel's proposals result in more regulation than Qwest is subject to today – under the current regulatory scheme Qwest can grandfather and discontinue services – the requirement to offer stand-alone features is contrary to that. Under the current regulatory scheme Qwest can file for rate increases with the Commission – Public Counsel's rate freeze proposals are contrary to that. Under the current regulatory scheme Qwest can de-average analog business services, long distance, and other competitively classified services – Public Counsel's proposal would restrict that ability. Under the current regulatory scheme Qwest can currently price packages and bundles at any level above cost – Public Counsel would unnecessarily restrict the pricing of these services.

C. Basic Residential Service

35 Public Counsel spends a great deal of time defending its proposal for a 1FR freeze, characterizing the freeze as "protection" for the 1FR.[20] Public Counsel argues that the record is not adequate to support a $1 increase as fair, just and reasonable. This is incorrect. Staff, Qwest, and even Public Counsel offer evidence that Qwest is not currently earning at its last authorized rate of return. All parties examined Qwest's financials and came very close to each other in estimating Qwest's unadjusted return. All parties agreed the unadjusted rate of return is 5.93%.[21] Even with the adjustments made by Staff and PC, Qwest is under its rate of return. Staff provides evidence that a $2 increase would be fair as well, thereby removing any real doubt about the fairness of a $1 increase.

36 Public Counsel relies on a treatise from 1998 (¶ 56) regarding rate setting that cannot

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[20] PC Brief ¶¶ 53-75.

[21] Exhibit 90C, Loube, p. 64; Exhibit 127C, Strain, p. 13; Exhibit 32C, Grate p. 5.

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reasonably have taken into account the type and extent of the competition that Qwest now faces. And Public Counsel's reliance on the GTE AFOR (¶ 57-59) is similarly outdated – as Public Counsel notes, that decision was rendered under the previous AFOR statute. That statute was amended so that a full rate case-type review of earnings is not necessary in order to approve an AFOR. Qwest agrees that rates should not be established based on guesswork, but they can be established based on a review of earnings, a comparison to other companies' rates, and evaluation of whether rates will remain affordable, and an evaluation of rates relative to costs. All of those analyses were provided in this case, and all of them support a finding that rates will still be reasonable even if there is a $1 increase over 4 years.

37 Public Counsel next argues that Qwest's authorized rate of return is stale, thereby suggesting that the earnings review that all parties conducted should not be given any weight.[22] However, this is, in fact, Qwest's most recent authorized rate of return, and provides at least a benchmark against which current earnings and rates may be measured. It should be noted that Public Counsel's adherence to the order in Docket No. UT-950200 is selective at best. On issues where the order is seen to aid Public Counsel's position, such as the incremental cost of local service, it is gospel – on issues such as rate of return, Public Counsel dismisses its importance. In Qwest's view the order should simply be taken for what it is worth – an order applying traditional rate making principles to set rates in an environment that is so distant from today's highly competitive environment that it offers little in the way of practical guidance. Qwest's references to the rate of return authorized in that order are made simply because all parties have used that rate of return as a proxy by which reasonableness may be evaluated.

38 Public Counsel argues that Qwest understates its actual rate of return.[23] However, the

[22] PC Brief ¶ 62-65.

[23] PC Brief ¶ 68

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adjustment proposed by Dr. Loube that purportedly supports this claim is his own invention, is incorrect and is a violation of the FCC's separations rules.[24]

39 Public Counsel then argues that because the residential rate is not below cost, no increase is warranted, and that in a competitive market rates would be driven downward toward cost and would never rise.[25] However, Public Counsel has also agreed that residential rates were established by regulation, not the operation of a competitive market, and that we therefore cannot attach any real significance to Qwest's ability to raise rates. Furthermore, to the extent that competition has lagged in connection with the stand-alone 1FR (a proposition that Public Counsel advances that Qwest does not necessarily endorse), it suggests, especially in comparison with the Commission-approved wholesale loop rates, that stand-alone residential service has little if any margin with which to entice competitors.

40 Public Counsel also contends that a $1 increase presents risks that ratepayer benefits of the Dex transaction will be lost or diluted. This claim is without merit, as Staff's analysis supports a $2 increase without minimizing the impact of the Dex adjustment. Qwest's witness, Phil Grate, demonstrates that Public Counsel's claims are without merit.[26]

41 Public Counsel next argues for a cap on installation/connection fees, stating that they should remain at current levels for the duration of the AFOR.[27] This is another proposal that would impose more regulation than Qwest is under today, where Qwest can file for rate increases to these non-recurring rates under tariff. Under the AFOR, these charges would remain in the tariff, thereby giving the Commission an opportunity to review any rate requests associated

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24 Exhibit 34C.

25 PC Brief ¶¶ 69-71.

26 Exhibit 32C, p. 32, line 13 – p. 35 line 15.

27 PC Brief ¶ 74.

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with these charges. Tariffing these rates provides for full Commission oversight and represents sufficient protection for consumers. More restrictive conditions should not be imposed.

42 Finally, Public Counsel argues to retain the directory assistance free call allowance, arguing that the free call compensates customers for calls to directory assistance that are not successful.[28] Qwest responded to this issue at paragraph 66 of its Opening Brief. This service is competitively classified, and no other carrier is compelled to offer a free call, even though "unsuccessful" calls are no doubt experienced by subscribers to other carriers as well. Further, for those customers who are unable to use the printed directory, Qwest provides the service without charge.

D. Retail Service Quality

43 See section V. below.

E. Technological Improvements and Advanced Services

44 Public Counsel would require Qwest to build DSL capability to 75% of its customers in all of its wire centers (estimated at 39,695 lines). Public Counsel makes other suggestions for broadband requirements as well.[29] These issues were addressed in Qwest's Opening Brief at paragraphs 50-55. Qwest's arguments in that Brief make it clear that the Settlement AFOR meets the statutory goals for broadband deployment to underserved areas and customers, that the Commission's jurisdiction in this area is limited by the FCC and federal law, and that Public Counsel's proposal is costly and unwarranted.

45 Public Counsel's proposal ignores the Washington-specific evidence presented in Mr.

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[28] PC Brief ¶ 75.

[29] PC Brief ¶¶ 77-86.

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Teitzel's rebuttal testimony showing that broadband internet penetration rates among Washington households with annual incomes of $25,000 and under have tripled (in one year) for households subscribing to DSL and nearly doubled for households subscribing to cable modem service. Additionally, public findings from the Pew Internet and American Life Project show that, on a national basis, the number of households with broadband internet access increased from March 2005 to March 2006 from 60 million to 84 million, an increase of 40%, with the increase among African-American households at 121% and among Hispanic households at 46% over this same period. If Public Counsel, in discussing "underserved" markets, intended to encompass these particular market segments by the use of the term, it is clear that broadband internet penetration is increasing in these segments at robust rates absent the incentives it suggests.

F. Accounting and Reporting

46 Public Counsel proposes that the threshold for property transfers remain at 1% rather than the 5% in the Settlement AFOR, and also proposes accounting and reporting requirements regarding the application of discounts.[30] These issues are addressed at paragraphs 37 and 69-70 of Qwest's Opening Brief. Ratepayers have no risk of loss when the company is not under cost-of-service regulation because without it, transfers of property can have no effect on rates, terms or conditions.[31]

G. Wholesale Provisions

47 Public Counsel has abandoned the provision regarding forbearance, consistent with the Settlement AFOR.[32]

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30 PC Brief ¶¶ 87-88.

31 Transfers of property to affiliates are subject to the affiliated interest rule of 47 C.F.R. 32.27. Transfers to non-affiliates are subject to business economics, the profit motive and Part 32 rules regarding of dispositions of gains and losses. Thus, significant protections remain regarding disposition of assets.

32 PC Brief ¶ 89.

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H. Extension, Modification, or Termination of AFOR

48 There is no need to adopt Public Counsel's proposals regarding AFOR termination. The AFOR appropriately allows the Commission to decide, at the relevant time, what process will be followed, which parties will participate, whether discovery will be available, etc. There is no need to decide those issues now, nor does the Settlement AFOR attempt to do so.

I. Notice to Customers

49 Public Counsel asks for a customer notice, though it is unclear to what end.[33] Qwest provided notice to its customers about the AFOR proposal, and the impact of that notice was de minimis at best. Only a tiny fraction of customers commented on the AFOR, and the few who appeared at the public hearing all supported the AFOR proposal. None asked for additional notices. Even under the AFOR Qwest will have to comply with statutory notice requirements to revise rates that are under tariff, and will, of course, notice customers if rates otherwise change. There is no need for an additional, post-approval notice of the AFOR.

J. The Settlement AFOR Does Not Create Uncertainty

50 Qwest disagrees with Public Counsel that the Settlement AFOR creates uncertainty.[34] The AFOR contains language that was agreed to by all parties, and includes a general statement that under the AFOR Qwest will be regulated as if it were competitively classified. This general statement is qualified by the detailed Appendix that clearly sets forth the regulatory provisions that will be waived for Qwest, and the extent to which they are. Any confusion regarding this provision is of Public Counsel's own making, as the terms are sufficiently clear and understood by the settling parties.

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[33] PC Brief ¶ 93.

[34] PC Brief ¶¶ 94-95.

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V. SERVICE QUALITY

A. The SQIP is Unnecessary and Punitive

51 Public Counsel believes that its Service Quality Incentive Plan ("SQIP") is essential to enhance and protect services quality.[35] This is simply not true. As Mr. Williams addresses in his testimony, Qwest's service quality levels in Washington since the expiration of the previous self executing remedy plan (the Service Quality Performance Plan, or "SQPP") have either improved or been sustained.[36] This is because, in a competitive market, Qwest must maintain high levels of service quality to retain its customers, regardless of the existence of any service quality penalty plan. Although it is somewhat a moot point, because Qwest has made it clear that it will not accept an AFOR that includes a self-executing remedy plan such as the SQIP, Qwest will rebut, on a point-by-point basis, Public Counsel' rationale that its SQIP is essential to an AFOR.

1. Public Counsel asserts that the SQIP will encourage investment[37]

52 Based on experience with the SQPP, this is not true. Public Counsel's own Brief chronicles the decline in the annual level of investment by Qwest in Washington during the period that the SQPP was in effect.[38] Furthermore, Mr. Williams points out that the decline in investment did not affect Qwest's improvement in service quality during the period of the SQPP.[39] He also provides evidence that aggregate investment per line has very little correlation to service quality performance by showing the improvement in two seemingly investment-related service quality measures, during a period of declining investment: Trouble Report Rate and Held Order greater than 90 days.

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35 PC Brief ¶ 96.

36 Exhibit 47, Williams Rebuttal Testimony, pp. 3-6

37 PC Brief ¶ 98.

38 PC Brief ¶ 99.

39 Exhibit 47, pp. 17-18.

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2. Public Counsel asserts that the SQIP is an anti-backsliding measure, not a response to recent performance[40]

53 Based on Public Counsel's own calculations of the operation of its proposed SQIP on Qwest's 2006 service quality results, this is not true.[41] Unlike the SQIP, a true anti-backsliding plan would set current performance as a benchmark. In contrast, Public Counsel's plan would require Qwest to pay over $1.1 million in annual penalties for performance that is superior to that of other regulated companies that are not encumbered with such a plan.[42] The operation of such a plan on only one provider in the state is unfair and discriminatory.

54 As Staff points out in its Initial Brief: ". . . [S]taff witness Kristen M. Russell explains in detail [that] Qwest's service quality has been superior to that of most other telecommunications companies in recent years, and there is nothing in this record to suggest – contrary to the contentions of Public Counsel – that this situation will deteriorate in the future. Public Counsel argues that a punitive SQIP must be put in place to ensure that it does not. Staff disagrees. A similar program expired in 2005, and Qwest's service quality remains quite satisfactory. There is no basis to conclude that the approval of an AFOR will alter this fact."[43]

3. Public Counsel asserts that the statutory complaint and penalty mechanism is not as effective.

55 Public Counsel makes this assertion based on a Commission finding in Docket No. UT-991358.[44] This finding, however, was not informed by the fact that Qwest's performance

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40 PC Brief ¶ 102

41 Exhibit 126C

42 Exhibits 126C and 138C

43 Staff Opening Brief, page 10.

44 Docket No. UT-991358, Sixteenth Supplemental Order, at ¶37; the Commission found: "This record does make it clear that the enforcement mechanism associated with the SQPP provides a better incentive for performance than that of the rules."

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post-SQPP has been equal to or better than its performance under the SQPP.[45] Furthermore, the currently level of competition, which provides the greatest incentive to provide high quality service, is much greater than it was in 2004 when the Commission made the finding referenced by Public Counsel.

4. Public Counsel asserts that the SQIP advances different goals than the Customer Service Guarantee Plan.

56 Public Counsel maintains that its proposed SQIP provides Qwest with the economic motivation to provide satisfactory service quality to all of its customers. To suggest that Qwest lacks the economic motivation to provide high quality service to its customers in a highly competitive environment reveals just how far removed from reality Public Counsel really is. One need only look at the very significant line loss data in Mr. Teitzel's testimony to find all the economic motivation that Qwest requires to provide the highest quality service to its customers.[46]

5. Public Counsel asserts that the SQIP helps protect against uneven investment and ensures all customers get consistent service quality.

57 Without a shred of evidence, Public Counsel alleges that because competition may be uneven in the state, than so might service quality. First, as Exhibit 12C reveals, Qwest is losing lines to its competitors in virtually every wire center out of which it provides services in Washington. Second, because Qwest administers its network and service support systems on a unified basis with common operating procedures, it would be difficult to provide uneven service to select areas. Finally, as previously addressed, Public Counsel has proven no correlation between service quality and investment levels.[47]

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45 Exhibit 47, pp. 3-6

46 Exhibit 11C, pp. 2-4; Exhibit 12C

47 Exhibit 47, pp. 17-18.

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B. Service Quality Plans in Other Qwest States

58 Public Counsel states that because other Qwest states have self-executing service quality penalty plans, then so should Washington. Using this same logic, it is a more persuasive argument that because eleven of Qwest's other states ***do not*** have self-executing service quality penalty plans, then neither should Washington. As Mr. Williams points out in his testimony: "[s]ervice quality incentive plans are virtually obsolete. They reflect a bygone era characterized by the imposition of punitive regulations on a carrier that required compensation to all customers for the service problems experiences by only a few customers. At the time of the Qwest/U S WEST merger, seven of the fourteen in-region states had a service quality incentive provision as part of their merger agreements, tariffs or other requirements. These states were Arizona, Colorado, Iowa, Minnesota, New Mexico, Oregon and Washington. Over time, in four of the seven states, the service quality incentive provisions were either terminated or allowed to expire."[48]

59 As Public Counsel indicates, the three states that still have self-executing service quality penalty plans are Arizona, Colorado, and New Mexico. And, as Mr. Williams testifies the Colorado penalty provisions have recently been reduced to two remaining measures, while the New Mexico provisions have been modified to reflect the less stringent Commission service quality rules.[49] Clearly, as competition has intensified in Qwest's region, its regulators have recognized that there is no longer a need for such plans.

60 Nor should the Commission be misled by Public Counsel's suggestion that other states have measures that exceed or are superior to those in Washington. The Commission should compare the measures that apply to Qwest in Washington with those that apply to other

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[48] *Id*., pp. 6-7

[49] *Id*., pp. 6-8

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carriers in Washington, and not accept Public Counsel's invitation to pick and choose from among the most onerous requirements in effect in other states. In addition, Public Counsel does not present a complete or balanced overview of those plans, and entirely omits mention of areas where the Washington provisions are more stringent than those in any other state – for example, the missed commitments credit for residential customers in Washington is $25.00, unmatched in any other state and higher by $9.00 than the next closest.[50]

C. The Settlement is Adequate to Enhance and Protect Service Quality

61 Public Counsel states that while it ". . . does not oppose the re-institution of the three addition element of the CSGP under the settlement, the record shows that these additional elements are inconsequential, in terms of the dollar amounts Qwest is likely to pay out . . . ." Evidently, Public Counsel believes that unless Qwest is paying millions of dollars a year in service quality penalties, it has no incentive to provide high quality service. As has been previously addressed, with competition rapidly eroding its customer base in Washington, Qwest does not need monetary penalties to provide high quality service. High quality service is the ticket to play in today's market in which customers can easily migrate between competitors.[51]

62 Furthermore, the service quality provisions in the Settlement are more than adequate to enhance and protect service quality, including: compliance with Commission's service quality rules, sufficient reporting requirements; agreement to leave the CSGP under tariff and unaltered during the AFOR; and agreement to add three additional provisions to CSGP. Like the rest of its AFOR proposal, Public Counsel's SQIP proposal is nothing more than a plea for more regulation. This is totally inconsistent with the competitive market.

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50 Tr. 447.

51 Exhibit 11C, pp. 4-6

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D. Service Quality Reporting Issues

63 Even though not required by rule, Public Counsel wants answer time supervision reports from Qwest, but no other company.[52] Public Counsel offers nothing in support of a requirement to place Qwest under more regulation than any other company, and this request should be rejected.

64 At paragraph 128 of its Brief, Public Counsel raises the unfounded concern that Qwest will not report out-of-service remedies as required by the rule and Commission orders. This concern has no basis in this record, and it is unnecessary to order the parties to agree on any reporting requirements.

VI. CONCLUSION

65 The Commission should reject Public Counsel's proposal, and reject any Public Counsel modifications to the Settlement AFOR. The agreed AFOR represents a well-balanced plan that addresses the diverse interests of all the signatories. The Commission should expeditiously approve the AFOR that is contained in Exhibit 4 in the hearing record, an AFOR that is in the public interest and that is supported by all parties except Public Counsel.

DATED this 1st day of May, 2007.

QWEST

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[52] PC Brief ¶ 127

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