

BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

JUN 30 2000

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

DOCKETED BY



IN THE MATTER OF THE MERGER OF THE
PARENT CORPORATIONS OF QWEST
COMMUNICATIONS CORPORATION LCI,
INTERNATIONAL TELECOM CORP., USLD
COMMUNICATIONS, INC., PHOENIX
NETWORK, INC. AND U S WEST
COMMUNICATIONS, INC.

DOCKET NO. T-01051B-99-0497

DECISION NO. 62672

OPINION AND ORDER

DATE OF HEARING: March 29, 2000 (public comments), April 24, 2000 (pre-hearing), April 27 and 28, 2000, and May 1, 2000

PLACE OF HEARING: Phoenix, Arizona

PRESIDING OFFICER: Jerry L. Rudibaugh

IN ATTENDANCE: William A. Mundell, Commissioner

APPEARANCES: Mr. Thomas Dethlefs, U S WEST Communications, Inc. and Mr. Timothy Berg, FENNEMORE CRAIG, on behalf of U S WEST Communications, Inc.;

Mr. Mace J. Rosenstein, Ms. Maura DeMouy and Ms. Marissa Repp, HOGAN & HARTSON, LLP, and Mr. Richard L. Sallquist, SALLQUIST & DRUMMOND, P.C., on behalf of Qwest Communications International, Inc.;

Mr. Raymond S. Heyman and Mr. J. Matthew Derstine, ROSHKA, HEYMAN & DeWULF, on behalf of Telephone Retiree Association of America and the Arizona Payphone Association;

Mr. Lindy Funkhouser, Mr. Scott S. Wakefield and Ms. Jessica Carpenter on behalf of the Residential Utility Consumer Office;

Mr. Gary L. Lane on behalf of SBC Telecom;

Mr. David A. Braun on behalf of the Arizona Consumers Council;

Ms. Diane Bacon on behalf of the Communications Workers of America;

Mr. Daniel M. Waggoner, DAVIS, WRIGHT & TREMAINE, LLP, and Ms. Joan Burke, OSBORN

1 MALEDON, on behalf of AT&T Communications of
the Mountain States, Inc.;

2 Mr. Michael W. Patten, BROWN & BAIN, P.A., on
3 behalf of McLeod USA Telecommunications Services,
Inc.;

4 Mr. Todd C. Wiley, GALLAGHER & KENNEDY, on
5 behalf of Covad and ELI;

6 Mr. Michael T. Hallem, LEWIS & ROCA, on behalf of
Rhythms Links, Inc.;

7 Mr. Robert Tanner, DAVIS, WRIGHT, TREMAINE,
8 LLP, on behalf of GST; and

9 Mr. Christopher K. Kempley, Assistant Chief Counsel,
10 Legal Division, on behalf of the Utilities Division of the
Arizona Corporation Commission.

11 **BY THE COMMISSION:**

12 On September 3, 1999, U S WEST Communications, Inc. ("USWC" or "U S West"), along
13 with Qwest Communications Corporation, USLD Communications, Inc., and Phoenix Network, Inc.,
14 (collectively "Qwest"), submitted their Joint Notice of Proposed Merger (hereinafter, USWC and
15 Qwest collectively referred to as "Applicants"). By the Joint Notice of Proposed Merger, USWC and
16 Qwest seek an order from the Arizona Corporation Commission ("Commission") approving the
17 proposed merger of the parent corporation of Qwest and the parent corporation of USWC, pursuant to
18 A.A.C. R14-2-803(B).

19 On December 27, 1999, the Utilities Division Staff ("Staff") of the Commission filed a
20 Request for Procedural Order ("Request"). On January 4, 2000, the Residential Utility Consumer
21 Office ("RUCO") filed a Response to Staff's Request. On January 7, 2000, U S WEST and Qwest
22 filed a Response to Staff's Request. On January 18, 2000, Staff filed a Reply. Our January 19, 2000
23 Procedural Order set the matter for hearing commencing on March 29, 2000. On February 25, 2000,
24 Applicants filed a document entitled "Supplement to Joint Notice of Proposed Merger
25 ("Supplement"). Our March 8, 2000 Procedural Order continued the hearing until April 27, 2000
26 while maintaining the March 29, 2000 date for public comment purposes.

27 NEXTLINK Arizona, Inc. ("NEXTLINK"), GST Telecom, Inc. ("GST"), the
28 Communications Workers of America - Arizona State Council ("CWA"), RUCO, SBC Telecom, Inc.

1 (“SBC”), the Telephone Retiree Association of Arizona, Inc. (“Retirees”), the Arizona Payphone
2 Association (“Payphones”), Rhythms Links, Inc. (“Rhythms”), Covad, McLeodUSA, Cox
3 Communications, Inc. (“Cox”), Sprint Communications, L.P. (“Sprint”), and AT&T Communications
4 of the Mountain States, Inc. (“AT&T”) requested and were granted intervention. Subsequently,
5 Rhythms, AT&T, Sprint, GST, and NEXTLINK withdrew from the case.¹

6 On April 27, 2000, the hearing commenced before a duly authorized Administrative Law
7 Judge of the Commission. U S WEST, Qwest, RUCO, Retirees and Staff presented evidence.
8 Additionally, SBC and the CWA made appearances and cross-examined witnesses. At the
9 conclusion of the hearing, the matter was adjourned pending submission of briefs by the parties on
10 May 12, 2000.

11 DISCUSSION

12 Proposed Merger

13 On July 18, 1999, Qwest and U S WEST entered into an Agreement and Plan of Merger
14 (“Proposed Merger”). Qwest is a worldwide broadband Internet communications company whose
15 principal business is providing leading-edge communications to businesses and consumers. Qwest
16 has operations throughout North America, Europe and Mexico, and has developed one of the most
17 technologically advanced, secure and reliable networks capable of carrying data, image and voice
18 communications. U S WEST’s principal business is telecommunications and related services,
19 including local exchange telephone services, exchange access services, long distance within Local
20 Access and Transport Areas (“LATA”), high speed data and Internet services, wireless
21 communications and directory services.

22 The Applicants urged the Commission to approve the Proposed Merger without conditions.
23 According to the Applicants, the Commission may reject the Proposed Merger pursuant to A.A.C.
24 R14-2-803(C): if it determines that it would impair the financial status of the public utility, otherwise
25 prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility
26 to provide safe, reasonable and adequate service. Applicants opined that the evidence demonstrated
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28 ¹ At the conclusion of the evidentiary hearing, SBC also withdrew.

1 that the Proposed Merger will not impair USWC's financial status, otherwise impair its ability to
2 attract capital at fair and reasonable rates and will not impair USWC's ability to provide safe,
3 reasonable or adequate service.

4 According to Qwest and U S WEST, the Proposed Merger will create a next generation
5 telecommunications company dedicated to bringing advanced voice, data and broadband Internet
6 services to customers in Arizona, across the United States, and around the world. The merger will
7 bring together Qwest's advanced network providing broadband Internet communications with U S
8 WEST's innovative local service offerings and leadership in providing high-speed Internet access
9 through Digital Subscriber Line ("DSL") technology. USWC has led the industry in its deployment
10 of DSL technology and is already providing DSL service to 40 in-region cities. Applicants opined
11 the strategic merger of Qwest and U S WEST will serve the public interest by producing significant
12 procompetitive effects that will lead to substantial benefits for customers in Arizona.

13 The Telecommunications Act of 1996 ("Act") currently prohibits U S WEST from providing
14 long distance telecommunications services between LATAs within its 14 state region, and between
15 these LATAs and locations outside its region. Upon the closing of the merger, the interLATA
16 service prohibition also would apply to Qwest. Consequently, as of the closing, Qwest plans to
17 discontinue providing these interLATA services, and these services will be divested under separate
18 agreements. However, Qwest and U S WEST expect to work actively to satisfy the regulatory
19 conditions set forth in the Act so that interLATA services can be provided in particular states starting
20 in 2000 and 2001.

21 Qwest and U S WEST opined that the Proposed Merger would create a stronger competitor
22 and will provide significant value for shareholders, employees, and customers for the following
23 reasons:

- 24 • The combination of Qwest and U S WEST will create the benchmark large-capitalization
25 growth company in the communications/Internet sector for the new millennium, with
26 approximately \$18.5 billion of pro forma year-2000 revenue and \$7.4 billion pro forma
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28

1 year-2000 EBITDA² and will be accretive to Qwest's earnings per share and cash flow per
2 share beginning in the first year of combined operations;

- 3 • During the period from 2000 through 2005 the combination of Qwest and U S WEST will
4 enable them to achieve gross revenue synergies of more than \$12 billion and net financial
5 and operational synergies of approximately \$10.5 billion to \$11 billion. They expect that
6 these synergies will be comprised of (1) incremental revenues as the combined company
7 expands its local, data, Internet Protocol and long-distance service; (2) operating cost
8 savings in areas such as network operations and maintenance, sales and marketing, billing
9 and customer and back office support; and (3) capital savings through elimination of
10 duplication in the companies' planned network buildouts and in other infrastructure and
11 back-office areas.
- 12 • The combination of Qwest and U S WEST will accelerate strategic development and
13 enable them to grow faster than each could grow alone and will increase revenues and
14 profits faster than each would accomplish alone. In particular, they expect the
15 combination will accelerate the delivery of Internet-based broadband communications
16 services provided by Qwest to the large customer base of U S WEST and will bring
17 together complementary assets, resources and expertise and the network infra-structure,
18 applications, services and customer distribution channels of their companies and the
19 combination of customer bases, assets, resources and expertise in a timely manner will
20 permit each to compete more effectively in their rapidly consolidating industries. They
21 believe the combination will also enable them to rapidly increase customer base for
22 respective products by acquiring the other company's customer bases; the combined
23 company would have an expanding client base of more than 29 million customers,
24 including many multinational corporations;
- 25 • They believe worldwide broadband end-to-end infrastructure, expanded range of products
26 and services, access to each other's customers, people and processes and combined use of
27

28 ² Earnings Before Income Taxes, Depreciation and Amortization.

1 distribution and operating systems will create growth for the combined company and that,
2 as a large company with global scale and scope, multiple capabilities, end-to-end
3 broadband connectivity, and a full suite of data, voice and video products and services,
4 they can successfully compete in the telecommunications industry in the long-term; and

- 5 • They believe they will be able to redeploy capital in the years 2000 through 2005 in the
6 aggregate amount of approximately \$7.5 billion toward new investment in Internet
7 applications and hosting, out-of-region facilities based competitive local exchange service,
8 out-of-region broadband access and Internet services, wireless expansion and video
9 entertainment. They can fund this redeployment of capital with approximately \$5.3
10 billion of savings from the reduction in the dividends currently paid by U S WEST and
11 \$2.2 billion of savings from capital expenditure synergies.

12 In response to concerns regarding deterioration of service quality, Applicants asserted that the
13 Proposed Merger provides the combined company with increased incentives to meet the needs and
14 demands of retail and wholesale customers. Applicants indicated that in most cases the customer's
15 contact with the telecommunications network starts with basic local exchange service. For that
16 reason, Applicants opined that neglect of basic local exchange service could cost the provider to lose
17 the revenue stream from both basic and advanced services.

18 Applicants also asserted that the Proposed Merger provides increased incentives to meet the
19 requirements of Section 271 of the Act. Without Section 271 approval, the merged company will
20 face significant competitive disadvantages in the national interexchange market due to the holes in its
21 service territory created by divestiture.³

22 RUCO, Retirees, CWA, and Staff supported the Proposed Merger with conditions. All
23 expressed concerns that if conditions are not imposed, all the potential benefits would flow to Qwest
24 and USWC while the risks of adverse consequences will be borne by Arizona ratepayers. RUCO
25 proposed three conditions, while Staff proposed 27 conditions. According to Staff, its proposed
26 conditions are designed to do the following: 1) Protect captive ratepayers from risks and potential

27
28 ³ In order to comply with the law, Qwest must divest its in-region interLATA customers and services to effectuate
the Proposed Merger.

1 cost increases solely relating to the merger; 2) Ensure that the quality of service provided to those
2 captive customers does not deteriorate under the merged entities and provide incentives to improve
3 quality of service; and 3) Provide an opportunity for captive customers to actually achieve a share in
4 the potential benefits from the merger, should they occur.

5 RUCO, CWA, and Staff asserted that the existing quality of service of USWC is not at
6 desirable levels. For that reason, they recommended conditions to increase the merged company's
7 incentives to meet existing service quality standards. Staff proposed nine conditions to provide
8 incentives to improve quality of service

9 While generally supporting Staff's condition regarding quality of service, RUCO argued that
10 USWC already is obligated to provide such service. RUCO opined that quality of service conditions
11 alone will not provide any incremental benefits. For that reason, RUCO proposed three additional
12 conditions: 1) Fifty percent of the expected net synergies of \$10.5 billion to \$11 billion, during the
13 period 2000 to 2005, should be passed through to the ratepayers in the pending USWC rate case.
14 According to RUCO, the Arizona portion would result in a reduction in the revenue requirements of
15 \$107.3 million; 2) to address the potential harms to competition for residential customers, new
16 entrants should receive temporary discounts off the standard unbundled rates and wholesale prices
17 when they serve residential customers; and (3) The Commission should require USWC to continue to
18 invest in its most rural wire centers.

19 According to RUCO, most of the benefits of the Proposed Merger will flow to Qwest and
20 USWC stockholders. RUCO asserted that the Proposed Merger provides no benefits to USWC's
21 regulated customers in Arizona, especially residential and rural customers. At the same time, RUCO
22 opined there were a number of risks to Arizona customers:

- 23
- 24 • The Proposed Merger could hinder the development of local competition by eliminating
25 Qwest as a competitor to USWC and by strengthening the position of USWC as the
26 dominant carrier in its service territory;
- 27 • The Proposed Merger would combine a dominant local exchange carrier with Qwest's
28 nationwide broadband network which could result in the merged company gaining an
even greater ability to stifle competition and protect its dominant market share;

- 1
- The Proposed Merger poses a risk that the merged company could divert resources outside of Arizona and/or toward urban business markets; and
 - The Proposed Merger poses a risk that the merged company with its emphasis on national and international goals would be even less motivated to provide quality of service than is USWC currently.
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6 Applicants asserted that many of the conditions proposed by Staff and RUCO are extremely
7 onerous. According to Applicants, the proposed conditions would penalize USWC and would result
8 in unrealized synergies being refunded to ratepayers. Applicants opined that the conditions
9 recommended by Staff and RUCO would impair USWC's financial status.

10 Conditions

11 Staff Condition No. 1

12 Staff's Condition No. 1 would require a commitment on Applicants to preserve or enhance the
13 quality of service in Arizona. Applicants did not believe this condition was necessary.

14 Resolution

15 Applicants have not provided any reason for not making this a condition. In fact, Applicants
16 agree that it is a proper objective but they did not want it to be a condition to the Proposed Merger.
17 We also note that Applicants agreed to a similar condition in Iowa. We concur with Staff and will
18 require Applicants to agree to Condition No. 1.

19 Staff Condition No. 2

20 Staff proposed that the merged company shall continue to follow the existing complaint
21 processes, as they are written in Commission Rule R14-2-510 ("Rule 510"). Further, company
22 representatives will investigate complaints and return the resolution to a Commission representative
23 within five working days. For each month in which the company's performance is not in compliance
24 with this standard, it will calculate a credit payable of \$83,333, representing \$1.0 million divided by
25 12 months. The Commission shall determine the disposition of such credits.

26 Applicants asserted this condition is draconian. Applicants opined that if they took six days
27 (instead of five) to investigate a single complaint once each month of the year, USWC would be
28 required to pay a penalty of one million dollars. Applicants requested Staff's Condition No. 2 be

1 rejected because it imposes an unlawful penalty in a discriminating manner. According to
2 Applicants, the maximum penalty for violation of a Commission rule is \$5,000 pursuant to the
3 Arizona Constitution and Arizona Revised Statutes 40-425.

4 Staff opined that the condition was a reasonable means of ensuring improved attention to
5 complaints. Further, Staff indicated this proposal was similar to a provision adopted in at least one
6 other state.

7 Resolution

8 We concur with the Applicants. USWC should continue to be treated similar to other utilities
9 pursuant to Rule 510. We also concur the appropriate penalty for violation of Rule 510 is set forth in
10 A.R.S. § 40-425.

11 Staff Condition No. 3

12 Condition No. 3 makes a series of changes to USWC's service quality tariff. Staff
13 summarized those changes as follows: 1) provide that the Commission prescribes the use of penalty
14 funds received from USWC; 2) require that quarterly reports filed under the tariff be made public; 3)
15 require accounting for held orders on a daily basis; 4) amend the penalty calculation for out-of-
16 services; 5) adjust the percentages of held orders in the penalty calculation to account for growth in
17 access lines; and 6) require that penalties and offsets be calculated on a per call center basis.

18 According to Applicants, Condition No. 3 should be rejected for several reasons: Reporting
19 of held orders on a daily basis will require two full time employees with little additional information
20 above what is currently provided; public reporting of service quality results should apply to all local
21 service providers; the proposal to account for penalties based upon four Call Centers when only three
22 exist merely serves to increase penalties without regard to reasonableness of the amount imposed;
23 and the proposal to revise to the 1995 held order "no penalty" range without regard to growth in the
24 number of access lines is arbitrary. Applicants proposed Subpart 1 of Condition No. 3 be modified to
25 read as follows:

26 At the end of paragraph 2.6.1.B., insert the following:
27 USWC shall establish and credit a reserve on its books of
28 account in the amount of any penalty due under this Tariff
pending a determination by the Commission at an open
meeting whether the penalties due for any given year

1 should be refunded to individual affected customers,
2 refunded to the general body of ratepayers, deposited in the
3 Arizona Universal Service Fund or invested in specific
4 USWC service quality improvement projects as directed by
5 the Commission. Within thirty days of the entry of a final
6 Commission order directing disbursement of the penalties
7 due, USWC shall disburse funds equal to the penalties due
8 in compliance with the Commission's order.

9 Applicants also proposed that for purposes of Section 2.6.1.E of USWC's Service Quality
10 Tariff, held orders will be counted once each month at the end of the month. An order would be
11 considered held when the order is not filled by the due date appearing on the order without regard to
12 the number of days that have passed since the application date.

13 In response, Staff indicated the quarterly reports are necessary so that consumers can make
14 informed choices. The modification to the held orders report is necessary to track held orders
15 pursuant to the USWC Service Quality Tariff ("Tariff"). In such Tariff, a held order is defined as an
16 order that cannot be filled within ten days or by the customer request date if that date is longer than
17 ten days. In 1995, when the Tariff went into effect, USWC informed Staff that it would not be able
18 to report those service orders that were not filled within ten days because its tracking system was not
19 set up for that. As a result, Staff had accepted the USWC's existing tracking method as a fair trade-
20 off since it counted all unfilled orders, regardless of age. In 1997, USWC modified its system to only
21 count unfilled orders that were more than ten days old. However, they were only reported for the last
22 day of the month. As a result, the modified report does not report as held orders those that are placed
23 in the last ten days of one month and are completed in the following month even though they could
24 be held for 40 days.

25 CWA supported Staff's Condition No. 3. CWA asserted that the Commission must set the
26 standard that poor service quality levels will not be tolerated in Arizona. According to CWA, the
27 poor service quality levels are not a recent phenomenon and the Commission needs to address this
28 on-going problem now in order to protect the public interest. CWA also noted that Applicants have
29 agreed to service quality penalties in the Minnesota and Washington merger dockets.

30 Resolution

31 We generally concur with Staff. Subsequent to the adoption of the Tariff, USWC modified its
32 method of reporting held orders which resulted in held order amounts improving without any actual

1 service improvement. USWC has raised legitimate concerns regarding Staff's proposal possibly
2 requiring two additional employees and the fact that penalties are based upon four Call Centers when
3 only three exist. As a result, we shall modify Staff Condition No. 3 to be based on three Call Centers.

4 We concur with Applicants proposed modification to Section 2.6.1.E. including maintaining
5 the existing no penalty range of (.0281% to .0490%).

6 We concur with Applicants proposed substitute language for Subpart 1 of Condition No. 3.
7 We also concur with Applicants that the quarterly service quality reports should not contain customer
8 proprietary information. We concur with Applicants' proposal on held orders for purposes of Section
9 2.6.1.E.

10 Lastly, we concur with Staff's proposed method of reporting and tracking out-of-service
11 criteria contained in Section 2.6.1.F.

12 Staff Condition No. 4

13 Condition No. 4 provides that the Tariff be amended so that the penalty amounts would be
14 related to the cost of implementing the U S WEST Service Improvement Initiative ("Initiative")
15 proposal by USWC. According to USWC, its Initiative was designed to "Implement long-term,
16 sustainable service improvements to meet customer needs in Arizona well into the next century."

17 The following are the major initiatives listed for 2000:

- 18 1. Add 100 additional technicians for residential and small business installation and
19 repair during 2000;
- 20 2. 300 cross boxes with a high concentration of cable trouble reports have been identified
21 as candidates for replacement during 2000;
- 22 3. 10,000 pedestals with a high concentration of cable trouble reports have been
23 identified as candidates for replacement during 2000; and
- 24 4. Additional consultants (80 by the end of 2000) will be added in the business office to
25 handle increased call volumes.

26 In addition to imposing penalties related to the cost of implementing the Initiative, Staff proposed
27 that the penalties be doubled each year until a zero annual penalty is paid for that service category.

28 CWA supported Condition No. 4.

1 Applicants objected to Condition No. 4 primarily because penalties would be doubled even if
2 the performance of USWC came very close to the established standard. Additionally, Applicants
3 asserted that the proposed penalties are so large that they actually frustrate USWC's ability to provide
4 safe, reasonable and adequate services.

5 Resolution

6 We concur with Staff's emphasis on achieving the major initiatives listed by USWC for 2000.
7 We also share the concerns of USWC that the proposed penalties are so large that they actually
8 frustrate the purpose. With that in mind, we will approve the following additional penalties: For
9 each of the major initiatives listed by USWC that are not completed during 2000, USWC shall pay a
10 penalty double the cost to complete the initiative. For example, if they added 99 additional
11 technicians instead of the stated 100, the penalty would be double the cost of adding the 100th
12 technician. We believe this will provide an incentive to USWC to meet their stated objectives but not
13 severely penalize them for just missing the objective.

14 As to the on-going Tariff penalties, we concur with Staff that there needs to be additional
15 incentives. We concur with Staff's concept that the penalties pursuant to the Tariff should be
16 increased if USWC fails to meet the requirements in a particular service category in consecutive
17 years. We also agree with Applicants that it should not be an automatic doubling of the penalties if
18 the company can demonstrate good cause for failing to meet the appropriate standard. As a result, we
19 shall adopt as a rebuttal presumption Staff's proposed doubling of penalties when the company fails
20 to meet the same standard in consecutive years. The company will have an opportunity to
21 demonstrate why the circumstances at that time do not warrant a doubling of the penalties. While we
22 concur with Staff that penalty amounts should be doubled commencing in 2000, we shall also place
23 an additional limitation that no single violation will be subject to a penalty in excess of \$5,000.

24 Staff Condition No. 5

25 Condition No. 5 would require the merged company to commit to invest a minimum of \$692
26 million, for each of the next two years from the date of this Order, for capital expenditures for
27 infrastructure modernization and maintenance to achieve telephone service improvement in Arizona.
28 The \$692 million amount would maintain the 1999 Arizona capital expenditure level. While we

1 concur with Staff that penalty amounts should be doubled commencing in 2000, we shall also place
2 an additional limitation that no single violation will be subject to a penalty in excess of \$5,000.

3 Applicants asserted that they intended to continue to make necessary investments in Arizona.
4 However, Applicants opposed a specific commitment based solely on 1999 investment which was
5 substantially higher than the \$402 million average over the last five years. Applicants opined that the
6 Commission should focus on setting service quality levels and requiring USWC to meet those levels
7 instead of mandating the amount of investment.

8 Resolution

9 We generally concur with Applicants. The amount of investment will not necessarily
10 improve service quality. Based on the record, it is not clear why the 1999 investment level was
11 significantly higher than the recent historical average. Without evidence to support this as an on-
12 going investment requirement, we are not convinced this amount is needed on an annual basis. With
13 the on-going growth in Arizona, we can see no reason why Applicants would not be willing to
14 commit to an investment level for each of the years 2000 and 2001 at least in the amount of the
15 historical average of \$402 million. Accordingly, we shall condition our approval of the merger on
16 USWC committing to invest at least \$402 million for each of the next two years from the date of this
17 Order for capital expenditures for infrastructure modernization and maintenance. Because there is a
18 compelling need to upgrade Arizona's rural telephone services, 12% of the minimum amount of \$402
19 million dollars to be invested each of the next two years-roughly \$48.24 million dollars annually-
20 shall be used *specifically* to upgrade or extend telecommunication services in USWC rural exchanges
21 in central offices of 50,000 or less access lines.

22 Staff Condition No. 6

23 Condition No. 6 requires Applicants to agree and commit that Arizona work force levels shall
24 be maintained at levels that are required to provide good service to customers. It also requires
25 continuation of local authority for the five-year period after consummation of the merger. Condition
26 No. 6 requires the USWC executive position responsible for Arizona, the USWC executive position
27 responsible for service performance in Arizona, and the USWC executive position responsible for
28 installation and repair service in Arizona to continue to be located in Arizona for at least the next five

1 years.

2 CWA supported Condition No. 6. CWA asserted that USWC testified to the Commission in
3 October 1999 regarding USWC's inability to hire qualified employees. CWA opined that if the
4 Commission imposed employment levels it could provide Applicants the incentive to recruit and
5 retain a full time workforce.

6 Applicants indicated they fully intend to maintain a workforce adequate to provide high
7 quality service to its Arizona customers. Further, Applicants have no plans to change the executive
8 positions responsible for service quality in Arizona. Applicants also opined that it is not appropriate
9 to impose a specific work force level or organizational structure on USWC.

10 Resolution

11 We concur with Applicants that it is not appropriate for the Commission to impose a specific
12 work force level or organizational structure on USWC. However, it is appropriate for the
13 Commission to require a commitment from Applicants to maintain an adequate work force to insure
14 good quality service. Accordingly, we shall approve language agreed to by Applicants in Iowa as an
15 appropriate condition. That language is as follows:

16
17 "Applicants agree and commit that Arizona employees directly
18 involved in the provisioning and maintenance of service will not be
19 disproportionately reduced for two years beginning upon
20 consummation of the merger and that work force levels will be
21 maintained at levels that are required to provide good service
22 quality to customers."

23 Staff Condition No. 7

24 Condition No. 7 requires Applicants to convert all remaining USWC central office switches in
25 Arizona to digital switches by June 30, 2001. According to Staff, this simply formalizes previous
26 commitments of USWC. In response, Applicants indicated they expect to meet this commitment
27 however, they did not believe there was justification for imposing this as a condition to the merger.

28 Resolution

USWC has previously committed to the proposal contained in Condition No. 7. We find it
reasonable to include this commitment as a condition. Accordingly, we will approve Condition No.

7.

2 Staff Condition No. 8

3 Condition No. 8 requires the merged company to undergo periodic audits by independent
4 auditors to determine if the local public switched telephone network in Arizona is being adequately
5 maintained, expanded and modernized. According to Staff, the risk of service quality deterioration
6 justifies this requirement.

7 CWA opined that Condition No. 8 is the most crucial condition for approval of the merger.
8 Further, CWA noted that the Colorado Commission had ordered as a merger condition that annual
9 audits shall be performed by independent third parties. CWA asserted that independent audits are
10 necessary because of the historical conduct of both USWC and Qwest.

11 Applicants requested Condition No. 8 be rejected. Applicants criticized Condition No. 8 for
12 being unlimited in both dollar amount and duration. In addition, Applicants opined that such a
13 requirement would unnecessarily burden USWC without any corresponding benefits to the
14 ratepayers. As a result of Applicants' concerns, Staff incorporated a five year limitation on the
15 audits.

16 Resolution

17 We concur with the audit concept proposed in Condition No. 3. We also believe Applicants
18 have raised legitimate concerns. The Quality of Service Task Force may recommend to the
19 Commission one audit at that time to be conducted by an independent auditor to be completed by a
20 date agreed upon by the Commission Staff and the Company. The audit shall examine whether the
21 Company's network is being adequately maintained, expanded and modernized. It shall also examine
22 whether the Company's network maintenance, expansion and modernization is being done on a
23 reasonably comparable basis in rural, urban and suburban areas of the State. In addition, the audits
24 shall verify that the Company has complied with the investment levels and infrastructure
25 improvement requirements contained in this Order. Finally, the audit shall look at the quality of
26 service provided by the Company and whether it has improved since the merger. The Commission
27 Staff shall determine, subject to Commission approval, whether further audits or reporting
28 requirements are necessary, based upon the results of this audit. In order to encourage everyone to

1 keep the costs at a reasonable amount, we shall permit USWC to defer 50 percent of the costs for
2 inclusion in a future rate case.

3 Staff Condition No. 9

4 Condition No. 9 would prohibit USWC from paying dividends to the merged parent company
5 beginning in 2002 if USWC fails to meet all of the Arizona service quality standards. Staff opined
6 that this condition provides maximum incentive to improve service to adequate levels and is
7 reasonable in light of concerns over the merged company failing to adequately invest in Arizona.
8 CWA supported Condition No. 9 as a way to make USWC understand the Commission wants quality
9 of service problems resolved.

10 Applicants asserted that Condition No. 9 was an unwarranted intrusion upon the right of
11 USWC to manage itself and for its shareholders to earn a reasonable return on their investment.
12 Further, Applicants argued that Condition No. 9 was an unlawful penalty that exceeded the
13 Commission's constitutional and statutory authority.

14 Resolution

15 While we agree with Staff that Condition No. 9 will provide the maximum incentive to
16 improve service quality, we believe the other conditions imposed herein will provide sufficient
17 incentives for Applicant. Accordingly, we will not approve Condition No. 9.

18 Cost of Capital and Financing Conditions

19 Staff Condition No. 10

20 Condition No. 10 would require that the cost of capital as reflected in USWC's rates shall not
21 be adversely affected by the result of the Proposed Merger. It would require Applicant to agree and
22 commit to the use of any imputed or hypothetical capital structure in future cases to reflect the cost of
23 capital of USWC without the effects of the merger.

24 Applicant opined that Condition No. 10 was not reasonable. According to Applicants, any
25 such determination should be made in the context of a rate case proceeding and not part of this
26 docket.

27 Resolution

28 Clearly, ratepayers in Arizona should not have to pay higher rates as a result of the higher cost

1 of capital associated with Qwest. We find Condition No. 10 to be a reasonable requirement for the
2 protection of Arizona ratepayers.

3 Staff Condition No. 11

4 Condition No. 11 would preclude Applicants from obtaining credit under any arrangement
5 that would permit a creditor, upon default, to have recourse to USWC's regulated assets. Staff
6 indicated that Condition No. 11 would act to protect the local USWC assets from being placed at risk
7 as a result of the Proposed Merger.

8 In response, Applicants asserted that the Commission need not be concerned about the
9 creation of obligations with recourse against the assets of USWC because of the structure and
10 covenants of USWC's existing financials. Applicants indicated that if USWC were to pledge assets
11 to issue debt or allow affiliated companies to issue debt with recourse to USWC assets, the company
12 would have to modify all existing bond indentures (with current bondholders' approval) to provide
13 the same asset specific recourse to all bondholders.

14 Resolution

15 We generally concur with Staff. Condition No. 11 is a reasonable provision for the protection
16 of Arizona ratepayers and is almost identical to a provision agreed to by Applicants in Utah. We will
17 approve Condition No. 11 with a modification that subpart (g) shall expire no later than December
18 31, 2002 instead of 2005 as proposed by Staff. Subpart (g) generally requires Applicants to assure
19 rates are not increased as a result of adverse consequences directly caused by the merger. The further
20 out we go the more difficult it would be to determine if the merger was the cause of rates increasing.
21 For that reason, we will replace 2005 with 2002 in Condition No. 11

22 Accounting Conditions

23 Staff Condition Nos. 12 and 13

24 Conditions Nos. 12 and 13 require the merged entities to continue to follow the Uniform
25 System of Accounts for their regulated operations and make provisions to protect regulated
26 customers from being required to pay costs associated with the Proposed Merger as well as the
27 unconsummated merger with Global Crossing.

28 Applicants opposed Condition Nos. 12 and 13 primarily because they did not believe the

1 conditions were necessary. Applicants opined the existing rules and procedures should be adequate.

2 Resolution

3 While existing rules and procedures may be adequate, we find Condition Nos. 12 and 13 are
4 reasonable conditions consistent with existing rules and procedures that will assist the Commission in
5 its on-going regulatory oversight. Accordingly, we approve Condition Nos. 12 and 13.

6 Conditions Facilitating Regulation

7 Staff Condition Nos. 14 through 20

8 According to Staff, Condition Nos. 14 through 20 are all intended to facilitate the
9 Commission's ability to regulate USWC following the merger.

10 In general, Applicants opposed Condition Nos. 14 through 20 because they were not
11 necessary. Applicants asserted they intend to comply with existing laws and Commission rules and
12 therefore these proposed conditions are redundant.

13 Resolution

14 We find that Condition Nos. 14, 15, 17, 18, and 19 generally are conditions that require
15 Applicants to follow existing laws. While some of these may be redundant, we find them reasonable
16 and accordingly will approve them.

17 Condition No. 16 will require USWC to "maintain a state headquarters in Arizona that is
18 staffed sufficiently to at least maintain Arizona's local presence with government (other than
19 legislative and lobbying) entities and community organization."

20 Applicants opined that they will maintain a sufficient local public policy in Arizona following
21 the proposed merger.

22 Resolution

23 We find the language agreed to by Applicants in Utah to be an acceptable alternative to
24 Staff's proposal. Accordingly, we will approve the following language as Condition No. 16:

25 U S WEST Communications, Inc. will maintain a sufficient local
26 public policy presence in Arizona following the merger to allow
27 Arizona regulators, government agencies and community
28 organizations to have reasonable and adequate access to the
company.

1 Condition No. 20 requires transactions between USWC and affiliates to be structured so that the
2 Arizona operations of USWC will not be compromised.

3 Applicants opined that Condition No. 20 refers to "soundness and integrity" which will create
4 controversy and disagreement over the meaning of the words. As a result, Applicants opposed
5 Condition No. 20.

6 Resolution

7 This condition is virtually identical to a commitment made by Applicants in Iowa. We find it
8 to be reasonable and will approve Condition No. 20.

9 Staff Condition No. 21

10 Condition No. 21 requires the merged company shall provide a quarterly aggregate
11 Inter-carrier Monitory Report to the Commission Staff. The report is to contain inter-carrier
12 provisioning and repair data in comparison with the service which the merged company provides
13 itself. Staff proposed that Condition No. 21 remain in place until the Commission issues a final
14 decision in the Section 271 docket and the wholesale service quality docket.

15 Applicants opposed Condition No. 21 since these matters are being actively considered in
16 other dockets.

17 Resolution

18 We concur with Applicants. We do not find it necessary to impose interim wholesale service
19 quality standards as conditions to this Proposed Merger.

20 Staff Condition No. 24⁴

21 Condition No. 24 requires that competitors will be able to interconnect with, and make use of
22 essential elements, facilities, functions, and features of, the merged company on the same general
23 terms and conditions as with USWC.

24 In response, Applicants requested Condition No. 24 be rejected because USWC is already
25 required to comply with A.A.C. R14-2-1307(B) and A.A.C. R14-2-1310(C). Furthermore, Staff
26 indicated in its surrebuttal testimony that Condition No. 24 is not necessary if Condition No. 14 is
27

28 ⁴ Condition Nos. 22 and 23 were withdrawn by Staff.

1 adopted.

2 Resolution

3 Condition No. 14 has been adopted which makes Condition No. 24 not necessary.

4 Staff Condition No. 25

5 Condition No. 25 requires the merged company to improve the Operations Support System
6 (“OSS”) interfaces for Arizona CLECs and to agree to support any Arizona specific independent tests
7 of the OSS. In response, Applicants indicated the OSS interfaces are already the subject of
8 workshops and testimony as part of the pending Section 271 docket. As a result, Applicants opined it
9 is unnecessary to impose conditions as part of this docket.

10 Resolution

11 We find the language agreed to in the Utah Settlement is reasonable. Accordingly, we shall
12 approve the following Condition:

13
14 The merged company agrees to honor USWC’s commitment to the
15 Arizona-specific, independent tests of the OSS that are required by
the Commission.

16 Staff Condition No. 26

17 Condition No. 26 would require the merged company to provide DSL or similarly capable
18 service access to at least 75 percent of all customers within 18 thousand feet of each USWC wire
19 center in Arizona by December 31, 2002.

20 In response, Applicants asserted the decision to provision DSL capable loops should be made
21 by the market place. According to the Applicants, not all customers will demand DSL capable loops.
22 Applicants also opined that Condition No. 26 conflicts with Staff’s other conditions that place a
23 priority on improving the quality of basic telephone service.

24 Resolution

25 We concur with Applicants. While this Commission desires high quality telecommunications
26 service in all areas, the number one priority should be high quality basic phone service.

27 Staff Condition Nos. 27 and 28, RUCO Condition No. 1

28 Staff’s Condition Nos. 27 and 28 as well as RUCO’s Condition No. 1 provide for calculation

1 and sharing with customers of achieved merger “synergy” savings. Condition No. 28 provides for
2 rebates to customers based on the merger benefits. The rebate will be suspended after USWC has
3 reached full compliance with the Service Tariff.

4 Applicants opposed these conditions because of: (1) the difficulty of tracking and quantifying
5 the merger synergies; and (2) the ratemaking mechanism already is designed to pass any achieved
6 cost savings on the ratepayers.

7 Resolution

8 We concur with Applicants.

9 RUCO Condition No. 2

10 Because of the Proposed Merger’s potential harms to competition, RUCO recommended
11 Applicants provide new entrants temporary discounts off the standard unbundled rates and wholesale
12 prices. RUCO opined that the wholesale discounts will encourage competitors to enter the Arizona
13 market which will help resolve the service quality problems.

14 Applicants opined that RUCO has provided no evidence that discounts are necessary to
15 encourage competition in Arizona. According to Applicants, any discounts to competitors will have
16 to be recovered from the USWC residential and business customers. In addition, Applicants asserted
17 that such discounts would amount to an implicit subsidy that violates the letter and spirit of the 1996
18 Act.

19 Resolution

20 We concur with Applicants. Any modifications to the existing unbundled network element
21 rates and resale discounts should be established as part of the generic cost docket.

22 RUCO Condition No. 3

23 RUCO expressed concern that management’s priorities and goals may be diverted from rural
24 areas. As a result, RUCO recommended Applicants should be required to invest an average of \$300
25 per line, per year, in USWC’s 30 most rural wire centers for the next five years. According to
26 RUCO, this will not require any additional capital expenditures since USWC can shift some of its
27 existing capital budget away from urban areas.

28 Applicant’s opposed RUCO’s proposal. Applicants asserted that RUCO has made no

1 assessment of the needs of these exchanges. Further, Applicants opined that it would be more
2 appropriate to address the matter to the industry as a whole as part of the universal service docket.

3 Resolution

4 We concur with Applicants. There was not sufficient evidence to require USWC to invest an
5 average of \$300 per line, per year, in USWC's 30 most rural wire centers for a five-year period.
6 Furthermore, there was no evidence to support shifting existing capital budget away from urban areas
7 towards rural areas. With that said, we believe this matter should be further reviewed as part of the
8 USWC pending sale of rural exchanges.

9 Retiree Condition Nos. 1, 2, 3, 4, and 5

10 The Retirees expressed concerns that Applicants will misuse the \$5.7 billion surplus in the
11 USWC pension trust fund. According to the Retirees, there is currently nothing to prevent USWC
12 pension assets from being used to (1) provide pension and retirement benefits to Qwest executives
13 and employees (by expanding the USWC pension to include them); (2) provide early retirement
14 benefits and other "reduction in force" incentives for Qwest employees; and (3) medical and
15 disability benefits for Qwest executives and employees. The Retirees asserted the USWC pension
16 was intended for USWC retirees and the funds should be protected for that purpose. For that reason,
17 the Retirees proposed that any approval of the merger should be conditioned upon the following
18 terms:

- 19 1. The merged company must maintain USWC's pension and post-retirement benefits, at
20 a minimum, at existing benefits levels;
- 21 2. The merged company must implement a reasonable cost of living mechanism under
22 the pension plan, consistent with the legitimate benefit expectations of the USWC
23 retirees;
- 24 3. The merged company must provide an initial cost of living adjustment to make up for
25 the lack of any meaningful increase to retirees over the last 10 years;
- 26 4. The merged company must not use USWC pension funds to benefit Qwest employees
27 by, among other things, using the surplus plan assets to provide pension and other
28 post-retirement benefits for Qwest employees from USWC pension surplus; and

5. The allocation of the surplus of pension fund assets must be addressed in the pending USWC rate case, ACC Docket No. T-01051B-99-0105. (collectively referred to as the "TRAA Conditions").

CWA supported the Retirees.

In response, Applicants asserted the proposals of the Retirees lack any connection to the merger and have already been rejected in Colorado, Iowa, Montana, and Wyoming. Applicants indicated that the retiree benefits are protected under the Employee Retirement Income Security Act ("ERISA") as set forth in federal law. Applicants opined that the request for a cost of living increase seeks a benefit which the retirees are not entitled under the current plan. Applicants argued that the Commission does not have the authority to rewrite the Plan. Applicants did offer the following assurances: "No pension assets will be used as investment capital by the merged company, or to pay outstanding debts or obligations, other than for payment of U S WEST pension or other benefits as permitted by the Plan, the federal IRS code, and ERISA."

Resolution

We generally concur with Applicants. U S WEST and Qwest recognize the concerns expressed by retirees and the Commission, and U S WEST and Qwest will comply with their existing obligations under applicable collective bargaining agreements, pension and health care plans, the IRS Code and ERISA. The Company will use no pension assets in any way that is not permitted by the pension plan, the IRS code and ERISA.

Condition/Resolution

Applicants commit to preserve or enhance current Diversity Programs established by USWC for the purpose of continued development of minority recruitment and promotion within its Arizona operations.

Condition/Resolution

Based on the record, we can deduce that many quality of service problems are the result of internal discord between management and labor. Therefore, we will require that Applicants form a seven member Quality of Service Task Force, to be comprised of: 3 members representing the company's Arizona management team, 3 members representing the company workers' union, and 1

1 member from the Arizona Corporation Commission staff. The purpose of this committee shall be to
2 identify and prioritize Arizona specific quality of service problems, and find internal solutions for
3 short and long term remedies. The Task Force will present the Commission with its findings and
4 plan of action within 120 days of this Order, for full implementation by January 1, 2002. Nothing in
5 this condition shall be construed to limit either the Applicants or the Arizona Corporation
6 Commission from concurrently addressing quality of service issues in any other forum.

7 Qwest CC&N

8 During the merger proceedings, the Merger Applicants filed three additional filings, the
9 Supplement to the Joint Notice on February 25, 2000 (the 'Supplement'), the Addendum to the
10 Supplement on March 16, 2000 (the 'Addendum'), and the Further Addendum to the Supplement on
11 April 11, 2000 (the 'Further Addendum'). In these additional filings, the Merger Applicants
12 explained that as part of the consummation of the merger, to comply with Section 271 of the
13 Communications Act of 1934, as amended ('Section 271'), the subsidiaries of Qwest
14 Communications International, Inc. (the 'Qwest Subs') must cease providing interLATA service in
15 the U S WEST region.

16 Accordingly, to permit this restructuring/divestiture process – which is necessary for the
17 closing of the merger – to proceed, the merger applicants sought:

18 (a) Issuance of Certificates of Convenience and Necessity for TeleDistance, Inc.
19 ('TeleDistance') to provide in Arizona: (1) non-dominant, competitive resold and facilities-based
20 interexchange telecommunications services, and (2) alternative operator services;

21 (b) Authorization of the assignment of selected assets from the Qwest Subs to
22 TeleDistance; and

23 (c) Approval of the transfer of stock ownership of TeleDistance Holdings, Inc. ('TD
24 Holdings') from Qwest Communications International Inc. ('Qwest Inc.') to the buyer, Touch
25 America, Inc. ('Touch America').

26 Staff and the Applicants agree that the Commission should issue the requested CC&N,
27 authorize the assignment of assets and approve the transfer of stock ownership, provided that the
28

1 customers of the Qwest Subs are notified of the transfer of ownership at least 30 days prior to the
2 transfer of TD Holdings to Touch America. We concur.

3 Qwest Inc. shall pay any and all Primary Interexchange Carrier ("PIC") change charges
4 associated with the transfer of its interLATA customer base in Arizona to a Buyer or other
5 interexchange carrier, as long as the customer transfers to a new interLATA carrier of choice within
6 60 days of mailing of the customer notice informing the customer of the transfer and the new
7 interLATA carrier of choice has not otherwise paid, or would not in the ordinary course pay, the PIC
8 change charge. The Companies agreed to this same condition in Minnesota and we agree that
9 Arizona consumers should not bear the cost associated with what amounts to a Company rather than
10 a customer initiated transfer to another provider and that Qwest's customers should have some period
11 of time to change carriers, without being penalized, in the event they do not like the services of the
12 Buyer.

13 Summary

14 The Proposed Merger should make Applicants more competitive in the telecommunications
15 industry. Further, Applicants estimate there will be synergies over the next five years of \$12 billion.
16 Clearly, the Proposed Merger benefits the shareholders of the merged companies. However, this
17 Commission must balance the interests of the Arizona ratepayers with the interests of the
18 shareholders.

19 Because there is no effective competition in the USWC service area in Arizona, we are
20 concerned of the short-term risks to the ratepayers. USWC has been experiencing quality of service
21 problems which need to be corrected. While Applicants have opined they will provide satisfactory
22 quality of service, we can not accept their request to simply trust them to do the right thing. USWC
23 does not have an envious track record for quality of service. Applicants have indicated the merged
24 company will place an emphasis on broadband services. This will divert management attention away
25 from basic telephone service. Additionally, we agree with Staff and RUCO there is a risk of
26 investment capital being diverted from basic telephone service and invested in out-of-region markets
27 where there are greater growth opportunities. There is also the risk that the higher capital cost of
28 Qwest will result in higher rates for Arizona captive customers. Primarily as a result of the above

1 concerns, the Commission has adopted many of the conditions recommended by the parties. Without
2 such conditions to protect the interests of the Arizona ratepayers, we would have to deny the
3 Proposed Merger pursuant to A.A.C. R14-2-803(B) and Article XV of the Arizona Constitution for
4 the following reasons: 1) It would not be in the public interest; 2) It would impair USWC from
5 attracting capital at fair and reasonable terms; and 3) it would impair the ability of the public utility to
6 provide safe, reasonable and adequate service.

7 * * * * *

8 Having considered the entire record herein and being fully advised in the premises, the
9 Commission finds, concludes, and orders that:

10 **FINDINGS OF FACT**

11 1. USWC is a Colorado corporation engaged in providing telecommunications service to
12 the public within portions of Arizona pursuant to authority granted by this Commission.

13 2. On September 3, 1999, USWC and Qwest filed with the Commission a Joint Notice of
14 Proposed Merger.

15 3. NEXTLINK, GST, CWA, RUCO, SBC, Retirees, Payphones, Rhythms, Covad,
16 McLeodUSA, Cox, Sprint, and AT&T were granted intervention in this docket.

17 4. Our January 19, 2000 Procedural Order set the matter for hearing commencing on
18 March 29, 2000.

19 5. Our March 8, 2000 Procedural Order continued the hearing until April 27, 2000.

20 6. On July 18, 1999, Qwest and USWC entered into the Proposed Merger.

21 7. Qwest is a worldwide broadband internet communications company whose principal
22 business is providing leading-edge communications to business and consumers.

23 8. According to Applicants, the Proposed Merger will create a next generation
24 telecommunications company dedicated to bringing advanced voice, data and broadband Internet
25 communications with USWC's innovative local service offerings and leaderships in providing high-
26 speed Internet access through DSL technology.

27 9. The Act currently prohibits USWC from providing long distance telecommunications
28 services between LATAs within its 14 state region, and between these LATAs and locations outside

its region.

2 10. Upon the closing of the merger, the interLATA prohibitions would also apply to
3 Qwest.

4 11. Qwest and USWC expect to work actively to satisfy the regulatory conditions in the
5 Act so that interLATA services can be provided in particular states starting in 2000 and 2001.

6 12. During the period from 2000 through 2005, Applicants estimated the Proposed Merger
7 will enable them to achieve net financial and operational synergies of approximately \$10.5 billion to
8 \$11 billion.

9 13. Applicants expect these synergies will be comprised of 1) incremental revenues as the
10 combined company expands its local, data, Internet Protocol and long-distance service; 2) operating
11 cost savings in areas such as network operations and maintenance, sales and marketing, billing and
12 customer and back office support; and 3) capital savings through elimination of duplication in the
13 companies; planned network buildouts and in other infrastructure and back-office areas.

14 14. Applicants indicated the Proposed Merger will accelerate the delivery of Internet-
15 based broadband communications services provided by Qwest to the large customer base of USWC
16 and will bring together complementary assets, resources and expertise and the network infra-
17 structure, applications, services and customer bases, in a timely manner will permit each to compete
18 more effectively in their rapidly consolidating industries.

19 15. Staff, RUCO, Retirees and the CWA supported the Proposed Merger with conditions.

20 16. RUCO, Retirees, CWA, and Staff expressed concerns that if conditions are not
21 imposed, all the potential benefits would flow to Applicants while the risk of adverse consequences
22 will be borne by Arizona ratepayers.

23 17. RUCO and Staff presented evidence that the existing quality of service provided by
24 USWC is marginal.

25 18. USWC has had to pay penalties for failing to meet its Tariff requirements.

26 19. Qwest has a higher cost of capital than USWC.

27 20. USWC has a history of failing to meet the requirements of its Tariff.

28 21. There is a risk that as a result of the Proposed Merger, investment monies will flow to

1 out-of-region customers.

2 22. Qwest must divert itself of its in-region interLATA customers in order to merge with
3 USWC.

4 23. Applicants plan to concentrate on the broadband data business.

5 24. Most USWC customers do not purchase broadband services.

6 25. As a result of the Proposed Merger, there is a risk that necessary investments in the
7 existing voice network will be diverted to broadband services.

8 26. Arizona consumers of basic phone service have no effective competition for their
9 business.

10 27. Financing of pension plans has been a cost of service included in rates.

11 28. TeleDistance, Inc. ('CC&N Applicant' or 'TeleDistance') is a Delaware corporation
12 authorized to do business in Arizona since February 2000.

13 29. The Merger Applicants filed three additional filings, the Supplement to the Joint
14 Notice on February 25, 2000 (the 'Supplement'), the Addendum to the Supplement on March 16,
15 2000 (the 'Addendum'), and the Further Addendum to the Supplement on April 11, 2000 (the
16 'Further Addendum'). In these additional filings, the Merger Applicants explained that as part of the
17 consummation of the merger, to comply with Section 271 of the Communications Act of 1934, as
18 amended ('Section 271'), the Qwest subs must cease providing interLATA service in the U S WEST
19 region.

20 30. To effectuate the federally required divestiture, and for tax and business reasons,
21 Qwest Inc. established a new wholly owned direct subsidiary, TD Holdings, which has one wholly
22 owned subsidiary – TeleDistance.

23 31. Prior to the consummation of the merger, the Qwest Subs will assign the customers
24 and other assets to be divested to TeleDistance.

25 32. Qwest Inc. plans to sell the stock of TD Holdings to Touch America (the 'Stock
26 Transfer'), thereby transferring control over TeleDistance to Touch America. At such time, the name
27 of TeleDistance will be changed to Touch America Services, Inc. and the name of TD Holdings will
28 be changed to Touch America Services Holdings, Inc.

1 33. Accordingly, to permit this restructuring/divestiture process – which is necessary for
2 the closing of the merger – to proceed, the Applicants sought:

3 (a) Issuance of Certificates of Convenience and Necessity for TeleDistance to provide in
4 Arizona: (1) non-dominant, competitive resold and facilities-based interexchange
5 telecommunications services, and (2) alternative operator services;

6 (b) Authorization of the assignment of selected assets from the Qwest Subs to
7 TeleDistance; and

8 (c) Approval of the transfer of stock ownership of TD Holdings from Qwest Inc. to the
9 buyer, Touch America.

10 34. The Applicants published notice of the application pursuant to A.A.C. R14-2-1104
11 and R14-2-1105. On April 7, 2000, the Applicants filed affidavits of publication.

12 35. TeleDistance agrees to comply with and participate in the Arizona Universal Service
13 Fund mechanism instituted in Decision No. 59623, dated April 24, 1996 (Docket No. R-0000-95-
14 0498).

15 36. TeleDistance and the Applicants agree to comply with all Commission rules and
16 regulations.

17 37. On March 24, 2000, the Commission Staff pre-filed the direct testimony of Kevin
18 Mosier, which addressed the merger applicants' request that the Commission issue to TeleDistance a
19 CC&N, authorize the assignment of certain assets and approve the transfer of stock ownership of TD
20 Holdings from Qwest Inc. to Touch America. Staff recommended that the Commission issue
21 TeleDistance the requested CC&N, authorize the assignment of assets and approve the transfer of
22 stock ownership subject to certain conditions.

23 38. At the hearing on April 28, 2000, Qwest and Staff presented evidence on the issuance
24 of CC&N, the assignment of the assets to TeleDistance and the approval of the stock sale. Staff also
25 stated on the record that all of the conditions proposed in its pre-filed testimony were satisfied by the
26 Applicants' subsequent filings, except for the proposed condition that the Applicants provide notice
27 concerning the transfer to affected customers.

1 39. The management team of Touch America has many years of experience in the
2 telecommunications industry.

3 40. Touch America and TeleDistance have the technical capability to provide the services
4 that are proposed in the application.

5 41. Currently, there are several incumbent providers of resold and facilities-based
6 interexchange telecommunications services and alternative operator services in the service territory
7 requested by TeleDistance.

8 42. It is appropriate to classify all of TeleDistance's authorized services as competitive.

9 43. The Applicants have submitted the financial statements of Touch America's parent
10 company, Montana Power, including the Securities and Exchange Form 8-K and Form 10-K, which
11 demonstrate that Touch America garnered over \$84 million in revenues for the year ending
12 December 31, 1999, resulting in operating income of over \$35 million. Audited financial statements
13 for fiscal year 1998 set forth telecommunications revenues in excess of \$87 million, with income
14 after expenses of nearly \$50 million.

15 CONCLUSIONS OF LAW

16 1. USWC is a public service corporation within the meaning of Article XV of the
17 Arizona Constitution and within the meaning of A.R.S. §§ 40-250 and 40-251.

18 2. The Commission has jurisdiction over Applicants and of the subject matter of the
19 application.

20 3. Notice of the Proposed Merger was given in accordance with the law.

21 4. Pursuant to A.A.C. R14-2-803(B) and Article XV of the Arizona Constitution, the
22 Proposed Merger should be approved with the Conditions set forth herein.

23 5. Notice of the CC&N application was given in accordance with the law.

24 6. A.A.C. R14-2-1105 allows a telecommunications company to file an application for a
25 Certificate to provide competitive telecommunications services.

26 7. Pursuant to Article XV of the Arizona Constitution as well as the Competitive
27 Telecommunications Service Rules, A.A.C. R14-2-1101 *et seq.* ('Competitive Rules'), it is in the
28

1 public interest for the CC&N Applicant to provide the telecommunications services set forth in its
2 application.

3 8. With the conditions stated below, TeleDistance is a fit and proper entity to receive a
4 Certificate authorizing it to provide non-dominant, competitive resold and facilities-based
5 interexchange telecommunications services and alternative operator services in Arizona.

6 9. Pursuant to A.A.C. R14-2-1108, the telecommunications services that Applicant
7 intends to provide are competitive within Arizona.

8 10. Pursuant to Article XV of the Arizona Constitution as well as the Competitive Rules,
9 it is just and reasonable and in the public interest for the CC&N Applicant to establish rates and
10 charges which are not less than the Applicant's total service long-run incremental costs of providing
11 the competitive services approved herein.

12 11. The Applicants have complied fully with the requirements in A.A.C. R12-2-1002(D).

13 12. Staff's recommendation that the customers of the Qwest Subs be notified of the
14 transfer of ownership to Touch America prior to the transfer is reasonable and is adopted as set forth
15 below.

16 **ORDER**

17 IT IS THEREFORE ORDERED that the Joint Notice of Proposed Merger is hereby approved
18 subject to the conditions contained herein.

19 "IT IS FURTHER ORDERED that the Application of TeleDistance (which shall be renamed
20 Touch America Services, Inc.) for a Certificate of Convenience and Necessity for authority to
21 provide non-dominant, competitive resold and facilities-based interexchange telecommunications
22 services and alternative operator services in Arizona shall be, and is hereby, granted, as conditioned
23 below.

24 IT IS FURTHER ORDERED that the Qwest Subs may retain their Certificates of Convenience
25 and Necessity post-merger, provided that such companies may not provide interLATA services post-
26 merger, prior to the combined company's compliance with Section 271.

27 IT IS FURTHER ORDERED that the petition of TeleDistance to determine that its
28 telecommunications services are competitive is hereby approved.

1 IT IS FURTHER ORDERED that the assignments of selected assets from the Qwest Subs,
2 necessary to satisfy Section 271, to TeleDistance is authorized.

3 IT IS FURTHER ORDERED that the transfer of stock ownership of TD Holdings from Qwest
4 Inc. to Touch America is approved.

5 IT IS FURTHER ORDERED that at least 30 days prior to transfer of ownership to Touch
6 America, the customers of the Qwest Subs shall be provided notice of the transfer.

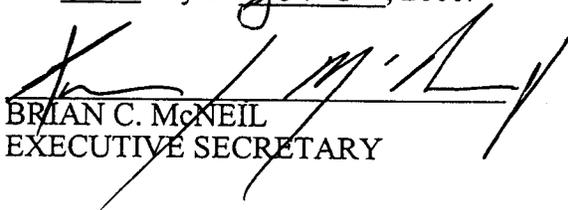
7 IT IS FURTHER ORDERED that Qwest Communications Corporation and U S WEST
8 Communications, Inc. shall provide assurances that Touch America, Inc. shall comply with all the
9 conditions required of Teledistance, Inc. as part of this docket.

10 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

11 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

12
13   
14 CHAIRMAN COMMISSIONER COMMISSIONER

15
16 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
17 Secretary of the Arizona Corporation Commission, have
18 hereunto set my hand and caused the official seal of the
19 Commission to be affixed at the Capitol, in the City of Phoenix,
20 this 30th day of June, 2000.

21 
22 BRIAN C. McNEIL
23 EXECUTIVE SECRETARY

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T-01051B-99-0497

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EXPLANATION OF VOTE

COMPANY: US WEST/QWEST MERGER

OPEN MEETING DATE: June 28, 2000

DOCKET NO. T-01051B-99-0497

AGENDA ITEM: U-1

PREPARED BY: Commissioner Mundell

DATE: June 30, 2000

WAM

My vote in support of the US West/Qwest merger application was made after careful consideration of all of the issues encompassed by the merger application. Safeguarding the needs of Arizona consumers in a developing competitive telecommunications market was a paramount concern. I concluded that the merger is in the public's interest and will enhance the prospects of better service quality delivered at fair and reasonable prices. In addition, I am also confident that the multi-stage approval process involving the federal government and state utility regulators has led to a better deal for consumers without adversely affecting shareholders. I am hopeful that the merger will produce better telecommunications services for Arizonans served by US West/Qwest.

More importantly, I wanted the retirees and employees to have additional time to review the language that may impact their benefits. My motion to give retirees and employees such an opportunity was unfortunately not supported by my colleagues. I will continue to closely scrutinize US WEST/Qwest's commitment to its employees and retirees and their benefits.

