BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN.	))))	DOCKET NO. T-01051b-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	))))	DOCKET NO. T-00000D-00-0672

DIRECT

TESTIMONY

OF

MATTHEW ROWELL

CHIEF ECONOMIST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 18, 2004

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Executive Summary

My testimony explains Staff's recommendations concerning the changes Qwest has proposed to its Price Regulation Plan.

Qwest has proposed elimination of the inflation/productivity factor as part of a revised plan. Staff supports the proposed elimination of the inflation/productivity factor. Qwest has proposed the elimination of the revenue cap on Basket 3 services. Staff does not support elimination of the Basket 3 revenue cap. Qwest has proposed that all packages be treated as Basket 3 services. Staff supports treating all Packages as Basket 3 services with certain restrictions. Qwest has proposed that all new services be treated as Basket 3 services automatically. Staff does not support treating all new services as Basket 3 services automatically.

Qwest has proposed the concept of Competitive Zones whereby Qwest will have significant pricing flexibility in certain geographic areas. Staff supports the concept of Competitive Zones but can not support the specific proposal that Qwest has offered. Staff offers an alternative Competitive Zone proposal.

Qwest has proposed that Voicemail services and Billing and Collection services be deregulated. Staff supports deregulation of these services. Qwest has proposed alterations to its Promotional tariffs that Staff also supports.

My Testimony addresses the competitive aspects of Qwest's proposal to receive AUSF support. (Staff Witness Thomas Regan presents Staff's primary recommendation on Qwest's AUSF proposal.

My Testimony also contains a discussion of the competitive situation in the Arizona telecommunications market and contains recommendations relevant to competition.

I. Introduction

Q. Please state your name and business address for the record.

A. My name is Matthew Rowell. My business address is: Arizona Corporation Commission, 1200 W. Washington St., Phoenix, Arizona 85007.

Q. What is your position at the commission?

A. I am the Chief of the Telecommunications and Energy section of the Commission's Utilities Division.

Q. Please describe your education and professional background.

A. I received a BS degree in economics from Florida State University in 1992. I spent the following four years doing graduate work in economics at Arizona State University where I received a MS degree and successfully completed all course work and exams necessary for a Ph.D. My specialized fields of study were Industrial Organization and Statistics. Prior to my Commission employment I was employed as a lecturer in economics at Arizona State University, as a statistical analyst for Hughes Technical Services, and as a consulting research analyst at the Arizona Department of Transportation. I was hired by the Commission in October of 1996 as an Economist II. I was promoted to the position of Senior Rate Analyst in November of 1997 and to Chief Economist in July of 2001. In my current position I am responsible for supervising nine professionals who work on a variety of telecommunications and energy matters.

Q. What is the purpose of your testimony?

A. My testimony will explain Staff's recommendations regarding Qwest Corporation's ("Qwest") filing for a renewed price regulation plan. Specifically my testimony will address the changes to Qwest's current price regulation plan that Staff recommends.

Q. Please summarize the provisions of Qwest's current price regulation plan.

A. In Decision No. 63487 (March 30, 2001) the Commission approved an alternative form of regulation ("AFOR") plan for Qwest. The AFOR divided Qwest services in to three baskets:

- Basket 1: Basic/Essential Non-Competitive Services
- Basket 2: Wholesale Services
- Basket 3: Flexibly-Priced Competitive Services

Basket 1

The weighted average price level ("Price Index") of all services contained in Basket 1 is capped using an annual inflation/productivity adjustment factor (described in detail below.) On an annual basis Qwest adjusted prices in Basket 1 to account for the effect of the inflation/productivity adjustment. Prices for many services could be adjusted up or down with 30 days notice (but increases were capped at 25% per year.) Certain basic services in Basket 1 have "hard caps," that is, their prices can not increase (but they can decrease.) Individual service prices must exceed Total Service Long Run Incremental Cost ("TSLRIC") and comply with the imputation requirements of A.A.C. R14-2-1310(C).

Basket 2

Basket 2 contains wholesale services such as access charges, PAL lines, and Unbundled Network Elements ("UNEs.") Many of these services are governed by their own specific pricing rules and those rules continued during the term of the AFOR. Intrastate switched access rates were to reduce by $5 million per year during the initial term of the plan.

Basket 3

Basket 3 includes services that have been accorded pricing flexibility or have been determined to be competitive under A.A.C. R14-2-1108. The Basket 3 price cap index was set at the then existing revenues from Basket 3 services plus 13.4% and was adjusted upwards by $5 million a year to account for the access charge reductions. New services could be placed in Basket 3, however, the Commission can require a different classification. New services are filed as tariff filings. Packages of services from Basket 1 and Basket 3 need to be filed for review by Staff, pursuant to A.A.C. R14-2-1108. The price of a Basket 3 service or service package must exceed the TSLRIC of the service or package and comply with the imputation requirements of A.A.C. R14-2-1310(C).

Q. What changes has Qwest requested to its Price Regulation plan in its May 20, 2004 filing?

A. Qwest is proposing five basic changes to the AFOR.[1] First, Qwest proposes to eliminate the inflation/productivity adjustment factor for the cap on Basket 1.

Second, Qwest is proposing a slight downward adjustment in the Basket 1 Price Index Cap and elimination of the zone charges for basic service in retail Zones 1 ($1.00) and 2 ($2.00.)

Third, Qwest is proposing a Competitive Zone plan, whereby it would be allowed additional pricing flexibility within certain geographic areas that are determined to be competitive.

Fourth, Qwest proposes to eliminate the revenue cap[2] on Basket 3.

Fifth, Qwest proposes that any new services should automatically be considered Basket 3 services and that its promotional offerings be subject to the same conditions as its competitors.

[1] In its original filing Qwest had also proposed a sub-basket in Basket 2 for competitive wholesale services. However, that request does not appear in Qwest's revised filing so Staff is assuming the company is no longer pursuing it.
[2] Note that "revenue cap" and "price cap index" are synonymous.

II. The Inflation/Productivity Adjustment Factor and the Price Regulation Plan

1. Overview of the various types of alternative forms of regulation ("AFORs").

Q. Why have Federal and State Commissions implemented alternative forms of regulation ("AFORs")?

A. Some commissions have recognized that traditional rate base rate of return ("ROR") regulation created an environment that did not provide incentives for utility companies to operate in the most efficient manner. Because ROR provided the utility with its costs and a return on investment, some experts contend that it was possible that the utility would over-invest in plant and equipment in order to increase its earnings. Alternative forms of regulation were implemented to increase the incentive for utilities to provide their services more efficiently.

Q. What types of AFORs have been implemented for telecommunications companies?

A. AFORs that have been implemented include indexed price cap plans, price cap plans, rate freezes, price cap plans with earnings sharing, and price cap plans with revenue sharing.

Q. What is a pure price cap plan?

A. A pure price cap plan is one where there are no changes to the maximum rates that a company can charge during the term or the plan. Under this type of plan, any revenues and earnings are limited only by the company's ability to generate revenues and profits. Pure price cap plans are essentially the same as rate freezes.

Q. Did Commissions modify pure price cap plans when they were initially introduced?

A. Yes. Because price cap plans were untested, Commissions modified pure price cap plans in order to prevent unexpected results. The modifications most Commissions adopted were the implementation of earnings sharing and revenue sharing.

Q. Please describe an indexed price cap plan.

A. An indexed price cap plan is one where rates for individual services or groups of services may change by an amount that results from the application of a formula. The formula that is used may include such items as an adjustment to the cap that is based on changes in the rate of inflation, a measure of the expected productivity gain, and changes outside the utility's control. The current price cap plan for Basket 1 services in Arizona can be described as an indexed price cap plan.

Q. Please describe earnings sharing.

A. Under an earnings sharing regime, no change to a company's rates are made if the earnings fall between a range above and below the target rate of return (sometimes called the dead band). In some instances, returns above the upper limit of the dead band are returned to ratepayers in the form of payments or credits. In addition, a return level was generally specified beyond which all earnings are returned to ratepayers. Rate adjustments may have been included that allowed for increases in rates if earnings fell below certain levels. Since an earnings sharing plan requires that a company's earnings be periodically verified, such plans have been characterized as administratively burdensome.

Q. What is a revenue cap plan?

A. A revenue cap plan is similar to a price cap plan. The difference is that instead of capping prices for services or groups of services, revenues for service are limited. The cap may be adjusted to account for such things as customer growth, changes in inflation and productivity. Qwest's Basket 3 services in Arizona are essentially under a pure revenue cap.

Q. How is earnings sharing different from revenue sharing?

A. With earnings sharing, earnings above a certain level are returned, in whole or in part, to ratepayers. In a revenue sharing plan, revenues above a certain level are returned in whole or in part to ratepayers. The issues associated with verifying whether the company did or did not experience positive earnings levels are avoided with a revenue sharing approach.

Q. Do you have any information on the evolution of AFORs?

A. Yes. Table 1 is informative. It shows the number of states that adopted AFORs over the past two decades.

Table 1 Number of States with:

Year	Rate of return regulation	Rate case moratoria	Earnings sharing regulation	Price Cap Regulation	Other
1985	**50**	**0**	**0**	**0**	**0**
1986	**45**	**5**	**0**	**0**	**0**
1987	**36**	**10**	**3**	**0**	**1**
1988	**35**	**10**	**4**	**0**	**1**
1989	**31**	**10**	**8**	**0**	**1**
1990	**25**	**9**	**14**	**1**	**1**
1991	**21**	**8**	**19**	**1**	**1**
1992	**20**	**6**	**20**	**3**	**1**
1993	**19**	**5**	**22**	**3**	**1**
1994	**22**	**2**	**19**	**6**	**1**
1995	**20**	**3**	**17**	**9**	**1**
1996	**15**	**4**	**5**	**25**	**1**
1997	**13**	**4**	**4**	**28**	**1**
1998	**14**	**3**	**2**	**30**	**1**
1999	**12**	**1**	**1**	**35**	**1**
2000	**8**	**1**	**1**	**39**	**1**
2001	**7**	**1**	**1**	**40**	**1**
2002	**8**	**1**	**1**	**38**	**2**
Source:	**Sappington, David E. M., "The Effects of Incentive Regulation of Retail Telephone Service Quality in the United States," Review of Network Economics, Vol. 2, Issue 4, December 2003, pp. 355 - 375.**				

2. The inflation/productivity adjustment factor

Q. What was the purpose of the inflation/productivity factor?

A. The purpose of the inflation/productivity factor was to provide an incentive for Qwest to provide service more efficiently and at the same time to prevent Qwest from reaping excessive benefits had the AFOR not worked as expected.

Q. What is the current price cap formula for Basket 1 Services?

A. The current formula for the Price Cap Index for Basket 1 is:

$$1.00 + \%?\text{GDP-PI} - \text{X-Factor} = [\text{SUM } [P_N*Q_b]] / [\text{SUM } [P_q*Q_b]]$$

The left side of the above formula is the inflation/productivity adjustment factor. Essentially, it is inflation minus productivity. The change in GDP-PI (Gross Domestic Product Price Index) is an accepted measure of inflation and the X-factor is an estimate of annual productivity increases. The right side of the formula is the Price Cap Index. The numerator of the Price Cap Index is the sum of the proposed/new prices multiplied by the "base year" quantities of demand. Where price changes have not occurred the base year prices are used. The denominator is the sum of the base year prices multiplied by the "base year" quantities of demand.

Q. What was the rationale for including each of the price cap formula components?

A. GDP-PI is included as a measure of inflation that is intended to allow for real prices of services to remain constant over the term of the plan. This factor allows Qwest to change prices so that it can at least keep up with inflation. The X-Factor is an estimate of the change in productivity that can be expected over the term of the plan. This component provides Qwest with an incentive to make productivity gains that are greater than the estimated "normal" gain. If Qwest is able to exceed the normal productivity gains, it is able to retain those earnings for itself.

Q. What value was assigned to the X-Factor in the Settlement agreement that was approved by the Commission?

A. The X-Factor in the Settlement Agreement is 4.2 percent.

Q. Who establishes the GDP-PI?

A. GDP-PI is produced by the U.S. Department of Commerce, Bureau of Economic Analysis.

Q. What were the effects of the productivity factor on Qwest's revenues during the term of the plan?

A. Table 2 shows the revenue effects of the productivity factor and how it was calculated:

Table 2

Date	%?GDP-PI	Productivity Offset %	Adjustment %	Revenue Effect

April 2002	2.348	- 4.2	- 1.852	-$14.391M
April 2003	0.764	- 4.2	- 3.4358	-$28.321M
April 2004	1.678	- 4.2	- 2.5222	-$18.318M

Q. Are there any limitations on how price adjustments can be made as a result of the application of the formula?

A. Yes. Certain of the Basket 1 services have been "hard capped" meaning that even if the application of the formula results in a net increase in revenues for Basket 1, the rates for these services will not increase. These services are flat rate residential; flat rate business; 2- & 4-party service; exchange zone increment charges; low use option service; service stations service; telephone assistance programs; individual PBX trunks, including features; toll blocking; 900/976 blocking and basic listing service. In addition, prices for the remainder of the services included in Basket 1 may not increase by more than 25 percent in any one plan year.

Q. How is this different from other price cap plans that have been implemented?

A. Most Price Cap Plans do not currently include a hard cap and a productivity offset for retail service rates.

Q. Have you reviewed any information on the use of price indices and productivity offsets in other states' Price cap plans?

A. Yes. I reviewed the Commission Orders for Utah, New Mexico, Washington and Oregon. In addition, I reviewed information provided by the National Regulatory Research Institute and the State Telephone Regulation Report.

Q. For states in Qwest's RBOC region, what is the current regulatory treatment for services equivalent to those included in Basket 1?

A. Table 3 provides information on the current regulatory treatment of Basket 1 services in other Qwest states:

Table 3

State	2003	2004
CO	NI PC	NI PC
ID	Dereg, NI PC or RoR	Dereg, NI PC or RoR
IA	I PC	I PC
MN	NI PC	NI PC
MT	RoR	RoR
NE	N R	N R
NM	NI PC	NI PC
ND	NI PC	NI PC
OR	R F	R F
SD	NI PC	Dereg
UT	I PC	I PC
WA	RoR	RoR
WY	NI PC	Dereg or N R

Where:
NI PC - Non-Indexed Price Cap
I PC - Indexed Price Cap
RoR - Rate of Return Regulation
N R - Rates not Reviewed
R F - Rate Freeze
Dereg - Deregulated

Q. What is the prevalence of the use of inflation/productivity adjustment factors in state price cap plans?

A In the Qwest states, only Iowa and Utah include a productivity offset in their price cap formulas. Iowa's productivity offset is 2.6% while Utah's is 4.95%. In total twelve of the fifty states employ inflation/productivity adjustment factors. Table 4 shows the states that have inflation/productivity adjustment factors and the value for the X-factor (or productivity offset) in each state:

Table 4

State	X-Factor
Utah	4.95%
Arizona	4.2%
Delaware	3%
Illinois	3%

Wisconsin	3%
Iowa	2.6%
Kansas	2.3%
Tennessee	2%[3]
Michigan	2%
North Carolina	2%
Florida	1%
Maryland	3 year average of CPI

Source: State Telephone Regulation Report, July 30, 2004; August 13, 2004; and August 27, 2004

Besides the states listed above there are several states that have an inflation adjustment factor without any productivity offset. That is, the price cap is indexed to the percent change in the GDP-PI (or some fraction of it) without any adjustment.

Q. Is Staff aware of any Arizona utility besides Qwest that is subject to an inflation/productivity adjustment factor?

A. No.

Q. What was the basis for the current inflation/productivity factor?

A. The current inflation/productivity factor was the result of settlement negotiations.

Q. What is Qwest's proposal with respect to the inflation/productivity adjustment factor?

A. Qwest proposes to eliminate the inflation/productivity adjustment factor.

Q. Are circumstances sufficiently different today such that Qwest's proposal regarding the elimination of the inflation/productivity adjustment factor is justifiable?

A. Yes. At the time that the initial price cap plan was implemented, Qwest had been operating in an environment where it had limited competition and little incentive to increase its efficiency in the provision of services. In addition, Qwest was not subject to competition in its core business to the extent that it is today. Staff's analysis of Qwest's financial and competitive information suggests that Qwest is losing lines and revenues as a

[3] Actual index formula for Tennessee is the lesser of one-half of GDP-PI or GDP-PI minus 2%.

result of that competition. Given the line and revenue losses that Qwest has experienced recently Staff does not believe a productivity adjustment is appropriate. In an environment where revenues are growing a productivity adjustment may be appropriate to provide incentives to the company to operate efficiently. However, in an environment where revenues are declining imposing such incentives should not be necessary.

Q. What did the Commission have to say about the inflation/productivity adjustment factor in the Decision that approved implementation of the price cap plan?

A. In Decision No. 63487, beginning page 10, line 27, the Commission indicated that if the Commission finds at the end of the initial three year term of the plan that Qwest has enjoyed greater productivity gains than it has in the past the productivity factor could be adjusted.

Q. What is your recommendation on Qwest's proposal to eliminate the productivity offset?

A. Staff recommends that the Commission not include a productivity offset in a renewed Price Regulation Plan for Qwest.

3. Revenue Cap on Basket 3

Q. What is Qwest's rational for eliminating the revenue cap on Basket 3?

A. Qwest argues that the prices in Basket 3 are effectively constrained by competition and therefore no revenue cap is necessary.[4]

Q. What is Staff's recommendation on eliminating the cap on Basket 3?

A. Staff does not support eliminating the revenue cap on Basket 3 due to fair value considerations. Since Qwest still has a mix of both competitive and noncompetitive service offerings, Staff believes the revenue cap serves an important purpose under existing case law. This issue will be addressed fully in Staff's legal briefs.

Q. What is Staff's recommendation regarding the revenue cap on Basket 3?

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[4] Ziegler p. 10, lines 21- 22.

A. Staff witness Mike Brosch testifies that Qwest is currently experiencing a revenue deficiency of $3.53 million. Also, Staff witness Thomas Regan testifies that the rate design changes recommended by Staff will result in a reduction in Qwest's revenue of $7,193,350. This reduction is mainly due to a reduction in Access Charges of $8.9 million.[5] In light of that, Staff believes it is appropriate to increase the revenue cap on Basket 3 by $10,723,350 ($3,530,000+ 7,193,350.) Additionally, the Basket 3 and Basket 1 revenue caps should also be adjusted to account for the services and service packages that are moved from Basket 1 to Basket 3. The final revenue caps on Baskets 1 and 3 should be determined during the compliance phase of this case when it will be know which Baskets will contain which services.

4. Qwest's Proposals Regarding New Services and Packages

Q. Please explain Qwest's proposals regarding new services and packages.

A. Qwest proposes that service packages that contain both Basket 1 and Basket 3 services be considered Basket 3 services without the A.C.C. R14-2-1108 review that is now required. Qwest also recommends that all new services be considered Basket 3 services.[6]

Q. What consumer harm may occur if Qwest is allowed to automatically package Basket 1 and Basket 3 services?

A. Since the prices of Basket 3 services are flexible, consumers may end up paying more for a package of services than they would if they purchased the services separately. In order to protect consumers from this eventuality Staff recommends that a hard cap be placed on any packages that contain Basket 1 services. The hard cap should equal the sum of all the ala carte prices of the individual services in the package.

Q. What other consumer protections does Staff recommend?

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[5] Other rate design changes recommended by Mr. Regan result in a combined increase in Qwest's revenue of $1,706, 650 which offsets the $8.9 million access charge reduction for a total impact of 7,193,350.
[6] Revised Price Cap Plan Attachment to Qwest's May 20, 2004 filing, Page 3.

A. Qwest's proposal includes the provision that any Basket 1 service that is included in a package will continue to be offered on a stand alone basis. Staff supports this provision.

Q. What is Staff's recommendation regarding Qwest's proposal to move all packages to Basket 3?

A. As long as the two recommendations regarding consumer protections discussed above are implemented, Staff is not opposed to moving all packages to Basket 3.

Q. How many new services has Qwest introduced over the initial term of the AFOR?

A. Staff's research indicates that sixteen new services have been introduced by Qwest during the term of the AFOR. Fourteen new services were placed into Basket 1 when introduced:

1. 4/3/2001 Intro Number Forwarding
2. 4/3/2001 Intro Four New Features
3. 4/23/2001 new DSS contracting option
4. 11/19/2001 Intro Qwest Business Line Plus
5. 12/31/2001 Intro ValueChoice
6. 2/19/2002 211, 311 & 511
7. 4/15/2002 Intro Popular Choice and CustomChoice Complete
8. 6/24/2002 Two Line CUSTOMCHOICE Complete
9. 1/13/2003 Intro Digit Manipulation
10. 9/22/2003 Intro Selective Call Waiting
11. 1/5/2004 Intro QWEST CHOICE Home and
12. QWEST CHOICE Home Two-Line
13. 3/2/2004 Business Line Volume Purchase Plan
14. 7/6/2004 Intro new residence packages

Two new services were placed into Basket 3 when introduced:

1. 4/3/2001 Anywhere Voice Mail
2. 9/30/2002 Intro Managed Long Distance

Staff notes that these last two services were placed into Basket 3 because they are substantially similar to services that were already in Basket 3.

Q. What does Staff recommend regarding the introduction of new services by Qwest?

A. Staff does not believe that a presumption that *all* new services are competitive is appropriate. Most new services are extensions of or add-ons to basic local service. That is, they are only available to (or useful to) customers who already take basic local service from Qwest. Thus, it would be inappropriate to classify them as competitive on a state-wide basis when there are areas of the state where basic local service is not competitive. Therefore, Staff believes that the current process of evaluating new services through an R14-2-1108 filing should remain in place.

Q. What other recommendations does Staff have regarding service packages and new services?

A. Qwest's proposal provides that the price of all service packages and new services should exceed their TSLRIC and comply with the imputation requirements of A.A.C. R14-2-1310(c). Staff supports this provision.

Q. Has Staff prepared a proposed Revised Price Cap Plan?

A. Yes. A proposed Revised Price Cap Plan is provided as Exhibit 1 to my testimony.

III. Competitive Zones

Q. What is Staff's general recommendation regarding Qwest's Competitive Zone proposal?

A. In general, Staff supports additional pricing flexibility for Qwest where competition warrants it. While Qwest's proposal contains several aspects that concern us, Staff is not opposed to the general idea of Competitive Zones.

1. Qwest's Proposal

Q. Please describe Qwest's Competitive Zone proposal.

A. Qwest proposes that certain geographic areas should be deemed by the Commission to be "Competitive Zones." Initially, Qwest is proposing that the geographic areas to be considered should be the wire centers. If a wire center is deemed to be a Competitive Zone, *all* the services Qwest offers in that wire center will be considered to be Basket 3 services and will thus have flexible prices. Additionally, under Qwest's proposal, Qwest will be allowed to price its services differently in each Competitive Zone.

Q. What is a wire center?

A. Technically a wire center is the physical structure where an ILEC's local lines are terminated to a switch or switches, also known as a Central Office or end office.[7] When Qwest (and Staff) use the term wire center in the context of the Competitive Zone discussion, what we really mean is the wire center serving area, i.e., the geographic area that is served by a single wire center. I will follow Qwest's convention and refer to the wire center service area simply as a wire center. In densely populated urban areas wire centers can be quite small geographic areas. In rural areas wire centers can be quite large. In the Phoenix metropolitan statistical area (MSA) there are approximately 64 different wire centers. In the Tucson MSA there are approximately 22 wire centers. Whereas there are only approximately 47 wire centers in Qwest's service territory outside of the Phoenix and Tucson MSAs. In total there are approximately 133 Qwest wire centers.

Q. Are wire centers the only geographic area that Qwest is proposing be considered for Competitive Zone treatment?

A. Qwest has provided a list of wire centers that it believes should be classified as Competitive Zones in this proceeding (63 in the Phoenix MSA and 19 in the Tucson MSA.) However, Mr. Teitzel testifies that since CLECs often target smaller geographic areas such as business parks and housing developments, Qwest should have the flexibility to seek Competitive Zone treatment for these smaller areas in the future.[8]

Q. What pricing flexibility is Qwest seeking within Competitive Zones?

A. Qwest proposes that within Competitive Zones all services shall have a maximum rate and that as long as the actual price of a service does not exceed the maximum rate, price changes will go into effect immediately upon notice to the Commission by filing of a

[7] See Newton, Harry *Newton's Telecom Dictionary 20th Edition* CMP Books 2004
[8] Tietzel p.72 line 18 – p. 73 line 1

revised price list.[9] Qwest also wants the ability to set different actual rates for the same service in different Competitive Zones, i.e., in different wire centers.

Q. What criteria does Qwest propose be used to establish a Competitive Zone?

A. Qwest's proposed criteria are quite simple. Qwest proposes that a wire center be deemed a Competitive Zone if *any one* of the following criteria is met:

1. A competitor has facilities in place and is marketing or offering services in competition with Qwest; or,
2. A competitor is marketing or offering services through the provision of unbundled network elements provided by Qwest; or,
3. A competitor is marketing or offering services through the resale of Qwest's service.[10]

Q. How does Qwest propose the maximum rates for services in Competitive Zones be set?

A. It is not clear how the maximum rates for services provided within Competitive Zones will be set under Qwest's proposal. Nowhere in Qwest's testimonies is it explained how the level of the maximum rates would be determined; it is only stated that Qwest will file tariffs with maximum rates.[11] In response to Staff data request 15-2 which asked how Qwest proposed the maximum rates be established, Qwest stated that the maximum rates in Competitive Zones could be higher than current rates but offered no insight into how the level of maximum rates would be determined.

Q. Would Qwest's Competitive Zone proposal give Qwest the same pricing flexibility that CLECs in Arizona currently have?

A. No. Upon close examination it is apparent that Qwest's proposal would give Qwest *more* pricing flexibility than the CLECs now have. Both Mr. Shooshan and Mr. Teitzel testified that Qwest's Competitive Zone proposal would simply give Qwest the same pricing flexibility currently enjoyed by its CLEC competitors.[12] However, this is simply not the

[9] Tietzel P. 73 lines 5-7.
[10] See the attachment to Qwest's May 20, 2004 filing: "Revised Price Cap Plan Terms, Conditions and Operation of the Revised Price Cap Plan."
[11] i.d.
[12] Tietzel p. 73 line 16 – page 74 line16 and Shooshan p. 15 lines 4-15

case. At page 74 lines 3-14 of his testimony Mr. Teitzel provides examples of CLECs who he claims have the same pricing flexibility that Qwest is seeking:

> "…several CLECs have identified specific wire centers in which they will provide service. For example, Sprint's tariff indicates its business Local Exchange Service is available in Qwest wire centers identified as UNE Zones 1 and 2. Section 5 of McLeodUSAs Arizona Tariff No. 3 lists the cities and wire centers where McLeod is offering service, either over its own switch or through the use of network elements. Cox initially rolled out cable telephony service to consumers in the Chandler area, eventually extended its facilities to the greater Phoenix area a few years later, and just recently began offering service in Tucson."

These examples demonstrate that these CLECs have flexibility in *where* they provide service. This is different from the *pricing* flexibility that Qwest is seeking. Staff is not aware of any CLEC that has tariffs on file that allow it to price its services differently in each wire center. For the most part, CLECs have statewide tariffs and must charge uniform rates wherever they are serving. There are some CLECs that have different prices in the different UNE rate zones (e.g., McLeodUSA) however that is quite different from the flexibility Qwest is seeking in this proceeding. If Qwest is granted zone based pricing flexibility, the CLECs could very well apply for the same type of flexibility.

Q. How would the pricing flexibility Qwest is proposing compare to that currently enjoyed by Qwest's principal competitor, Cox Communications[13]?

A. Qwest's proposal would give it much more pricing flexibility than Cox currently has. Currently Cox's tariffed rates apply to all of its customers in Arizona. Cox is not currently able to charge customers in different wire centers (or other geographic areas) different rates. Also, Cox's rates for basic residential and business service are capped at their current levels: $13 for residential and $30 for business. This contrasts with Qwest's

[13] Staff considers Cox to be Qwest's principal competitor because Cox is the only CLEC that uses its own facilities exclusively, it has far more residential customers than any other CLEC, and it has a substantial number of business customers.

proposal, which would allow Qwest to submit maximum rates for basic service that are above current levels.

Q. Has Qwest made a Competitive Zone proposal before?

A. Yes, in Qwest's last price cap proceeding Qwest made a proposal regarding Competitive Zones similar to the one it is making now. The Commission rejected the Competitive Zone proposal at that time but did state that the idea of Competitive Zones could be acceptable under certain circumstances. Specifically, Decision No. 63487 (at page 19 lines 16-27) states that: "In the future, the parties may be able to fashion a provision that allows Qwest to compete in areas where it truly faces established competition, but such provision must better describe the geographic areas and population served as well as promote specific and clear protections against anti-competitive behavior."

Q. Does Qwest's current Competitive Zone proposal conform to the requirements of Decision No. 63487 quoted above?

A. No. Staff is unable to discern any "specific and clear protections against anti-competitive behavior" in Qwest's current proposal. In response to Staff data request 15-1, which inquired about Qwest's opinion regarding the requirements of Decision No. 63487, Qwest states, "the provisions of R14-2-1108(H) give the ACC full authority to rescind Competitive Zone classification should such 'anticompetitive behavior' be shown to exist." Since rule R14-2-1108(H) existed at the time Decision No. 63487 was issued, it is unlikely that the Commission, at that time, believed the Rule was sufficient to address its concerns. In my testimony below, I propose several modifications to Qwest's proposal that should address concerns about anti-competitive behavior. Most importantly Staff believes that the criteria Qwest proposes for Competitive Zone classification are inadequate. Staff believes that these modifications along with the Commission's imputation rules (A.A.C. R14-2-1310(C)) should provide significant protections against anti-competitive behavior.

Q. Please state Staff's general opinion of Qwest's Competitive Zone proposal.

A. Staff is not opposed to the idea of Competitive Zones in general. Allowing Qwest to have the ability to respond to its competitors does seem on its face to be fair. However, the proposal that Qwest put forward contains very little detail. It is not clear to Staff how their proposal would be administered. Before any Competitive Zone proposal is adopted Qwest should be required to provide a detailed plan of administration to the Commission. Additionally, certain specific elements of the proposal made by Qwest are of concern to Staff. Staff cannot recommend adoption of Qwest's Competitive Zone proposal unless the following elements of that proposal are addressed:

- Provider of last resort obligation
- Consumer protections
- Geographic areas
- Consumer notice problem
- Potential for bait and switch
- Criteria for determining if a zone is competitive
- Specific wire centers identified by Qwest as competitive

2. Provider of last resort obligation

Q. What are Staff's concerns regarding how Qwest's Competitive Zone proposal would affect Qwest's provider of last resort obligations?

A. Qwest's testimonies do not address the provider of last resort obligation at all. However, in response to Staff data requests 17-1 and 28-1 Qwest indicated that under its proposal once a zone is declared competitive by the Commission, Qwest would no longer have any provider of last resort obligations in that area. Qwest also indicated that the Commission should open a generic docket to address the issue of provider of last resort obligations in Competitive Zones. Qwest indicated it was not willing to maintain its provider of last resort obligation while that generic docket is pending. This causes concern for Staff because if Qwest's proposal is approved most of the state (on a population basis) would be without a provider of last resort.

Q. Why is the provider of last resort obligation important?

A. The provider of last resort obligation provides a guarantee that wire line telecommunications service will be available to any customer.

Q. What is Staff's recommendation regarding Qwest's provider of last resort obligation?

A. Qwest has provided no evidence that relinquishing their provider of last resort obligation is in the public interest. (In fact they did not even mention that it was a part of their Competitive Zone proposal until they were asked about it in Staff's discovery.) Currently there is no workable method of sharing the provider of last resort obligation among Qwest and the CLECs. Staff recommends that Qwest maintain its provider of last resort obligations over its entire service area regardless of whether particular areas are deemed to be Competitive Zones. Should the Commission follow Qwest's suggestion and open a generic docket to investigate this issue, Staff recommends that Qwest maintain its provider of last resort obligations at least until that generic docket is concluded.

3. Consumer Protections

Q. What consumer protections are included in Qwest's Competitive Zone proposal?

A. On its face, Qwest's Competitive Zone proposal contains no consumer protections yet it exposes consumers to significant risk.

Q. What are the risks that Qwest's proposal would impose on consumers?

A. Under Qwest's proposal consumers may be subject to significant price increases for basic services. In response to Staff data request 15-2 Qwest stated that under their proposal maximum rates for basic service could be set at levels in excess of their current prices. This would allow Qwest to raise the price for basic services in particular zones as it deems appropriate. Staff does not believe that such "at will" price increases for basic services are appropriate.

Q. Would not competition constrain Qwest's ability to raise the prices of basic services?

A. If the market for telecommunications services were truly vibrantly competitive, then Qwest's ability to raise prices would be constrained. However the factual evidence (explained in Staff witness Armando Fimbres' testimony) is not conclusive. Exhibit AFF-7 indicates that there is only one CLEC that is a serious competitor for residential consumers (Cox.) Also, the only two other CLECs that have any significant presence in the residential market (AT&T and MCI) recently announced that they are withdrawing from the residential local exchange market. On the business side there are several CLECs competing but their combined market share is still dwarfed by Qwest's. Mr. Fimbres has also calculated several different Herfindahl-Hirschman Indexes ("HHI") in order to gauge the degree of concentration in the Arizona telecommunications market. The HHI measures both the number of firms and their relative degree of inequality. The HHI is the sum of the squares of each firm's market share. This is given by the formula:

$$HHI = \sum_{i=1}^{N} S_i^2$$

Where S_i is the market share of the ith firm and N is the total number of firms.[14] All else equal, the more concentrated a market is the more likely it is that sellers will be able to raise prices above competitive levels. The United Stated Department of Justice, when evaluating horizontal mergers, views market concentration as a problem when the HHI is 1800 or higher. Mr. Fimbres calculated HHIs for the Arizona wire line

[14] For example, a market consisting of four firms with market shares of 30 percent, 30 percent, 20 percent and 20 percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from l0,000 (in the case of a pure monopoly) to a number approaching zero (in the case of a perfectly competitive market). Although it is desirable to include all firms in the calculation, lack of information about small firms is not critical because such firms do not affect the HHI significantly.

telecommunications market several different ways based on the different sources of data he used. All of the HHIs Mr. Fimbres calculated were well above the 1800 standard, even those that include wireless providers.

Staff does not interpret this factual evidence to mean that competition is insignificant or that there is no hope for competition in the future. However, Staff does not believe that the evidence supports the conclusion that the market is vibrantly competitive and that no consumer protections are needed.

Q. What recommendations does Staff have regarding consumer protections and Competitive Zones?

A. Staff recommends that the maximum rates for basic services in Competitive Zones should be set at their current levels. This will protect consumers against potentially unwarranted price increases. It will also allow Qwest the flexibility to compete. Qwest will be able to lower prices in areas where competition is particularly acute without having to lower prices across its whole territory. Qwest is claiming that it needs Competitive Zones in order to compete more effectively.[15] Companies generally do not compete by raising prices. Also, if the market is currently competitive enough to constrain the prices of basic services, this requirement will have no effect on Qwest because they would not be able to raise prices without losing a significant number of customers anyway.

Q. What are the basic services that Staff believes should be capped at their current levels?

A. Staff believes prices of the following services should be capped at their current levels: flat rate residential; flat rate business; exchange zone increment charges; low use option service; service stations service; telephone assistance programs; individual PBX Trunks,

[15] Ziegler p. 10 lines 7-10, Teitzel p. 72 line 20

including features; Caller ID block; toll blocking; 900/976 blocking; and basic listing service.

4. Geographic area

Q. What geographic area is Qwest proposing be used to define Competitive Zones?

A. Qwest is proposing that the wire center be the initial geographic area but believes smaller areas, such as particular developments, should be allowed for consideration in the future.

Q. What are Staff's concerns regarding use of wire centers to define Competitive Zones?

A. The wire center will have advantages and disadvantages if it is used for that purpose. The advantage of using the wire center is that information on UNE-L, UNE-P, and resold lines is readily available to Qwest at the wire center level. Thus, a detailed analysis of that type of information is possible for each wire center. The disadvantages of the wire center are that listing information is not available at the wire center level, information on CLECs who use their own network exclusively is not available at the wire center level (but Qwest has provided problematic estimates), information on wireless carriers and VOIP providers is not available at the wire center level and customers are not familiar with the concept of a wire center.

Staff believes that the decision of whether an area should be deemed competitive should be based on an analysis of the available facts. Certain facts are available at the wire center level. The number of competitors serving customers in a wire center through UNE-L, UNE-P, and resale is known to Qwest. Also the specific number of lines each such competitor is serving in a wire center is known to Qwest. However, Qwest may not know how many different customers each competitor is serving. This may be important to the Commission; one competitor serving one customer with 1,000 lines (e.g., a call center) is different from a competitor serving 1,000 customers each with one line. Listings

information can tell us how many customers each CLEC has but not how many lines. Listings information is broken down geographically by area-code boundaries which are much larger than wire centers. Another problem with analyzing competition at the wire center level is that pure facilities based competitors (such as Cox) do not use wire center boundaries and thus they are unable to tell us how many customers or lines they are serving in each (Qwest) wire center. Also, Qwest does not know how many customers facilities based CLECs are serving in each wire center. They have provided us with estimates based on Local Interconnection Service ("LIS") trunks but those estimates are problematic because several CLECs appear to have LIS trunks but are not using them to provide voice telecom service (or not using them at all.) These data problems are explained more fully in the testimony of Staff Witness Armando Fimbres.
Another problem with using the wire center is that it would not be competitively neutral. Staff believes that any Competitive Zone proposal should be competitively neutral. Since wire center boundaries are based on the locations of *Qwest's* central offices Qwest knows which addresses are in which wire centers. CLECs can map addresses into wire centers by using Qwest's data bases but that mapping process could be an administrative burden for them.

Aside from these problems, wire centers present a problem when it comes to communicating with consumers. People not familiar with the telecom industry do not know what a wire center is. Very few people know what wire center they live in.[16] Thus, if prices vary across wire centers it will be difficult to communicate to customers why it is that the prices available to them differ from those available to their neighbors.

[16] ILECs intentionally moved away from a related scheme used long ago when numbers began with the letters of the end-office, e.g., EM4-1212 or LA3-1212. Reacquainting customers with this concept seems anachronistic.

Q. What other options are there for the geographic areas that define Competitive Zones?

A. There are several options, each of which has its advantages and disadvantages. Other geographic areas that Staff considered are:

- Zip codes
- Area code boundaries
- Rate Centers
- Metropolitan Statistical Areas ("MSAs")
- Counties
- LATAs

Zip codes have the advantage of being readily understood by consumers; most people know what zip code they are in. However, it has been difficult to find information on competition specific to individual zip codes. Many carriers have been thus far unable to tell us how many customers or lines they are serving in each zip code. (This may seem counter intuitive since CLECs do send their bills through the mail but for many business customers the billing address is different from the service address.)

Area code boundaries have the advantage when it comes to data. Wire centers can be easily mapped into area code boundaries and listings information is available at the area code boundary level. However, using area code boundaries could result in wire centers that are not competitive being deemed competitive. Also, area code boundaries would not give Qwest the competitive flexibility it is seeking.

Rate Centers are similar to area code boundaries. The data availability issues are less dramatic since CLEC rate centers tend to be the same as Qwest rate centers but they are large enough that non-competitive wire centers may be lumped in with competitive wire centers and the pricing flexibility they afford Qwest is limited.

MSAs, counties, and LATAs are also so large that non-competitive wire centers may be lumped in with competitive wire centers and the pricing flexibility they afford Qwest is limited.

Q. What geographic area does Staff recommend be used as the basis for Competitive Zones?

A. As the above discussion lays out any geographic area that is considered will have pros and cons. While the data available at the zip code level has been limited, Staff believes this limitation can be overcome. Designating Competitive Zones at the zip code level will provide Qwest with a great deal of competitive flexibility and will allow for a comparison of all types of competition. Additionally, consumers are familiar with the concept of zip codes and this will help alleviate the customer notice problems discussed below.[17] For these reasons Staff believes that, should the Commission decide to adopt a Competitive Zone proposal for Qwest, the zip code should be the geographic area used as the basis of the Competitive Zones.

For larger zip codes, the Competitive Zone designation could be narrowed to only a portion of the zip code as competitive conditions warrant.

Q. Please provide general information about zip codes.

A. There are 74 different zip codes within the city limits of Phoenix, 186 zip codes within Maricopa County, and 215 zip codes within the Phoenix MSA. There are 51 zip codes within the city limits of Tucson and 65 zip codes within Pima County and the Tucson MSA. There is a zip code map attached to my testimony as Exhibit 2.

[17] Zip code compilations are also used by the FCC when examining broadband deployment levels.

Q. Qwest has stated that while they are asking for Competitive Zone treatment at the wire center level now, they should be free to apply for Competitive Zone treatment for smaller geographic areas like housing developments or office parks. What are Staff's recommendations regarding these smaller geographic areas?

A. Staff did try to analyze the competitive situations in particular developments identified by Qwest; however, Staff was unable to find any data at that level of granularity. Conceptually, Staff has no objection to using these smaller areas. However, should Qwest apply to the Commission for Competitive Zone treatment in these smaller areas it should be required to provide a factual basis for that determination. In order to gain approval for a smaller zone, Qwest must provide the Commission with the same level of detailed information as is available for zip codes.

Q. Would using zip codes as the basis for Competitive Zones be administratively burdensome to Qwest?

A. It would certainly be easier for Qwest to use the wire center as the basis for Competitive Zones. However, using zip codes should not be an unmanageable task for them. They should have zip code information on all of their customers and even if they don't, mapping street addresses into zip codes is certainly possible. More importantly, Staff believes that any Competitive Zone proposal should be *competitively neutral*, i.e., it should not favor the CLECs or Qwest. Qwest's proposal to use wire centers as the basis for Competitive Zones actually gives it an advantage over most CLECs. Most CLECs do not know the exact boundaries of Qwest's wire centers, especially those that use only their own facilities. Thus, under Qwest's proposal, it may be administratively burdensome for the CLECs to determine which of their customers are in Competitive Zones. It seems fair that the CLECs should know where the Competitive Zones are so that they can tailor their offerings accordingly. Using zip codes will put the same administrative burden on Qwest and the CLECs regarding keeping track of which customers are in Competitive Zones.

Using wire centers will put an administrative burden on the CLECs but not on Qwest. In summary, Staff believes that any Competitive Zone proposal should be competitively neutral and because the wire center is a vestige of the incumbent's legacy network, it can not be considered to be competitively neutral.

5. Consumer notice problem

Q. Please explain what Staff means by the consumer notice problem.

A. Qwest is obligated to maintain tariffs that list the prices for all of its tariffed services. Qwest has also agreed to publish a short list of basic services and their prices in the Qwest Dex directory. When Qwest Dex was sold, the publishing agreement between Qwest and the acquirers included provisions that all existing and new regulatory obligations would be adhered to. Thus, a short list of Qwest's basic rates has been included in the Qwest Dex Directory. If Qwest's Competitive Zone proposal is adopted by the Commission it may be difficult to continue the publication of basic rates in Qwest Dex and it may be difficult to maintain meaningful tariffs. Qwest is seeking Competitive Zone treatment in 82 different wire centers. That could mean 83 different rates for each service that would have to be listed in the tariff and in Qwest Dex (the 82 Competitive Zones plus the non-competitive area.) Qwest's responses to Staff data requests 12-8, 12-9, and 12-10 make it clear that Qwest intends to be able to price its services differently in each wire center. A tariff with 83 different rates for the same service could be unintelligible. Also, including 83 different rates for each basic service in Qwest Dex would be quite confusing for customers, especially given that most customers are unfamiliar with the concept of a wire center. This would defeat the whole purpose of including information on basic services in Dex.

Q. Is it really likely that there will be 83 different rates for a given service under Qwest's proposal?

A. While Qwest would have the ability to charge 83 different rates for a particular service, it is probably not likely to do so. It doesn't seem likely that such extreme price differentiation would be desirable to Qwest or manageable by Qwest. However, there is the potential for several different rates for a given service at any one time and thus there is still a customer notice concern.

Q. Are there other similar problems that would need to be addressed in order to adopt Qwest's proposal?

A. Yes. Qwest's proposal, which could include 83 different rates for services, would put a considerable administrative burden on the Commission. The Commission is required to maintain tariffs available for public inspection. The multitude of tariff filings that could result from Qwest's proposal would make this difficult.

Q. What does Staff recommend regarding this customer notice problem?

A. With respect to the basic services listed in the Dex directory, Staff recommends that Qwest continue to be required to have its rates for basic service published in the directory. In order to avoid customer confusion, only the maximum rates should be included in the directory. Further, as stated above, maximum rates for basic services should be capped at their current levels.

6. Potential for bait and switch

Q. What does Staff mean by the potential for bait and switch?

A. Under Qwest's Competitive Zone proposal Qwest could offer customers in certain areas discounted prices and then raise those prices back up to the maximums with minimal notice. Staff believes that there is the potential for customer harm as a result.

Q. What does Staff recommend regarding this potential problem?

A. Staff recommends that any discounts provided to a Competitive Zone remain in place for at least one year unless Qwest clearly notifies its customers that the discount is temporary and clearly explains what the duration of the discount will be. If Qwest wants to offer a discount for a limited period of time it should be free to do so; however, both new and existing customers should be clearly notified of the limited duration of the discount. Absent such notification, any discounts provided to Competitive Zones should remain in effect for a minimum duration of one year.

Q. CLECs do not have such a requirement. Why should Qwest have this restriction and not the CLECs?

A. The evidence presented in my and Mr. Fimbres' testimonies indicates that the telecom market in Arizona is highly concentrated and that Qwest still retains the dominant position. Given Qwest's dominant position in the market it is reasonable to place restrictions on it that other carriers do not have.

7. Criteria for determining if a zone is competitive

Q. What criteria does Qwest propose be used to determine if an area should be deemed a Competitive Zone?

A. Qwest proposes that a wire center be deemed a Competitive Zone if *any one* of the following criteria is met:

1. A competitor has facilities in place and is marketing or offering services in competition with Qwest; or,
2. A competitor is marketing or offering services through the provision of unbundled network elements provided by Qwest; or,
3. A competitor is marketing or offering services through the resale of Qwest's service.[18]

Q. What are Staff's concerns with these criteria?

A. Staff believes these criteria are far too loose. These criteria would allow for the establishment of a Competitive Zone in an area where there is only one reseller operating. Staff does not believe that the existence of one reseller constitutes real competition.

[18] See the attachment to Qwest's May 20, 2004 filing: "Revised Price Cap Plan Terms, Conditions and Operation of the Revised Price Cap Plan."

Two concerns exist with Qwest's proposed criteria. One is the use of the lowest possible metric, such as "A competitor…" which Staff interprets to mean one competitor. The simple presence of one competitor gives no weight to important elements such as volume of competition, breadth of competition, or sustainability of competition. A second concern with the criteria offered by Qwest is the equal weight or relevance given to three factors which are in different stages of use and acceptance by CLECs. By the simple metrics offer by Qwest, all proposed wire centers could conceivably be classified as Competitive Zones with very little analysis, however, the broad availability of sustainable competitive alternatives in any geographic area remains a concern for Staff.

Q. Are there any current established criteria used for competitive determinations in Arizona?

A. Yes. The Arizona Administrative Code already has criteria laid out for determining that a telecommunications *service* is competitive. Specifically, rule R14-2-1108(B) provides that:

> The petition for competitive classification shall set forth the conditions within the relevant market that demonstrate that the telecommunications service is competitive, providing, at a minimum, the following information:
> 1. A description of the general economic conditions that exist which make the relevant market for the service one that is competitive;
> 2. The number of alternative providers of the service;
> 3. The estimated market share held by each alternative provider of the service;
> 4. The names and addresses of any alternative providers of the service that are also affiliates of the telecommunications company, as defined in R14-2-801;
> 5. The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms, and conditions; and
> 6. Other indicators of market power, which may include growth and shifts in market share, ease of entry and exit, and any affiliation between and among alternative providers of the services.

Q. The criteria established in rule 1108(B) were designed for the classification of a particular service as competitive not the establishment of Competitive Zones. Are the 1108(B) criteria appropriate for the purpose of establishing Competitive Zones?

A. Yes. The classification of a given company's services as competitive and the classification of geographic areas as competitive are conceptually similar. The information required by 1108(B) is as relevant to the classification of geographic areas as competitive as it is to the classification of particular services as competitive.

Q. Has Qwest explained why the criteria for establishing a Competitive Zone should differ from the criteria already established in 1108(B)?

A. No. Qwest has not explained why a deviation from the standard established in R14-2-1108(B) is appropriate or necessary. Interestingly, Qwest believes the 1108 rule is appropriate in the instance when competitive conditions change (e.g., all the competitors leave a Competitive Zone) and competitive classification of a zone needs to be reversed. In that instance Qwest believes that R14-2-1108(H) should apply.[19] R14-2-1108(H) states:

> Any telecommunications service classified by the Commission as competitive may subsequently be reclassified as noncompetitive if the Commission determines that reclassification would protect the public interest. Notice and hearing would be required prior to any reclassification. The burden of proof would be on the party seeking reclassification.

So Qwest believes that the 1108 rule is appropriate to declassify areas as Competitive Zones but Qwest does not believe R14-2-1108 is appropriate for classifying areas as competitive. Staff can not explain this apparent double standard in Qwest's recommended application of R14-2-1108 to its Competitive Zone proposal.

Q. Does Staff believe that a deviation from the standard established in rule 1108(B) is appropriate or necessary?

A. No. Rule 1108(B) allows the Commission to examine the relevant factual information needed to evaluate the competitive situation in a given area. R14-2-1108(B) also allows the Commission great flexibility in how it chooses to use that factual information.

[19] Teitzel p. 76 lines 1-4.

Qwest's proposed criteria would only allow the Commission to perform the most cursory factual review. Given Qwest's dominant position relative to the CLECs, Staff can not recommend that the criteria for establishing Qwest's services as competitive be less stringent than the criteria for establishing CLEC services as competitive. To the contrary, because Qwest is the entrenched dominant provider for local service throughout its service territory the criteria used to determine whether competitive classification is appropriate should be more stringent for Qwest. In other words, given Qwest's market dominance in most areas, Staff recommends that additional factors be considered for Qwest than those used in the past by Staff and the Commission.

7. Specific wire centers identified by Qwest as competitive

Q. Where is Qwest requesting Competitive Zones?

A. Qwest is requesting Competitive Zone classification for 63 wire centers in Phoenix metro and 19 wire centers in Tucson metro. This represents 60% of Qwest's 136 wire centers in Arizona. Of Qwest's total Arizona wire centers, 39 are UNE Zone 1, 33 are Zone 2 and 64 are Zone 3. Qwest is requesting competitive flexibility in the form of Competitive Zones in 37 of 39 UNE Zone 1 wire centers, 17 of 33 Zone 2 wire centers and 28 of 64 Zone 3 wire centers. Furthermore, the Competitive Zone requests consist of 29 UNE Zone 1, 11 Zone 2 and 23 Zone 3 wire centers in Phoenix metro. Similarly, 8 UNE Zone 1, 6 Zone 2 and 5 Zone 3 Competitive Zone wire centers are being requested for Tucson metro. (see Exhibit AFF-4) Qwest is requesting Competitive Zone classification for every wire center that can reasonably be considered in the Phoenix metro and Tucson metro, with the exception of Marana West. It is also worth noting that the wire centers for which Qwest is requesting Competitive Zone classification constitute about [redacted] lines or [redacted] of their total switched access lines in Arizona.

Q. What concerns does Staff have with the wire centers Qwest has identified as competitive?

A. Staff is concerned that some of the wire centers Qwest has identified as competitive actually have very little competitive activity. The inclusion of these wire centers is likely a result of the criteria that Qwest employed to identify competitive wire centers.

Q. How did Staff determine that some of the wire centers Qwest has identified as competitive actually have very little competitive activity?

A. Taking wire center data provided by Qwest, Staff developed an estimate of CLEC market share in each wire center. In response to RUCOs data request 2.28A through 2.28F, Qwest provided UNE-L, UNE-P, and resale numbers per wire center. In response to RUCO data request 2.38 Qwest provided its *estimate* of pure facilities based CLEC lines. Combining this information with data on Qwest's lines contained in Qwest Exhibit DLT-17 yields the following CLEC market shares per wire center in the Phoenix and Tucson areas:

Table 5 CLEC Market Share for Phoenix Wire Centers identified by Qwest as Competitive Zones[20]

Wire Center Name	Estimated CLEC Market Share
DUDLEYVILLE	**[redacted]**
WHITLOW	**[redacted]**
RIO VERDE	**[redacted]**
KEARNY	**[redacted]**
ORACLE	**[redacted]**
FLORENCE	**[redacted]**
WHITE TANKS	**[redacted]**
MAMMOTH	**[redacted]**

[20] The Phoenix MSA includes all of Maricopa and Pinal counties. Dudleyville, Kearney, Oracle, Mammoth, and San Manuel are not in the Phoenix LATA and not in the Phoenix local calling area but are in the Phoenix MSA. Florence, Superior, Coolidge, Eloy, Gila Bend, and Casa Grande are in the Phoenix LATA and MSA but not in the Phoenix local calling area.

SUPERIOR	**[redacted]**
CIRCLE CITY	**[redacted]**
STANFIELD	**[redacted]**
COOLIDGE	**[redacted]**
WICKENBURG	**[redacted]**
WINTERSBURG	**[redacted]**
MARICOPA	**[redacted]**
ELOY	**[redacted]**
GILA BEND	**[redacted]**
BUCKEYE	**[redacted]**
HGLY QUEEN CREEK	**[redacted]**
NEW RIVER	**[redacted]**
TOLLESON	**[redacted]**
PINNACLE PEAK	**[redacted]**
PHOENIX-LAVEEN	**[redacted]**
DEER VALLEY NORTH	**[redacted]**
PHOENIX-SUNNYSLOPE	**[redacted]**
THUNDERBIRD	**[redacted]**
CHANDLER-SOUTH	**[redacted]**
PHOENIX-NORTHEAST	**[redacted]**
SUPERSTITION-EAST	**[redacted]**
PHOENIX-EAST	**[redacted]**
SCOTTSDALE	**[redacted]**
CAVE CREEK	**[redacted]**
HIGLEY	**[redacted]**
CHANDLER-WEST	**[redacted]**
FORT MCDOWELL	**[redacted]**
PHOENIX-MID RIVERS	**[redacted]**
PHOENIX-SOUTHEAST	**[redacted]**
SUPERSTITION-MAIN	**[redacted]**
BEARDSLEY	**[redacted]**

SUPERSTITION-WEST	**[redacted]**
TEMPE-MAIN	**[redacted]**
MESA-MAIN	**[redacted]**
PHOENIX-GREENWAY	**[redacted]**
CHANDLER-MAIN	**[redacted]**
LITCHFIELD PARK	**[redacted]**
PHOENIX-WEST	**[redacted]**
SHEA	**[redacted]**
PHOENIX-SOUTH	**[redacted]**
GLENDALE-MAIN	**[redacted]**
PHOENIX-NORTH	**[redacted]**
GILBERT	**[redacted]**
PHOENIX-CACTUS	**[redacted]**
PHOENIX-FOOTHILLS	**[redacted]**
PHOENIX-NORTHWEST	**[redacted]**
TEMPE-MCCLINTOCK	**[redacted]**
PHOENIX-PEORIA	**[redacted]**
PHOENIX-MARYVALE	**[redacted]**
PHOENIX-PECOS	**[redacted]**
CASA GRANDE	**[redacted]**
COLDWATER	**[redacted]**
PHOENIX-BETHANY WEST	**[redacted]**
SAN MANUEL	**[redacted]**
PHOENIX-MAIN	**[redacted]**

Table 6 CLEC Market Share for Tucson Wire Centers identified by Qwest as Competitive Zones

Wire Center Name	Estimated CLEC Market Share
MARANA	**[redacted]**
MOUNT LEMMON	**[redacted]**
VAIL NORTH	**[redacted]**
TUCSON WEST	**[redacted]**
TUCSON SOUTHWEST	**[redacted]**
TUCSON-SOUTH	**[redacted]**
GREEN VALLEY	**[redacted]**
TUCSON-EAST	**[redacted]**
CRAYCROFT	**[redacted]**
VAIL SOUTH	**[redacted]**
RINCON	**[redacted]**
CATALINA	**[redacted]**
TUCSON-NORTH	**[redacted]**
CORONADO	**[redacted]**
CORTARO	**[redacted]**
TANQUE VERDE	**[redacted]**
TUCSON SE	**[redacted]**
FLOWING-WELLS	**[redacted]**
TUCSON-MAIN	**[redacted]**

Tables 5 and 6 list only the wire centers that Qwest has recommended be designated Competitive Zones, the tables do not include all wire centers. It needs to be stressed that the estimated CLEC market shares in Tables 5 and 6 are based in part on Qwest's *estimates* of pure facilities based CLEC lines. As is discussed above and in the testimony of Staff witness Fimbres, Qwest's estimates of pure facilities based lines probably under estimates Cox's presence but overestimates the presence of other carriers.

Q. How do Tables 5 and 6 Illustrate Staff's concerns with the wire centers Qwest believes should be designated as Competitive Zones?

A. Staff believes that there should be actual confirmed competition in an area before it is designated as competitive. Staff is not persuaded that wire centers that have very little actual competition should be designated as competitive. Some of the wire centers listed in Tables 5 and 6 have very little confirmed CLEC activity. Many of the wire centers have CLEC penetration rates in the single digits (or less.) Additionally, the higher CLEC penetration rates shown for some wire centers are driven mainly by Qwest's *estimate* of pure facilities based competition. In fact, fully 69% of the CLEC presence in the Phoenix wire centers listed in Table 5 is attributable to Qwest's *estimate* of facilities based competitors presence. Similarly, 64% of the CLEC presence in the Tucson wire centers listed in Table 6 is attributable to Qwest's *estimate* of facilities based competitors presence. Given that so much of the available evidence regarding these Competitive Zones is driven by Qwest's estimates (which are problematic) Staff is uncomfortable with designating these specific wire centers as competitive.

8. Staff's recommendation regarding Competitive Zones

Q. Please summarize Staff's recommendations concerning Competitive Zones.

A. Conceptually Staff is not opposed to the idea of establishing Competitive Zones. As long as the consumer protections discussed above are in place, Staff does not believe that the general idea of Competitive Zones will be harmful to consumers. However, Staff finds it difficult to support the specific proposal laid out in Qwest's testimonies. Staff is concerned about the use of the wire center as the geographic basis for the Competitive Zones. Should the Commission decide to approve the concept of Competitive Zones, Staff recommends that zip code boundaries be used as the geographic basis for the Competitive Zones. However, if the data submitted by Qwest and other carriers support Competitive Zone classification for only a portion of the zip code area; the Commission should have the option of narrowing the area to which the Competitive Zone designation would apply.

Q. Why does Staff believe that zip codes are preferable to wire centers?

A. Staff's main concern with the wire center is the potential for customer confusion. As discussed above, customers are unfamiliar with the concept of wire centers and thus communicating with them regarding their rates could be problematic. Customers are familiar with the zip code concept which could serve to mitigate some customer confusion.

Another concern is the measurement data needed for a competitive determination. At the wire center level, the only practical data available for evaluating the level of competition is contained within Qwest's interconnection databases. Wire centers are historical, wire line, local exchange designations used only by ILECs, such as Qwest. Many new telecommunications entrants do not define their service areas on the same terms. Analyzing competitive information on the basis of Qwest's wire centers is impractical for inclusion of the broad set of market participants.

Zip codes are geographic definitions provided by the US Postal Service and used by *all* telecommunications providers for service and billing operations. Using zip code based information would allow Competitive Zone consideration at the highest level – statewide - or the lowest level – the discrete zip code – with several possibilities in between, such as city and county levels. Without use of zip code information, for example, analytical consideration of Qwest's related proposal for Competitive Zones defined by geographies other than wire centers, e.g., housing developments, is impractical. The use of zip code level information also lays the groundwork for the eventual inclusion of market information from competitive alternatives, such as wireless and VoIP.

Staff initiated actions to obtain zip code level information for this proceeding but has been unable to conclude its analysis based on such information. Therefore, Staff conducted its Competitive Zone analysis with traditional wire center information but is recommending that the Commission order continuing measurement and analysis be based on zip code information.

Q. How does Staff propose this analysis based on zip code information be conducted?

A. If the Commission endorses the idea of establishing Competitive Zones and adopts Staff's recommendation to base those zones on zip codes, Staff recommends that a separate proceeding be established to determine which zip codes should be treated as Competitive Zones. After the conclusion of the pending proceeding, Qwest could make a filing consistent with R14-2-1108 which would identify the zip codes Qwest believes should be treated as competitive. Qwest's filing should, at a minimum, contain all of the information required by R14-2-1108 broken down to the zip code level where possible. Specifically, Qwest should provide the number of UNE and resale lines broken down by CLEC in each zip code for which it is seeking competitive classification. Because Qwest can only estimate the number of pure facilities based CLEC lines it is better to get that information from the CLECs directly. All Arizona CLECs who have CC&N's allowing them to provide facilities based service should be required to provide the number of pure facilities based lines and customers they are serving in each zip code for which Qwest is seeking competitive classification. All of the above information should be broken down by business and residence customers. Any Arizona CLEC impacted by Qwest's

Competitive Zone proposal which desires to comment on Qwest's proposal should be allowed to participate in the proceeding.

Upon receipt of Qwest's filing, Staff will make its recommendation to the Commission within 120 days. Should Qwest's filing not comply with R14-2-1108 or any Commission requirements, Staff will issue a notice of deficiency within 14 days and the 120 day time clock will be suspended until Staff deems Qwest's filing as sufficient.

Q. Why does Staff believe that information on Competitive Zones should be broken down based on residential and business services?

A. Staff believes that the business and residential markets for telecommunications services are fundamentally different. Competitive conditions in these markets may be quite different. In some areas, competitive classification may be appropriate for business customers only.

Q. Why does Staff believe a sufficiency review of Qwest's R14-2-1108 filing is necessary when no such sufficiency review is conducted when CLECs make filings under R14-2-1108?

A. Because Qwest is the dominant provider of wire line telecommunications service in its service territory, Staff believes the analysis of its R14-2-1108 filing needs to be exceptionally thorough. Since individual CLECs typically have very few customers relative to the market as a whole and their level of investment in infrastructure is typically quite small relative to the market as a whole, it is very unlikely that they will have the ability to influence the market price for telecommunications service in any meaningful way. The same can not be said for Qwest. Additionally, with a standard R14-2-1108 case Staff is not bound by the 120 day time clock it is proposing here. Thus, deficiencies can be addressed through the discovery process. With a 120 day time clock Staff and the interveners will need as much of the information as possible provided by Qwest with its filing in order to ensure timely processing.

Q. What advantages are there to determining which zip codes should be classified as Competitive Zones in a separate proceeding?

A. First, a second proceeding will allow Staff and the parties to sort out the data problems regarding pure facilities based providers mentioned above and discussed in detail in Staff witness Fimbres' testimony. Staff believes that an informed decision regarding which areas really are competitive should be based on accurate data. Second, a seperate proceeding will allow Staff and the parties to incorporate any feedback the Commission has to offer regarding the pending proceeding into their analysis and recommendations.

Q. If the Commission determines to use geographic areas other than zip codes, what recommendations does Staff have regarding such a determination?

A. Staff's primary recommendation is to base Competitive Zones on zip codes and to make those determinations in a separate proceeding. However, whether the Commission uses wire centers, zip codes or some other option as the geographic area the R14-2-1108 criteria should form the basis of any finding. Qwest did not use the R-14-2-1108 criteria in its identification of wire centers for Competitive Zone classification. Staff believes that Qwest's limited criteria produced many Competitive Zone designations that are not appropriate.

Q. Does Staff have any other recommendations regarding Competitive Zones?

A. Yes. In order to prevent Qwest from pricing services at unfairly low rates Staff recommends that all prices for services within Competitive Zones must exceed the TSLRIC of each service and Qwest must comply with the imputation requirements of

A.A.C. R14-2-1310(C) within Competitive Zones. In addition, the price floor for 1FR and 1FB service should exceed the highest existing applicable UNE-P rate.[21]

IV. Arizona Universal Service Fund Issues

Q. What is the purpose of your testimony on Arizona Universal Service Fund (AUSF) issues?

A. Staff witness Thomas Regan will address the revenue requirements aspect of Qwest's AUSF proposal. My testimony will address Qwest's contention that their AUSF proposal will enhance the prospects for competition in rural areas.[22]

Q. Does Staff believe that Qwest's AUSF proposal will result in increased competition in rural Arizona?

A. The Company has failed to conclusiovely demonstrate that their proposal will result in increased competitive options for consumers in rural areas therefore, Staff believes it is inappropriate to tax ratepayers based upon Qwest's speculations. Rule R14-2-1206(E) requires that AUSF funding be portable to an ILEC's competitors. That is, if an ILEC is receiving AUSF support in a particular area and it loses a customer to a CLEC, then the CLEC would receive the AUSF support attributable to that customer. Because the rural parts of Qwest's service territory tend to be in UNE zones 2 and 3, the UNE rates in Qwest's rural areas tend to be high. These high UNE rates have been cited as a barrier to competitive entry in rural areas. Thus, AUSF support for those areas would lower the costs for CLECs who wish to compete in rural areas. Theoretically, it makes sense that lower costs would be beneficial for CLECs in rural areas; however, Staff has been unable to find any factual evidence supporting the contention that providing AUSF support to

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[21] If the UNE-P product, or a product substantially similar to UNE-P, should be offered under a different name this requirement should still be binding.
[22] Shooshan p. 18 lines 10-15 and Ziegler p. 13 lines 5-7

Qwest will enhance competition. Also, factors other than costs (e.g., potential revenue) likely influence a CLECs decision to provide service in a particular area.

Q. What investigation did Staff do regarding the likelihood that AUSF support in Qwest's rural areas would result in increased competition in those areas?

A. Staff sent a data request (STF 2-1) to all Arizona certificated CLECs asking whether they are receiving state universal service funding in any other state and if so they were asked to identify the relevant states. The vast majority of CLECs reported that they are not receiving any universal service funding of any kind. A small number of CLECs indicated that they are receiving state universal service funding in a few states. The states identified by these CLECs are Texas, Pennsylvania, Illinois, Wyoming, Nebraska, and Kansas.[23] Staff contacted each of these states' public utilities commissions and asked a series of questions regarding the states' universal service funds and rural competition. None of these states reported that their state universal service funds were intended to promote local competition. Nebraska reported that there is a substantial amount of UNE-P based competition in its rural areas. None of the other states reported significant amounts of rural competition.

Q. Did Qwest provide any factual evidence regarding the impact of AUSF on competition in rural areas?

A. No.

Q. What factors other than costs would effect a CLECs decision to compete in rural areas?

A. Revenues. The revenue opportunities in rural areas may be substantially different than those in urban areas.

Q. Do the Commission's rules place any restrictions on CLECs obtaining AUSF support that may be relevant?

[23] MCI also identified Michigan but when Staff contacted the Michigan Commission we were informed that Michigan does not have a state universal service fund.

A. Yes. R14-2-1206(E) requires that a CLEC receiving AUSF support must be willing to serve "all customers in the specific AUSF support area." This provision of the rules would ensure that Qwest's proposal would offer no benefits to CLECs who specialize in serving certain type of customers only.

Q. Are the higher UNE rates in rural areas necessarily a barrier to competitive entry?

A. Higher UNE rates certainly do not help competition. However, it is interesting to note that (according to data supplied by Qwest) in the Phoenix and Tucson areas the number of lines served by pure facilities based CLECs is more than double that served by UNE-L, UNE-P and resale based CLECs.[24] Since UNE rates in these urban areas are not particularly high, this implies that factors other than UNE costs may be impeding UNE based competition.[25]

Q. What does Staff recommend regarding Qwest's AUSF proposal?

A. Staff witness Thomas Regan will sponsor Staff's primary recommendation regarding Qwest's AUSF proposal. The purpose of my testimony is to point out that the affect of Qwest's AUSF proposal on competition in rural areas is, at best, uncertain. Additionally, Staff recommends that any additional federal or state universal service funding received by Qwest during the term of the Revised Price Cap Plan be considered an adjustment to the price caps established under the plan.

V. Deregulation of Voicemail

Q. Has Qwest petitioned the Commission to deregulate Voice Messaging Service?

[24] Derived from Qwest response to RUCO data requests 2.28 a –f and 2.38.
[25] The current UNE rates were established in Decision No. 64922 on June 12, 2002. Prior to that Qwest's Arizona UNE rates were considerably higher.

A. Yes. Qwest has previously filed a petition to deregulate voice messaging service (Docket No. T-01051A-98-0575) and has reiterated this request in its amended application for renewed price regulation plan (Docket No. T-01051B-03-0454 and T-00000D-00-0672).

Q. What is the basis for Qwest's petition?

A. Qwest has petitioned the Commission to deregulate voice messaging pursuant to A.R.S. 40-281(E) which states: "When the commission determines after notice and hearing that any product or service of a telecommunications corporation is neither essential nor integral to the public service rendered by such corporation, it shall declare that such product or service is not subject to regulation by the commission."

Q. How does Qwest support its position?

A. According to Qwest, the voice messaging service it offers does not constitute "transmitting messages or furnishing public telegraph or telephone service", and is in fact "totally independent of basic telephone service."[26] Further, Qwest asserts that voice messaging service is not essential or integral to basic telephone service because "basic telephone service can be and is provided to residential and business customers irrespective of voice messaging."[27]

Q. What factors have you considered in evaluating Qwest's petition to deregulate voice messaging service?

A. Pursuant to *Mountain States Telephone and Telegraph Co. v. Arizona Corporation Commission*, 132 Ariz. 109, 644 P.2d 263 (App. 1982), when determining whether or not to deregulate voice messaging service, the Commission must determine if the service is essential and integral to the public service rendered by the provider.

Q. Are there any prior Commission decisions to help guide the Commission in this matter?

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[26] US West Communications, Inc.'s Petition for Deregulation of its Voice Messaging Service, September 25, 1998 – T-01051A-98-0575 at ¶ 3

[27] US West Communications, Inc.'s Petition for Deregulation of its Voice Messaging Service, September 25, 1998 – T-01051A-98-0575 at ¶ 4

A. Yes. In 1986, Mountain States Telephone and Telegraph filed an application for deregulation and withdrawal of filed tariffs relating to the mobile radio common carrier industry. In its order granting the company's petition to deregulate radio telephone services (Decision No. 55633), the Commission relied on several factors in rendering its decision.

Staff recommended that a service be considered essential and integral if it "is judged to be indispensable or is expected to be widely available."[28]

The Commission noted that mobile radio is very specialized in nature and "the network providing this service is discrete and separable from the public telecommunications network."[29]

In addition, the following findings of fact (among others) lead to the Commission's decision to grant Mountain Bell's application to deregulate mobile radio:

a. Mobile Radio is provided through a network that is discrete and separable from the public telecommunications network.

b. Mobile Radio has been successfully provided as a matter of private contract for very specialized needs.

c. Mobile radio common carriers are not providing a public service.[30]

Q: How does the Mountain States Telephone and Telegraph decision help to guide your analysis of the petition to deregulate voice messaging service?

A: Staff has utilized the test for the essential and integral nature of a service from the Mountain Bell decision as a basis to determine that voice messaging service is not essential and integral to the provision of the public service rendered by Qwest. Secondly, voice messaging service meets several of the criteria used by the Commission in rendering Decision No. 52633 in the Mountain States case. Voice messaging service is discrete and

[28] Decision No. 55633, Docket No. E-1051-86-016, July 2, 1987, page 4 line 18.
[29] Decision No. 55633, Docket No. E-1051-86-016, July 2, 1987, page 6 line 9.
[30] Docket No. E-1051-86-016, July 2, 1987, pages 8-9.

separable from the public telecommunications network. It has been successfully provided as a matter of private contract, and voice messaging businesses are not providing a public service.

Q: Please describe the factors that lead to this conclusion.

A: There are many examples of competitive providers offering voice messaging service in the marketplace. In its letter dated July 9, 2002, Qwest provided a supplemental list of alternate voice message providers listed in the DexOnline Yellow Pages that included more than fifty (50) companies. The majority of these companies are unregulated businesses that are not engaged in furnishing public telephone service.

Q: Does Staff find that Qwest's voice messaging service is indispensable?

A: No. Voice messaging service or close substitutes are expected to be, and are, widely available in the market. Along with the list of more than fifty competitive voice mail providers in Arizona, answering machines and answering services also serve as close substitutes for voice messaging service. Qwest has indicated that of its voice messaging service capable lines, approximately 25% of residential lines and 28% of business lines subscribe to the service. These numbers indicate that either voice messaging service is not indispensable to customers, or there are sufficient substitutes available to cover the messaging requirements of nearly three-quarters of Qwest's voice messaging capable phone lines.

Q: Did Staff perform an analysis to determine whether voice messaging service is a public service pursuant to Article 15 § 2 of the Arizona Constitution?

A: Yes. In determining whether Voice Messaging Service is a public service pursuant to Article 15 § 2, Staff has examined the relationship between voice messaging service and the public switched telephone network. While the provision of voice messaging service requires some elements of the public switched telephone network such as the call forwarding busy line/don't answer features on the customer's line and an interconnection between the central office and voice response unit (considered by Qwest to be Customer Premise Equipment), the public telephone network can and does operate properly whether or not voice messaging service is being provided.

Q: Is it possible for a company to provide voice messaging service without owning any facilities that would be considered elements of the public switched telephone network?

A: Yes. Many non-regulated voice mail providers are able to offer the service using a combination of their own voice mail platform and tariffed network services from a facilities-based local exchange company. Some competitive local exchange carriers such as MCI, SBC, and AT&T outsource their voice mail platforms.

Q: In general, can you describe the manner in which non-regulated companies provide voice messaging service?

A: Qwest's list of alternative voice mail providers shows a multitude of non-regulated companies that offer voice messaging service. Several of these companies provided a description of the equipment and public switched telephone network facilities necessary for them to provide voice messaging service.

Competitive voice messaging providers typically own or sub-contract the voice mail platform, own or lease various network facilities, and purchase various tariffed services from a local exchange carrier. The voice mail platform or voice response unit handles the voice messaging transactions such as recording, storing, and playing messages, and notifying the customer of new messages. Calls are terminated to the voice mail platform. The competitive provider can own or lease varying degrees of equipment and facilities above and beyond the voice mail platform. This determines the network services it must purchase at standard tariffed rates from the local exchange carrier. However, certain basic service elements are required from the LEC such as the Multi Line Hunt Group feature, Message Delivery Service, and the Message Waiting Indicator. In addition, the customer must have call forwarding features from its LEC to forward missed calls on to the voice mail platform via the public switched telephone network.

Q: Does the existence of these types of non-regulated providers help you to determine whether voice messaging service is a public service?

A: Yes. The abundance of non-regulated providers of voice messaging service is evidence that this feature is discrete and separable from the public switched telephone network. Voice messaging businesses are not providing a public service.

Q. Does the availability of answering machines affect the decision regarding voice mail deregulation?

A. Yes. Modern answering machines are close substitutes for voice mail service and are widely available and their prices are unregulated.

Q: What is your recommendation with respect to Qwest's petition to deregulate voice messaging service?

A: Based on the findings that voice messaging service is not essential and integral to basic telephone service, that it is discrete and separable from the public switched telephone network and that it is subject to private contracts; Staff recommends that the Commission grant Qwest's petition to deregulate voice messaging service. Staff also recommends that Qwest's pending application to deregulate voicemail (Docket No. T-01051A-98-0575) be closed. Pursuant to *Mountain States Telephone and Telegraph Co. v. Arizona Corporation Commission*, 132 Ariz. 109, 644 P.2d 263 (App. 1982), the Commission should reserve the right to ensure that voice messaging service is offered in a non-discriminatory fashion and that the service does not result in the evasion or frustration of the Commission's regulation of telephone service.

VI. Deregulation of Billing and Collection

Q. What has Qwest requested with respect to its Billing and Collection ("B&C") Services?

A. Qwest has requested that its B&C Services (referred to as "Information and Billing Services" in Qwest's Access Service Price Cap tariff) be deregulated.

Q. What is B&C Service?

A. B&C Service provides Access Service customers (IXCs) with billing, collection and information services. The services include the following:

- Recording – Records the information for calls that is necessary to bill customers for calls that have been made.
- Message Based Billing – Provides for the billing of customers for individual calls that they have completed. Services include usage sensitive toll services.
- Non-Message Based Billing - Provides for the billing of customers for services that they have received that are non-usage sensitive. Services include non-usage sensitive services such as private line services.
- Billing Analysis – Provides for the detection, investigation and deterrence of billing evasion activities.
  End User Account Activity – Provides for changes, adds or deletions to an end user's account information.
- Message Investigation – Provides for the investigation of calls that are disputed.
- Billing Information – Provides for the forwarding of end user records billing files and account data to the customer.
- Media Provisioning - Applies to the charges for the manner in which data is provided to the customer. Charges vary depending upon whether the medium used is magnetic tape, cartridges, data transmission, microfiche and the type of delivery methods requested.
- Ancillary Offerings – includes Market Messages, Screen Bill Fiche and Billing Name and address
- CARE/ISI – Provides for the ability to exchange information in the CARE/ISI format.
- Custom Request and Consulting – Services that are provided in response to a customer's special request.

Q. What is the current pricing regime for Qwest's B&C Service?

A. Currently, Qwest's B&C Service is provided as a flexibly priced service with maximum rates in Qwest's Access Service tariff. The current rates for services (other than ICB priced services) are contained in a price list.

Q. Describe the Billing and Collection service that Qwest proposes to deregulate.

A. Qwest proposes to deregulate all of the services currently contained in its Information and Billing Services tariff.

Q. Who are the alternative providers of B&C Service identified by Qwest?

A. In its response to Staff Data Request Nos. 30-14 and 30-15, Qwest indicated that carriers' own billing systems, major credit card companies, bill aggregators or other major direct billing providers are alternatives to Qwest-provided Billing and Collections, Market Message, End-User Inquiries, Custom Services and Consulting Services. Further, Qwest responded that IXCs' switches have the capability to record call detail information and that IXCs have the ability to take that call detail and determine the charges for their services.

Q. Has the Federal Communications Commission ("FCC") issued any decision on Billing and Collection Service?

A. Yes. In 1986, the FCC detariffed B&C Service.[31]

Q. What is the current regulatory status of Billing and Collection Service in the Qwest region?

A. In response to Staff Data Request No. 30-16, Qwest indicated that B&C has been deregulated in 8 of the 14 states in its region. Further, the service has been classified as competitive in 4 states with significant pricing flexibility, and that the service is "tariffed" in New Mexico.

[31] See Detariffing of Billing and Collection Services, CC Docket No. 85-88, 102 FCC 2d 1150 (1986) (Billing and Collection Detariffing Order) recon. denied, 1 FCC Rcd 445 (1986).

Q. **Who are the alternative providers of Billing and Collection Service that Qwest proposes to deregulate**

A. In its response to Staff Data Request Nos. 30-12 and 30-13, Qwest indicated that the following companies currently provide alternatives to Qwest-provided B&C Services:

* * * Confidential * * *
[redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted]
* * * Confidential * * *

Q. **Did you request information from IXCs and CLECs regarding B&C Service?**

A. Yes.

Q. **Were you able to reach any conclusions based on their responses to Staff's data requests?**

A. Yes. The majority of the respondents to Staff's Data Request indicated that they do not subscribe to or use any of Qwest's B&C Services. Some of the respondents indicated that they use Qwest B&C Service for at least part of their B&C needs. These responses indicate that B&C is not a service that can only be provided by Qwest. IXCs and CLECs have various alternatives. They can use their own equipment entirely or use a combination of their networks and services provided by others or rely entirely on others for B&C services. Based on these factors B&C service is not essential and integral to the provision of telephone service.

Q. **What is you recommendation with respect to Qwest's proposal to deregulate B&C Service?**

A. I recommend that the Commission approve Qwest's proposal to deregulate B&C Service. Pursuant to *Mountain States Telephone and Telegraph Co. v. Arizona Corporation Commission*, 132 Ariz. 109, 644 P.2d 263 (App. 1982), the Commission should reserve the right to ensure that voice messaging service is offered in a non-discriminatory fashion and that the service does not result in the evasion or frustration of the Commission's regulation of telephone service.

VII. Promotions

Q. Please describe Qwest's current Promotional Offering Tariff.

A. Qwest's current Promotional Tariff Offering allows the Company to engage in promotions from time to time. Under the terms of the tariff the promotions are designed to attract new customers or increase awareness of its offering. In addition the tariff states that the promotions will be designed to cover the marginal cost of the promotion. Qwest is required to provide 30 days notice to Staff if promotions are valued at greater than $25.00 per customer. Finally, Qwest must provide concurrent notification to Staff of promotions valued at less than $25.00 per customer and is required to report the results of the promotion to Commission Staff.

Q. What is Qwest's proposal regarding changes to its promotions tariff?

A. Qwest proposed to amend its Promotional Offering tariff such that it is not required to provide 30 days notice to Staff if promotions are valued at greater than $25.00 per customer. Additionally, Qwest proposes to eliminate the requirement that the promotional prices cover the marginal cost of the relevant services.

Q. Do any CLECs or IXCs have the sort of promotional offering flexibility the Qwest is requesting in this proceeding?

A. Yes. A number of CLECs and IXCs have general language in their tariffs that allow the companies to offer promotions that include, but are not limited to, rate discounts or waivers of non-recurring charges from time to time. This is the predominate approach.

Q. Do all CLECs and IXCs have the sort of promotional offering flexibility that Qwest is requesting in this proceeding?

A. No. Tariffs that apply to CLEC and IXC promotions vary depending on the language in their tariffs. Some file individual promotions that become effective on 30 days notice to the Commission because these promotions are filed as tariff revisions. Others include language in their tariff that requires them to file promotions with the Commission before they can become effective.

Q. What is Staff's recommendation on the proposal to grant Qwest additional flexibility regarding promotions?

A. Staff recommends that Qwest's proposal eliminating the requirement that Qwest's promotions be filed with the Commission 30 days prior to going into effect be approved. However, Qwest should be required to file promotions with the Commission concurrent with their effective dates. Also, Staff does not believe it is appropriate to end the requirement that promotional prices must cover marginal cost. The requirement that prices cover marginal cost is an important safeguard against anti-competitive behavior.[32]

VIII. Term of the Revised Price Cap Plan

Q. What term does Staff believe the Revised Price Cap Plan should have?

A. Staff believes a term of three years is appropriate. Nine months prior to the end of the three year period Qwest should file an application to renew, revise, or cancel the Revised Price Cap Plan. The Revised Price Cap Plan should remain in effect until the Commission issues an order that changes its terms. The three year period should begin upon Commission approval of the plan in this case.

Q. Should Qwest be precluded from making an application to revise or cancel the Revised Price Cap Plan during the three year term?

[32] Staff clarifies that the marginal cost test for a promotion should cover the entire term of the promotion. For example, if Qwest offers a discounted rate for two months in exchange for a two year commitment to a particular service, the marginal cost test should take into account all costs and revenues over the two year period.

A. No. Because competitive conditions may change Staff believes it is appropriate to allow Qwest and the Commission to open a review of the Revised Price Cap Plan if competitive conditions warrant. This would allow both Qwest and the Commission the flexibility necessary to address unforeseen problems that may result from the Revised Price Cap Plan.

Q. What reporting requirements does Staff recommend be imposed on Qwest during the term of the plan?

A. Staff recommends that Qwest be required to file annual reports that document the price changes that have taken places over a given year and that verify that Qwest is complying with the revenue caps established in this proceeding. These reports should be filed by the end of April for each year the Revised Price Cap Plan is in effect. Also, Staff Witness Brosch describes additional recommended reporting requirements in his testimony.

IX. UNE-P Availability and Other Competitive Issues

Q. What is UNE-P?

A. UNE-P is a wholesale product that bundles all of the network elements necessary to provide end users with local service (including switching.) The UNE-P product is functionally similar to the Resale of local exchange service. One important difference between UNE-P and Resale is the treatment of access charges. When a CLEC enters into a Resale agreement with Qwest (or any other ILEC), the CLEC has no claim to the access charges associated with its end users' long distance traffic. With Resale the ILEC keeps the access charges. Conversely, when a CLEC leases the UNE-P product from Qwest, the CLEC receives the access revenues.

Q. What is the current status of UNE-P?

A. Currently Qwest is providing UNE-P to CLECs with an existing interconnection agreement under TELRIC rates approved by the Commission (at least until year end.) However, the future status of UNE-P has been called into question by the Federal

Communications Commission's ("FCC") *Interim Unbundling Order*.[33] In its Order, the FCC put in place an interim plan which applies to the transition period before it adopts final unbundling rules and issued a Notice of Proposed Rulemaking seeking comment on final rules. Staff believes that, based on the *Interim Unbundling Order,* it is likely that the final rules will do away with the requirement that UNE-P be provided at Commission approved TELRIC rates, at least in certain markets.

Qwest indicated to Staff that it has already stopped offering UNE-P at TELRIC rates to new CLECs based upon paragraph 22 of the *Interim Unbundling Order*. Qwest has also indicated that it is offering a new product that is functionally equivalent to UNE-P it calls Qwest Platform Plus. The price of Qwest Platform Plus is the same as that for UNE-P until the end of this year but will then ratchet up in January of 2005, in January of 2006, and again in January 2007.[34]

Q. Currently how many CLEC customers are served through UNE-P?

A. UNE-P currently makes up a significant but not overwhelming portion of total CLEC lines. The following table shows the composition of lines currently served by CLECs:

Table 8

Percent of Total CLEC Lines[35]	
UNE-L	**5%**
UNE-P	**27%**
Resale	**1%**
Private Line Resale	**0.02%**
UNE-L with EEL	**0.3%**
Full Bypass	**67%**

[33] *In the Matter of Unbundled Access to Network Elements and Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* WC Docket No. 04-313 and CC Docket No. 01-0338, Order and Notice of Proposed Rulemaking (Released August 20, 2004)("*Interim Unbundling Order*").
[34] Qwest response to Cox data request 2-18.
[35] Response to RUCO data requests 2.28A through 2.28F, and 2.38, Full bypass numbers based on Qwest's *estimate.*

Q. Is the elimination of Commission approved rates for UNE-P more likely to affect business or residential customers?

A. UNE-P has been used primarily to serve residential customers. With the exception of Cox, all CLECs with significant numbers of residential customers have primarily used UNE-P to serve those customers. With the elimination of economic rates for UNE-P, Cox is likely to be left as the only CLEC serving significant numbers of residential customers. The market for traditional residential wire line service is likely to be a duopoly in that event.

Q. What are the implications of this duopoly market structure?

A. A duopoly market structure (and more generally an oligopoly market structure) is of concern to economists because with a small number of firms the potential for collusion (either explicit or tacit) is enhanced. Such collusion could keep prices above competitive levels to the detriment of consumers. However, it is not known whether such collusion will actually take place. Staff is not aware of any indications at this time of any collusive activity. There are highly concentrated industries that are not characterized by collusion and supra competitive prices (e.g., Boeing and Airbus are the only two manufactures of large commercial aircraft in the world and that market is generally regarding as competitive.) The degree to which concentration affects competitiveness varies from industry to industry.

Q. How would the above comments on concentration in the residential market change if other forms of competition such as wireless and VOIP are taken into consideration?

A. If wireless were to become an acceptable substitute for wire line service for most residential consumers, then the residential market would look less concentrated. Currently, Staff does not believe that wireless is a true substitute for wire line service.

Staff believes it is too early to determine the ultimate effect of VOIP. While many commentators tout VOIP as a technology that could bring wide spread competition to the wire line market, it should be remembered that many commentators felt the same way about UNE based competition in the years shortly after the 1996 Act was passed. Also, VOIP is only available to customers who also purchase a broadband connection.

Q. How is the Arizona market for business wire line telecommunications service different from the residential market?

A. There are many more CLECs providing business service then there are providing residential service. However, the overwhelming majority of business customers are still being served by Qwest.

Elimination of Commission approved pricing for UNE-P will have much less of an impact on the business market then it will on the residential market. UNE-P is not heavily depended on by CLECs serving business customers.

While in the residential market use of the UNE Loop ("UNE-L") is almost non existent, CLECs serving business customers are much more likely to use UNE-L. However, the number of business customers served through UNE-L is still not impressive even now, almost nine years after the 96 Act was passed.

There are CLECs who provide pure facilities based service to businesses. However, their numbers are not large and, with the exception of Cox, they are unlikely to be able to offer pure facilities based service to the full spectrum of potential business customers.

Q. Is there a particular reason why UNE-L based competition has not become more prevalent?

A. In its Triennial Review Order ("TRO") the FCC found that ILECs cannot handle the volume of UNE-L conversions necessary to serve the mass market.[36] A UNE-L conversion is the process of lifting a loop from the ILECs switch and then connecting it to a CLEC's switch.[37] This is a labor-intensive process that involves skilled technicians working in what can be confined conditions. In order to comply with the requirements of the TRO Qwest was developing, through a collaborative process, a Batch Hot Cut process to facilitate high volumes of UNE-L conversions. However, that collaborative process was never completed. Before the collaborative process on Batch Hot Cuts was abandoned Qwest and the CLECs had reached agreement on many issues and their impasse issues had been referred to the state commissions for resolution.

Q. Why was the Batch Hot Cut Process never completed?

A. The Commission (and most, if not all, other state Commissions) suspended its TRO proceeding after the United States Court of Appeals, D.C. Circuit issued its March 2, 2004 decision that vacated substantial portions of the TRO.

Q. Does the fact that the D.C. Circuit vacated parts of the TRO affect the FCC's finding that an improved Batch Hot Cut process was necessary?

A. No. The D.C. Circuit's decision vacated certain requirements of the TRO; it did not eliminate any of the FCC's factual conclusions.

Q. Does Staff believe that completion of the collaborative Batch Hot Cut process would enhance the prospects of competition?

A. Yes. An effective Batch Hot Cut Process will make UNE-L based competition much more viable. Staff recommends that as a part of this case the Commission should order Qwest to revive the collaborative Batch Hot Cut process. Qwest should be required to reconvene the members of the collaborative to determine if the status of the agreed upon and impasse issues has changed. If the collaborative determines that the status of the

[36] TRO ¶ 459
[37] UNE-L conversions are also referred to as "hot cuts."

issues has changed additional meetings should be scheduled to come up with a revised list of resolved and impasse issues. Whether additional meetings are necessary or not all impasse issues should be submitted to the Commission for resolution.

In our testimony Staff has endorsed enhanced pricing flexibility for Qwest and elimination of the inflation/productivity factor. Both of those Staff recommendations were based on the existence of competition. In fact, the continuation of the Price Cap Plan in general is based, from Staff's perspective, on the existence of competition. Thus, Staff believes it is reasonable to include in this case conditions that will help to bolster the prospects for competition on an ongoing basis. The pro-competitive condition that Qwest implement a viable Batch Hot Cut process serves the purpose of bolstering the prospects for competition on an ongoing basis.

Q. Does this conclude your direct testimony?

A. Yes, it does.