BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER  
Chairman

MARC SPITZER  
Commissioner

WILLIAM MUNDELL  
Commissioner

MIKE GLEASON  
Commissioner

KRISTIN 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

NOTICE OF FILING DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT.

Qwest Corporation files herewith the public/redacted version of the Direct Testimony in Support of Settlement, with associated exhibits, of David L. Ziegler, Jerrold L. Thompson and Philip E. Grate.

SUBMITTED this 6th day of September 2005.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
JEFF HATCH-MILLER, Chairman
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MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

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

DAVID L. ZIEGLER
DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT ON BEHALF OF QWEST CORPORATION

SEPTEMBER 6, 2005
## TESTIMONY INDEX

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EXECUTIVE SUMMARY

My testimony describes the consumer benefits of the Settlement Agreement (the "Agreement"); the term of the Agreement; notice to consumers; filing of tariffs and price lists; elimination of certain reporting requirements; and why the Agreement is in the public interest.

The Agreement has quantifiable consumer benefits that total $5.51 million and additional benefits that cannot be quantified in monetary terms because the benefit is either non-monetary or the number of impacted customers is unknown. Quantifiable benefits include the reduction in zone charges, a reduction in residential non-published and residential non-listed telephone listings and increased funding for the Telephone Assistance Plan for the Medically Needy. Consumer benefits that are not quantified in monetary terms are changes to the service quality tariff, increased line extension credits, a rate cap on directory assistance and the hard cap on Basket 1 services.

The proposed Agreement is in the public interest because it provides numerous consumer benefits as described in my testimony while allowing Qwest to be regulated similarly to its competitors in an increasingly competitive Arizona market.

It is my recommendation that the Commission find that the Agreement is in the public interest and approve the Agreement as filed.
I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND CURRENT POSITION.

A. My name is David Ziegler. I am employed by Qwest Services Corporation as Assistant Vice President – Arizona Public Policy. My business address is 4041 North Central Avenue, Phoenix, Arizona 85012. I am providing this testimony on behalf of Qwest Corporation ("Qwest"), the public service corporation providing telecommunications service in Arizona.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

A. I am responsible for regulatory, legislative and community affairs in Arizona.

Q. PLEASE REVIEW YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.

A. I received a Bachelor of Science degree in Business Administration from Columbia College in 1988. I have also attended numerous industry seminars on economics, management, marketing and technical courses. I began my career with Qwest (Mountain Bell) in 1978 in the business office. In 1980, I accepted the position of Manager - Residence Operations, where I was responsible for developing methods and procedures for billing and collections. In 1986, I moved to Strategy Development, where I was responsible for cost of service studies and economic regulatory issues. In 1994, I accepted the position of Manager-Regulatory Affairs in Colorado Regulatory where I was responsible for
managing regulatory issues before the Colorado Public Utilities Commission. In 1997, I accepted the position of Director - Regulatory Affairs in Colorado Regulatory. In 2001, I accepted the position of Regional Director – Out of Region, where I was responsible for regulatory and legislative activities in a 14-state area. In 2002, I accepted my current position.

Q. HAVE YOU PREVIOUSLY APPEARED BEFORE THE ARIZONA CORPORATION COMMISSION OR OTHER PUBLIC UTILITY COMMISSIONS AS A WITNESS IN REGULATORY PROCEEDINGS?
A. I have testified before the Arizona Corporation Commission (the “Commission”) in the hearing on the proposed settlement in Docket No. RT-00000F-02-271, Docket No. T-00000A-97-0238, and Docket No. T-00151B-02-0871 (consolidated). I have also testified before the Colorado Public Utilities Commission and the Illinois Commerce Commission.

Q. ARE YOU THE SAME DAVID ZIEGLER THAT PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?
A. The purpose of my testimony is to provide testimony in support of the Settlement Agreement (the “Agreement”) as filed by the Arizona Corporation Commission
Q. IS THE PROPOSED AGREEMENT IN THE PUBLIC INTEREST?

A. Yes. The proposed Agreement is in the public interest because it provides numerous consumer benefits while allowing Qwest to be regulated similarly to its competitors. In his direct testimony in support of settlement, Qwest witness Mr. Jerrold Thompson discusses additional reasons why this Agreement is in the public interest. The Agreement is the result of many months and meetings between the parties to develop a Renewed Price Cap Plan ("Plan") that balances the needs of the Company, its competitors and consumers in an increasingly competitive Arizona market.
III. CONSUMER BENEFITS

Q. WOULD YOU PLEASE DESCRIBE THE CONSUMER BENEFITS IN THE AGREEMENT?

A. The consumer benefits were designed to be statewide in scope, be meaningful, and affect as many customers as possible. Several of the consumer benefits affect all Qwest customers statewide. Those that benefit all customers are the hard cap on basket 1 services as described in the testimony of Mr. Thompson, a rate cap on directory assistance, and changes to the service quality tariff. Other consumer benefits are more targeted benefits but are statewide nonetheless. Those benefits consist of the reduction in zone charges, a reduction in residential non-published and residential non-listed telephone listings, increased funding for the Telephone Assistance Plan for the Medically Needy and increased line extension credits. Although the benefit of certain provisions within the Agreement cannot be quantified, the benefits that can be quantified total $5.5 million.

Q. PLEASE DESCRIBE THE DIRECTORY ASSISTANCE CONSUMER BENEFIT.

A. The directory assistance consumer benefit (Section 14) is a continuation of the directory assistance benefit in the previous price cap plan in that it caps the existing rate of $1.15 per call rather than pricing directory assistance at the higher market rate. It also includes one call allowance per month without charge,
two inquiries per usage and call completion. This benefit affects all Qwest customers statewide.

Q. PLEASE DESCRIBE HOW SERVICE QUALITY ISSUES AND THEIR ASSOCIATED CONSUMER BENEFIT HAVE BEEN ADDRESSED IN THE SETTLEMENT AGREEMENT.

A. Section 15 of the proposed Settlement Agreement addresses service quality issues in several ways. First, it contains incentives for Qwest to continue to maintain the high service quality levels that it achieved during the term of the initial price cap plan. Section 5 of the prior price cap plan contained a provision for business and residence customers to receive a $2.00 one-time credit during any year in which Qwest became subject to penalties under two or more of the five categories defined in Section 2.6 of the Service Quality Plan Tariff. Qwest's performance under the prior plan resulted in no customer credits being issued. The Renewed Price Cap Plan would carry over these provisions from the prior plan and provide additional incentive for Qwest to maintain high levels of service quality in addition to the competitive market incentives which exist in Arizona.

The second way in which the Agreement addresses service quality is by adopting the recommendation from Staff Witness Del Smith's Direct Testimony to adjust the penalty and offset ranges for Residence Office, Business Office, and Repair Office Access. This provision will provide Qwest with a strong incentive to perform satisfactorily because it will have the effect of increasing the ranges for
which penalties are assessed and decreasing the ranges for which penalty
offsets are received.

The third way in which the Agreement addresses service quality is by
establishing an additional objective for trouble reports. Pursuant to Section
2.5.6A of Qwest’s Service Quality Tariff, the Company must not exceed 8 trouble
reports per 100 access lines per month, averaged over a 3 month period. Under
the terms of the Settlement Agreement, Qwest would modify its Service Quality
Tariff to further require that the Company not exceed 3 trouble reports per 100
access lines in any month, averaged over all of its Arizona Wire Centers. This
provides an additional incentive to minimize trouble reports that benefits
customers.

Q. DOES THE AGREEMENT CONTAIN ANY OTHER SERVICE QUALITY
PROVISIONS?
A. Yes. The Agreement also permits modifications to the Service Quality Tariff that
would clarify Qwest’s obligations during conditions outside of its control. These
conditions, which are termed “Force Majeure”, do not significantly change
Qwest’s obligations, but provide greater clarity and include examples of events
for which Qwest would not be held responsible under the terms of the Tariff.

Q. PLEASE DESCRIBE THE REDUCTION IN ZONE CHARGES.
A. Zone charges reflect the fact that the farther a customer service location is from
the central office, the higher the cost of providing service to those customers. In
many exchanges statewide, there are two zones around the base rate area of the exchange, Zone 1 and Zone 2. The Agreement (Section 13(a)) reduces the zone charges by 50% for each zone. The current Zone 1 charge of $1.00 will be reduced to $0.50 and the current Zone 2 charge of $3.00 will be reduced to $1.50. Based on test year volumes, these reductions amount to $2M annually.

Q. PLEASE DISCUSS THE CONSUMER BENEFIT OF THE REDUCTION IN NON-PUBLISHED AND NON-LISTED TELEPHONE NUMBER RATES FOR RESIDENTIAL CUSTOMERS.

A. The Agreement provides that Qwest shall reduce rates for residential Non-Published and residential Non-Listed Telephone numbers (Section 13(b)) by $0.50. The current rates of $1.65 for residential Non-Published numbers and $1.30 for residential Non-Listed numbers will be reduced to $1.15 and $.80, respectively. Based on test year volumes, these reductions amount to $2.5M annually.

Q. WOULD YOU PLEASE DESCRIBE THE CONSUMER BENEFIT OF THE TELEPHONE ASSISTANCE PLAN FOR THE MEDICALLY NEEDY?

A. The Agreement provides for an increase in funding for the Telephone Assistance Plan ("TAP") for the Medically Needy of $1.0 Million per year. Qwest is currently providing $1.0 million of annual funding for this plan and under the Agreement that amount would increase to $2.0 million per year. In combination with the Federal Lifeline Program, the additional funding will pay the entire cost for basic
telephone service for up to approximately 7,200 new customers each year.

Under the Agreement, Qwest and DES will work together to develop a public
awareness program to increase participation in the TAP program.

Q. PLEASE DESCRIBE THE LINE EXTENSION CREDIT BENEFIT.
A. Qwest currently provides a one time credit of $3,000 towards the cost of
establishing telephone service and constructing facilities to locations in rural
areas outside of the Base Rate Area of an exchange. The intent of this credit is
to offset some of the high construction costs that rural customers incur which are
the result of longer loop lengths and lower customer densities. The Settlement
Agreement increases the amount of the Line Extension credit to $5,000 per
location. The higher Line Extension Credit amount will benefit customers living in
rural areas who according to Staff Witness Elijah Abinah's Direct Testimony, may
otherwise be unable to afford telephone service.

IV. TARIFFS AND CUSTOMER NOTICE

Q. PLEASE DESCRIBE THE NOTICE TO CONSUMERS AND THE FILING OF
REVISED TARIFFS AND PRICE LISTS.
A. Section 24 of the Settlement Agreement includes several provisions relating to
customer notices. First, Qwest has agreed to provide customers with two
separate bill inserts, the first to be sent beginning 60 days following entry of an
order approving the settlement, and the second to be sent 60 days after the first
bill insert. The notice is to inform customers of the following information:
that essential basic services which are part of any packages or offering remain available and can be obtained by the customer as a separate offering.

That the Arizona Corporation Commission remains the regulatory agency responsible for overseeing the terms, conditions, rates, and quality of intrastate telecommunications service provided by Qwest.

Complaints regarding any of Qwest's regulated services should be directed to the Commission’s Consumer Services Section.

Second, Qwest will provide training for its customer service representatives concerning the implementation of the Renewed Price Cap Plan.

Third, within 60 days from the effective date of the Renewed Price Cap Plan, Qwest will send a memorandum to organizations that assist persons with physical limitations which describes the exemption from Directory Assistance charges which is available to qualified persons with physical limitations that prevent them from using printed telephone directories. Qwest will also continue to provide this information in the red “Phone Service Pages” through its contractual arrangements with DEX.

V. REPORTS

Q. PLEASE DESCRIBE THE TWO REPORTS THAT ARE BEING ELIMINATED.

A. Section 27 of the Agreement provides for elimination of two reports that Qwest has been providing to the Commission. The first report is the deposit calculation
VI. TERM OF THE PLAN

Q. WOULD YOU PLEASE ADDRESS THE TERM OF THE PLAN?
A. The term of the Plan is three years from the effective date specified by the Commission in its order approving this Settlement Agreement and Renewed Price Cap Plan. It will continue in its entirety until the Commission either approves a renewed plan or terminates the Plan.

VII. CONCLUSION AND RECOMMENDATION

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE SETTLEMENT AGREEMENT AND THE RENEWED PRICE CAP PLAN?
A. My recommendation is that the Commission find that the Settlement Agreement and Renewed Price Cap Plan are in the public interest and approve the Settlement Agreement and Renewed Price Cap Plan as filed by the parties.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?
A. Yes.

report, which was the result of a customer deposit complaint in 1992 and is no longer an issue. The second report is the Public Access Line ("PAL") report. This report was in place because at one time Qwest provided both payphone service and PAL service. Qwest has since exited the payphone business, thereby making the PAL report unnecessary.
BEFORE THE ARIZONA CORPORATION COMMISSION

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

STATE OF ARIZONA

COUNTY OF MARICOPA

AFFIDAVIT OF

DAVID L. ZIEGLER

David L. Ziegler, of lawful age being first duly sworn, deposes and states:

1. My name is David L. Ziegler. I am Assistant Vice President – Arizona Public Policy for Qwest Services Corporation in Phoenix, Arizona. I have caused to be filed written testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

David L. Ziegler

SUBSCRIBED AND SWORN to before me this 6th day of September, 2005.

Deborah Statt

Notary Public

My Commission Expires: March 15, 2009

DEBORAH L. STATT
Notary Public – Arizona
Maricopa County
Expires 03/15/08
BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

IN THE MATTER OF QWEST CORPORATION'S
FILING OF RENEWED PRICE REGULATION
PLAN

IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS

DOCKET NO. T-01051B-03-0454
DOCKET NO. T-00000D-00-0672

JERROLD L. THOMPSON
DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT
ON BEHALF OF
QWEST CORPORATION

SEPTEMBER 6, 2005
# TESTIMONY INDEX

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EXECUTIVE SUMMARY

My testimony provides a description of the pricing flexibility afforded Qwest by the terms and conditions of the Settlement Agreement and Price Plan negotiated by the parties. Under the terms of the Agreement, Qwest has agreed to price constraints, price reductions, and overall revenue constraints from rate increases in exchange for the opportunity to raise or adjust prices for its competitive services.

Telecommunications is a very complex and competitive business in many parts of Arizona. This Settlement Agreement and Price Plan are the product of thorough consideration and careful balancing of the complex issues raised by the parties to the Agreement which include the Commission Staff, Qwest, local competitors (Cox, MCI, Time Warner, and XO), customers (Department of Defense and All Other Federal Executive Agencies), and investors (AUIA). I recommend that the Commission approve the Settlement Agreement and the Price Plan as submitted by the Parties.
I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.
A. My name is Jerrold L. Thompson. My business address is Room 4740, 1801 California Street, Denver, CO.

Q. WHAT IS YOUR POSITION WITH QWEST AND WHAT ARE YOUR RESPONSIBILITIES?
A. My title is Executive Director of Retail Issues in Qwest Service Corporation's Public Policy organization. In that position I direct and coordinate the company advocacy in matters relating to the manner in which Qwest Corporation ("Qwest") is regulated for retail services. These matters include regulatory reform in dockets before commissions and changes to laws with state legislatures.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE?
A. I have a Bachelor of Arts Degree in English and a Master of Business Administration Degree with a concentration in Accounting, both from the University of New Mexico. I have a Master of Taxation Degree from the College of Business and the School of Law of the University of Denver. I hold an inactive certificate as a Certified Public Accountant from the states of New Mexico and Colorado. I began working for Mountain Bell (now Qwest) in 1979 and have held numerous positions in industry relations, finance and accounting, costing and pricing, and public policy.
Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN ARIZONA?
A. Yes. Although I have not filed testimony in this docket prior to this testimony, I have provided testimony before the Arizona Corporation Commission ("Commission") on several occasions in the past including the rate case in 1994 (E-1051-93-183) and the rate case in 2000 (T-0105B-99-0105).

Q. HOW IS YOUR TESTIMONY ORGANIZED?
A. My testimony is organized into four topics, Competitive Zones and Universal Service, Operation of Baskets, Pricing and Deregulation of Voice Messaging and Billing and Collection services.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?
A. My testimony addresses the agreement among Qwest Corporation ("Qwest"), the Arizona Corporation Commission Utilities Division Staff ("Staff"), the Department of Defense and All Other Federal Executive Agencies ("DOD"), the regulated subsidiaries of MCI, Inc. ("MCI"), Time Warner Telecom of Arizona, LLC ("TW"), the Arizona Utility Investors Association ("AUIA"), Cox Arizona Telcom, LLC ("Cox"), and XO Communications Services, Inc. ("XO"), (collectively "the Parties") to a settlement of the pending Qwest application for renewal of its Price Cap Plan with modifications. Specifically, my testimony explains various aspects of the proposed Settlement Agreement ("Agreement") and alternative form of regulation plan ("the Plan") that is supported by the Parties as filed by Maureen
Scott, Staff attorney on August 23, 2005. My testimony discusses several aspects of the Plan in detail. My testimony, along with the testimonies of Qwest witnesses Mr. David Ziegler and Mr. Philip Grate, detail the reasons why the Commission should approve the Agreement and Plan as proposed by the Parties.

III. SETTLEMENT AGREEMENT

Q. HOW DO YOU VIEW THE SETTLEMENT AGREEMENT?
A. In my view, the Agreement proposes a thoroughly considered and thoughtfully balanced plan of alternative regulation that includes targeted benefits for consumers, recognition of the increasingly competitive market for telecommunications services in Arizona, incentives for Qwest to offer new and different competitive consumer choices, resolution of complex accounting issues, elimination of certain legal disputes, reductions in rates for Qwest's services purchased by its customers and its competitors, and movement toward cost-saving reductions in regulatory requirements. In sum, the Plan is in the public interest and should be approved by the Commission.

Q. WHICH AREAS OF THE AGREEMENT AND PLAN DOES YOUR TESTIMONY ADDRESS?
A. My testimony discusses the areas of Pricing, Operation of the Service Baskets, and the mechanics of the Agreement and Plan. Mr. Ziegler addresses the consumer benefits that have been incorporated into the Agreement and Plan and
Mr. Grate's testimony discusses the financial and accounting aspects of the Agreement and Plan.

IV. COMPETITIVE ZONES AND UNIVERSAL SERVICE FUNDS

Q. IN ITS DIRECT TESTIMONY QWEST PROPOSED THE USE OF COMPETITIVE ZONES AND REQUESTED FUNDS FROM THE STATE UNIVERSAL SERVICE FUND. HOW ARE THOSE TWO ISSUES ADDRESSED IN THE SETTLEMENT AGREEMENT?

A. In the process of negotiation, Qwest agreed to withdraw its request for competitive zones and not renew its request during the term of the Plan (Agreement, Section 26). Qwest also agreed to withdraw its request for Arizona Universal Service funds and to decrease its allowable revenue limits by a pro-rata share of any amounts of federal or state universal service funds received during the term of the Plan (Agreement, Section 19).

Competitive zones were a controversial topic in the direct testimony in this proceeding with very disparate points of view. The elimination of this issue removes this controversy. Qwest will continue to price its services to consumers in sparsely-populated areas in the state in similar ways to consumers in the highly competitive areas of Phoenix and Tucson. In other words, whatever consumer friendly action Qwest takes to compete in Phoenix and Tucson will be enjoyed by its customers in all other parts of Arizona whether those areas have the same level of competition or not.
During the course of the negotiations, the Commission solicited comments from interested parties concerning rule changes proposed by the Arizona Local Exchange Carriers Association in Docket No. RT-00000H-97-0137, In the Matter of Review and Possible Revision of the Arizona Universal Service Fund Rules. In the spirit of compromise, and in recognition of the fact that the rules for the operation of the fund could change as a result of the above docket, Qwest agreed to withdraw its request for $64 million of funding in this proceeding. Qwest is participating in Docket No. RT-00000H-97-0137 and could potentially qualify for universal service funding during the first three years of the Plan in that rulemaking. Qwest has agreed however, that any additional funding for universal service during the first three years of the Plan, whether from the state or federal jurisdictions, would result in a pro-rata decrease to the revenue opportunity established in the Plan (Agreement, Section 19).

V. OPERATION OF BASKETS

A. BASKET 1

Q. PLEASE EXPLAIN HOW THE PLAN SEPARATES SERVICES INTO DIFFERENT CATEGORIES AND HOW BASKET 1 IS TREATED IN THE PLAN.

A. The Plan creates four categories, or "baskets", of services provided by Qwest. All tariffed and price listed services are categorized in one of the Baskets. Basket 1 contains those services that are termed "Hard capped", Basket 2 contains those services allowed Limited Price Flexibility and Basket 3 consists of
Flexibly Priced Competitive Services. Basket 4 includes tariffed wholesale services.

Basket 1 consists of basic services whose prices will not be allowed to increase over the three year term of the Plan. These services include primary line flat-rate service to residence and business customers, low use option service, toll restriction, exchange zone increment charges, residence non-published and non-listed service, telephone assistance programs, and other miscellaneous services (Agreement, Section 12 and Appendix A-I). Prices for these Basket 1 services may be reduced but they may not be increased during the three year term of the Plan.

**B. BASKET 2**

Q. HOW DOES THE PLAN REGULATE BASKET 2 SERVICES?

A. The Plan acknowledges that competition has increased in Arizona since the prior plan and that the Plan should recognize degrees of relaxation of regulation. As such, a number of services were reviewed and agreed upon as services for which a limited amount of price flexibility should be allowed. These services include discretionary services such as central office vertical features and some complex business services (Agreement Section 12, and Appendix A-2). Prices for these services may be increased, but no more than 25% per year, and no more than the established aggregate limits (see Opportunity for Price Change below).
C. **BASKET 3**

**Q.** HOW DOES THE PLAN REGULATE BASKET 3 SERVICES?

**A.** Basket 3, Flexibly-Priced Competitive Services, consists of services that have been accorded pricing flexibility or have been determined by the Commission to be competitive under Commission Rule R14-2-1108 (Agreement Section 12, and Appendix A-3). Basket 3 also includes new services and packages of services offered by Qwest. Individual price increases for these services are not limited but the combined revenue increase opportunity for all services in this Basket is subject to the established limit (see Opportunity for Price Change below).

**D. **BASKET 4**

**Q.** HOW DOES THE PLAN REGULATE BASKET 4 SERVICES?

**A.** Basket 4, Wholesale Services, contains services provided to other providers of service in Arizona. Local access services to long distance companies, interconnection services, services to pay phone providers, and other miscellaneous services are included in this category (Agreement Section 12, and Appendix A-4). The Plan requires that these services be capped at the tariffed or contract price levels for the three year term of the Plan, or until contracts are renegotiated, or the FCC, the Commission or the courts determine that other prices are appropriate.

---

1 As part of the Agreement, Qwest agrees to make individual elements of its packages available on an a la carte basis and that the price of a package shall be no higher than the sum of the highest price of its a la carte prices of the services available for the package.
The Plan does provide for a decrease in intrastate switched access prices. This provision is discussed in greater detail in the next section of my testimony.

VI. PRICING

A. APRIL 1, 2005 PRODUCTIVITY ADJUSTMENT

Q. WHAT WAS THE COMMISSION DECISION REGARDING THE APRIL 1, 2005 PRODUCTIVITY ADJUSTMENT FROM THE PRIOR PLAN?

A. In its Decision No. 67734, the Commission made the following statement:

"We agree with RUCO that based on the terms of the current Price Cap Plan, and our holdings in Decision Nos. 66772 and 67047 that unless we approve a new Plan or terminate the current Plan, Qwest is required under the Continuation Clause of the Plan to make the April 1, 2005 productivity adjustment."

Further the Commission stated:

"Qwest has the burden of demonstrating that the terms of any Renewed Plan or other form of rate regulation that may ultimately be approved, whether produced by settlement or through litigation, include credit for the full value of the April 1, 2005 productivity adjustment being given to ratepayers."

Q. HOW DOES THE AGREEMENT ADDRESS THESE COMMISSION DECISIONS?

A. The Parties agree that Qwest's obligation under Decision No. 67734 is satisfied by a $12 million reduction to the allowable revenue from price changes for the first year of the Plan (Agreement, Section 7). Without this provision, Qwest would otherwise have the opportunity to raise rates by an additional $12 million.
the first year of the Plan. By reducing Qwest's opportunity to raise its rates,
Qwest is being denied the opportunity to earn its fair rate of return for one year.
$12 million is the one-year value of the productivity adjustment and therefore
represents the "full value" of that adjustment as provided in the prior plan.

B. SWITCHED ACCESS

Q. WHAT IS THE SWITCHEDACCESS COMPONENT OF THE SETTLEMENT
   AGREEMENT?

A. The Commission determined that Phase I of the docket In the Matter of the
   Investigation of the Cost of Telecommunications Access, should be considered in
   conjunction with the renewed Plan. Thus, Docket No. T-00000D-00-0672 was
   consolidated with Docket No. T-01051B-03-0454. Under the Agreement, Qwest
   will make a $12 million (annualized) reduction to its switched access prices.
   Specifically, under the terms of this Agreement Qwest will reduce its Carrier
   Common Line rate for originating traffic from $0.006244 to $0.00, its Carrier
   Common Line rate for terminating traffic from $0.014153 to $0.00, and its
   Interconnection charge from $0.00245 to $0.00. The reduction in switched
   access revenue of $12 million is accompanied by price increases in other
   services for an equivalent amount of revenue as discussed in the Opportunity for
   Price Change section of my testimony. The Parties agree that the reduction in
   switched access prices satisfies the issue of Qwest’s access rates for the three
   year term of the Plan (Agreement, Section 8).
C. SPECIAL ACCESS

Q. WHAT IS THE SPECIAL ACCESS COMPONENT OF THE SETTLEMENT AGREEMENT?

A. During the negotiations, Qwest agreed to provide, under the conditions of its Competitive Private Line Transport Services Tariff, a custom offer of intrastate DS-1 service that meets the specific needs of Parties to this Agreement. The offer is found as Attachment D to the Agreement. This offer, subject to the approval of the Agreement and Plan by the Commission, allows these and other similarly situated carriers a three-year volume-commitment arrangement at discounted prices (Agreement, Section 9).

D. OPPORTUNITY FOR PRICE CHANGES

Q. PLEASE EXPLAIN THE OPPORTUNITY FOR PRICE CHANGES THAT IS PART OF THE AGREEMENT AND PLAN.

A. Part of the Agreement, as described by Qwest witness Mr. Philip Grate, is the recognition that Qwest has an Arizona revenue deficiency of $31.8 million. The Parties to the Agreement have agreed that Qwest should be granted the opportunity to adjust certain of its rates during the term of the Plan to correct this deficiency. Because of the $12 million April 1, 2005 adjustment condition in the Plan, Qwest will not be allowed to increase its rates for services listed in Baskets 2 or 3 more than $31.8 in the first year of the Plan ($31.8 million less $12 million for the April 1, 2005 issue, plus $12 million to offset the switched access price
reduction). In the years following the first year of the Plan, the maximum amount
allowed to Qwest would be a cumulative total of $43.8 million ($31.8 million
revenue deficiency plus the $12 million to offset the switched access price
reduction). It is the position of the Parties that this pricing flexibility results in just
and reasonable rates for Qwest's intrastate operations (Agreement, Section 10).

E. ALLOCATION OF OPPORTUNITY

Q. THERE IS ALSO A PROVISION IN THE AGREEMENT THAT THE
OPPORTUNITY FOR PRICE CHANGES IS FURTHER LIMITED BY AN
ALLOCATION BETWEEN BASKET 2 AND BASKET 3 SERVICES. PLEASE
ELABORATE.

A. The $31.8 million increased revenue opportunity during the first year of the Plan
is allocated between Basket 2 and Basket 3 services such that no more than
$1.8 million is allowed from Basket 2 services. For years 2 and 3, no more than
a cumulative $13.8 million is allowed from Basket 2 services. The portion of the
revenue opportunity not used for Basket 2 is allocated to Basket 3, Flexibly-
Priced Competitive Services.
F. OTHER PRICING PROVISIONS

Q. WHAT OTHER PRICING PROVISIONS ARE INCLUDED IN THE PLAN?

A. Other provisions include agreement by the Parties that the Commission's rules on imputation do not need to be changed at this time and that Qwest be allowed to introduce promotional offerings upon one day notice to the Commission.

VII. DEREGULATION OF VOICE MESSAGING AND BILLING & COLLECTION

Q. WHAT RECOMMENDATION DOES THE PLAN HAVE FOR VOICE MESSAGING SERVICE AND BILLING AND COLLECTION SERVICES?

A. The Parties agree on deregulation of both Voice Mail Service and Billing and Collection Services. The Parties recommend that the Commission approve the deregulation of these services.

VIII. CONCLUSION AND RECOMMENDATION

Q. COULD YOU PLEASE PROVIDE YOUR CONCLUSION AND RECOMMENDATION TO THE COMMISSION?

A. The Agreement and Plan presented to the Commission contain many benefits. Several consumer benefits are described by the testimony of Mr. Ziegler. The benefits my testimony covers range from price stability for basic residence and business consumers, sharing competitive incentives with both urban and rural customers, foregoing revenue increases for the first year of the Plan (for the April
2005 adjustment), reducing switched access rates for long distance carriers, offering term and volume discounts for competitive special access services, limiting price increases for all three years of the Plan, and getting promotional discounts to customers quicker. The Plan is very comprehensive in its design and is supported by all of the signing Parties. I recommend that the Commission approve the Plan as presented.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?
A. Yes.
before the arizona corporation commission

in the matter of qwest corporation's filing of renewed price regulation plan.

in the matter of the investigation of the cost of telecommunications access.

state of colorado

county of denver

jerrold l. thompson, of lawful age being first duly sworn, deposes and states:

1. my name is jerrold l. thompson. i am executive director of retail issues for qwest services corporation in denver, colorado. i have caused to be filed written testimony in support of the settlement agreement in docket nos. t-01051b-03-0454 and t-00000d-00-0672.

2. i hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

further affiant sayeth not.

jerrold l. thompson

subscribed and sworn to before me this 31st day of august, 2005.

notary public

my commission expires: july 25, 2008
BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

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

PHILIP E. GRATE
DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT ON BEHALF OF QWEST CORPORATION

SEPTEMBER 6, 2005

PUBLIC VERSION
**TESTIMONY INDEX**

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EXECUTIVE SUMMARY

In reaching an Agreement, the parties stipulated to the amount of the fair value rate base, the rate of return on fair value rate base, the incremental revenue requirement (revenue deficiency) and the regulatory accounting Qwest is to use in future Arizona ratemaking to account for depreciation, other post-employment benefits and internal use software. The depreciation lives and methods that the Agreement prescribes reduce Qwest's test year depreciation expense 57% and will continue to be used in the future. Agreement on these key ratemaking and regulatory accounting issues allowed the parties to settle and avoid possibly protracted litigation. The revenue deficiency amounts that the parties advocated and that the Agreement stipulates are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Qwest</th>
<th>RUCO</th>
<th>Staff</th>
<th>Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$355.4 million</td>
<td>$159.5 million</td>
<td>$3.5 million</td>
<td>$31.8 million</td>
</tr>
</tbody>
</table>

Qwest has agreed to expanded reporting obligations whereby it will provide Staff separated results of operations annually. Qwest also agreed to file a rate case if its application for extension, renewal or termination of the Renewed Price Cap Plan contemplates increasing Arizona intrastate revenues more than a de minimis amount above the increased revenues that the parties agreed upon as part of this Agreement and that are permitted by the Renewed Price Cap Plan.
I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.
A. My name is Philip E. Grate. My business address is Qwest Corporation, 1600 7th Avenue, Seattle, Washington.

Q. ARE YOU THE SAME PHILIP E. GRATE WHO FILED DIRECT, REBUTTAL AND REJOINDER TESTIMONY IN THIS PROCEEDING?
A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT?
A. This testimony addresses the agreement among Qwest Corporation ("Qwest"), the Arizona Corporation Commission Utilities Division Staff ("Staff"), the Department of Defense and All Other Federal Executive Agencies, the regulated subsidiaries of MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Utility Investors Association, Cox Arizona Telcom, LLC, and XO Communications Services, Inc. (collectively "the Parties") to a Settlement Agreement ("Agreement") of the pending Qwest application for renewal of its current Price Cap Plan with modifications. Specifically I describe and explain the portions of the Agreement that pertain to cost-
of-service ratemaking issues, Arizona jurisdictional accounting and reporting issues, and filing for renewal.

III. STIPULATED COST-OF-SERVICE ISSUES

Q. DID THE PARTIES STIPULATE TO COST-OF-SERVICE ISSUES IN THE AGREEMENT?

A. Yes. The parties stipulated to the following cost-of-service issues:

- Fair Value Rate Base
- Rate of Return on Fair Value Rate Base
- Revenue Deficiency
- Jurisdictional accounting for Software, OPEBs, and Depreciation.

Q. WHY DOES THE AGREEMENT PROVIDE FOR SPECIFIC RESOLUTION OF THESE ISSUES AND NOT OTHERS?

A. In testimony, Staff argued that Qwest should agree to disagree on any number of ratemaking issues that do not impact the overall level of rate relief sought by Qwest and that Qwest should narrow the scope of the case to address only those issues that actually require a Commission finding to successfully conclude the proceeding.¹ The Agreement accomplishes this objective. It stipulates to those issues of ratemaking—rate base, rate of return and incremental revenue requirement (revenue deficiency)—upon which the Commission ordinarily makes findings of fact in rate cases, by agreeing on values but expressly not agreeing on treatment of a

¹ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 4.
number of ratemaking issues. However, the Agreement does stipulate to the
treatment of three accounting issues that require a Commission decision so as to
make clear the Arizona jurisdictional accounting to be followed in the conduct of any
future Qwest rate cases and to be used in expanded annual Arizona financial
reporting that the Company has agreed to provide.

Q. WHAT DOES THE AGREEMENT PROVIDE WITH REGARD TO RATE BASE,
RATE OF RETURN AND REVENUE DEFICIENCY?

A. In pertinent part, section 1 of the Agreement provides:

“For ratemaking purposes, and in accordance with the terms of this Agreement,
the Parties agree that the “fair value” of Qwest’s Arizona rate base for the test
year ending December 31, 2003 (the “Test Year”) is $1,507,745,000. For
ratemaking purposes and for purposes of this Agreement, the Parties agree that
a reasonable return on the fair value of that rate base is 9.5%.”

Section 2 of the Agreement provides:

“For ratemaking purposes and in accordance with the terms of this Agreement,
the Parties agree that Qwest’s jurisdictional revenue deficiency is $ 31.8 Million.”
[footnote omitted]
Q. HOW DO THE AMOUNTS FOR RATE BASE, RATE OF RETURN AND REVENUE DEFICIENCY SET FORTH IN THE AGREEMENT COMPARE WITH THE POSITIONS OF THE PARTIES IN TESTIMONY?

A. The following table compares the amounts specified in the Agreement with the positions of those Parties that filed testimony concerning rate base, rate of return and revenue deficiency.

<table>
<thead>
<tr>
<th></th>
<th>Qwest</th>
<th>RUCO</th>
<th>Staff</th>
<th>Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original Cost:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate Base</td>
<td>$1,717 M</td>
<td>$1,489 M</td>
<td>$1,560 M</td>
<td>NA</td>
</tr>
<tr>
<td>Rate of Return</td>
<td>11.18%</td>
<td>8.73%</td>
<td>9.50%</td>
<td>NA</td>
</tr>
<tr>
<td>Revenue Deficiency</td>
<td>$275.0 M</td>
<td>$159.5 M</td>
<td>$3.5 M</td>
<td>NA</td>
</tr>
<tr>
<td>Fair Value:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate Base</td>
<td>$2,141 M</td>
<td>$2,285 M</td>
<td>$2,229 M</td>
<td>$1,508 M</td>
</tr>
<tr>
<td>Rate of Return</td>
<td>11.18%</td>
<td>5.69%</td>
<td>6.65%</td>
<td>9.50%</td>
</tr>
<tr>
<td>Revenue Deficiency</td>
<td>$355.4 M</td>
<td>$159.5 M</td>
<td>$3.5 M</td>
<td>$31.8 M</td>
</tr>
</tbody>
</table>

Q. HOW DID THE PARTIES ARRIVE AT THE AMOUNTS FOR FAIR VALUE RATE BASE, RATE OF RETURN AND REVENUE DEFICIENCY REFLECTED IN THE AGREEMENT?

A. The amounts in the Agreement reflect the Parties' compromise of the many contested issues in this case. The compromise was negotiated as an indivisible part of the overall agreement to settle. The parties did not stipulate any agreement on a
number of contested ratemaking issues in the case. I call these issues “unstipulated ratemaking issues” in recognition of the fact that the Parties have not resolved how such issues should be treated for ratemaking purposes—they have only compromised on aggregate settlement values.

Q. PLEASE EXPLAIN HOW THE REVENUE DEFICIENCY IDENTIFIED IN THE AGREEMENT DIFFERS FROM QWEST’S CALCULATION OF THE REVENUE DEFICIENCY.

A. The difference between the $355.4 million revenue deficiency that Qwest advocated in testimony and the $31.8 million revenue deficiency stipulated in the Agreement is $323.6 million. The following schedule quantifies the elements of the $323.6 million difference:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stipulated jurisdictional accounting issues</td>
<td>$(170.0) million</td>
</tr>
<tr>
<td>Stipulated rate of return on original cost rate base</td>
<td>$(49.8) million</td>
</tr>
<tr>
<td>Unstipulated ratemaking issues</td>
<td>$(103.8) million</td>
</tr>
<tr>
<td>Total revenue deficiency difference</td>
<td>$(323.6) million</td>
</tr>
</tbody>
</table>
IV. STIPULATED JURISDICTIONAL ACCOUNTING ISSUES

A. Stipulation on Accounting for Internal-Use Software

Q. WHAT ISSUE REGARDING ACCOUNTING FOR INTERNAL-USE SOFTWARE WAS CONTESTED IN THIS CASE?

A. The issue that Staff, Qwest and RUCO contested is whether accrual accounting for internal-use computer software in accordance with the American Institute of Certified Public Accountants' Statement of Position 98-1 (SOP 98-1) was incorporated into Arizona regulatory accounting and Qwest ratemaking in 1999 when the FCC incorporated SOP 98-1 into the Uniform System of Accounts (USOA). Qwest and RUCO testified that it was. Staff's testimony argues that it was not and treats SOP 98-1 as adopted in the 2003 test year.

Q. WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING FOR INTERNAL-USE SOFTWARE?

A. The Agreement reflects a compromise of the parties' positions and assumes that SOP 98-1 was adopted at the beginning of the year 2001, the year in which Qwest's current Price Cap Plan became effective pursuant to Commission Decision No. 63487. Specifically, Section 3 of the Agreement provides:

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2 Docket No. T-01051B-03-0454: Direct Testimony of Marylee Diaz Cortez, page 6, line 20 to page 7, line 11; Rebuttal Testimony of Philip E. Grate, pages 23 through 32; Surrebuttal Testimony of Marylee Diaz Cortez, page 3, line 4 to line 16.
3 Docket No. T-01051B-03-0454, Direct Testimony of Steven C. Carver, page 45, line 8 to page 56 line 2.
"With respect to calculating Qwest's rate base and revenue requirement, Qwest shall be treated as having adopted on January 1, 2001 the American Institute of Certified Public Accountants' Statement of Position 98-1 (“SOP 98-1”) to account for the costs of internal use computer software, effective January 1, 2001."

Applying the assumptions employed in the Agreement instead of the assumptions Qwest and RUCO made with regard to this jurisdictional accounting issue reduces Qwest's calculated revenue requirement $30.6 million. A schedule showing this revenue requirement effect is set forth in Qwest Corporation—Exhibit PEG-S01.

B. Stipulation on Accounting for OPEBs

Q. WHAT IS OPEBS?
A. OPEBs is an acronym for other post-employment benefits.

Q. WHAT ISSUE REGARDING ACCOUNTING FOR OPEBS WAS CONTESTED IN THIS CASE?
A. The issue that Staff, Qwest and RUCO contested is whether Qwest's use of accrual accounting for OPEBs under Statement of Financial Accounting No. 106 (SFAS 106) began for Arizona ratemaking purposes in 1999. Staff argues that it did. Qwest and RUCO believe that it did not and that Qwest continues to operate under the.

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4 The assumptions used to compute this amount include the 9.5% rate of return to which the parties agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.

5 Docket No. T-01051B-03-0454, Direct Testimony of Steven C. Carver; page 56 line 4 to page 71, line 13.
cash (or “pay-as-you-go”) method of accounting that the Commission ordered
Qwest to continue using in Qwest’s last fully litigated rate case.

3 Q. WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING
FOR OPEBS?

A. The Agreement reflects a compromise of the parties’ positions and assumes that
SFAS 106 was adopted when Qwest’s current Price Cap Plan became effective
concurrent with the effective date of Commission Decision No. 63487, which was
April 1, 2001. Specifically, Section 3 of the Agreement provides:

“For settlement purposes, the Parties agree that with respect to calculating
Qwest’s revenue requirement, Qwest shall be treated as having adopted on April
1, 2001, Statement of Financial Accounting Standards (“SFAS”) 106 to account
for Other Post Employment Benefits (“OPEBs”), with a ten year amortization of
Qwest’s December 31, 2000 Accumulated Post-Retirement Benefit Obligation
(“APBO”) starting April 1, 2001.”

Applying the assumptions employed in the Agreement instead of the assumptions
Qwest and RUCO made with regard to this issue reduces Qwest’s calculated
revenue requirement $19.8 million. The calculation of this revenue requirement
effect is set forth in Qwest Corporation—Exhibit PEG-S01.

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6 Docket No. T-01051B-03-0454: Direct Testimony of Philip E. Grate, page 54, line 7 through page 56; Rebuttal Testimony of Philip E. Grate, pages 15 through 23; Surrebuttal Testimony of Marylee Diaz Cortez, page 8, line 1 to line 11.
7 A.C.C. Decision No. 58927, page 7, lines 9 through 19 and page 40, line 20 through page 45, line 5.
8 The assumptions used to compute this amount include the 9.5% rate of return to which the parties agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.
C. **Stipulation on Accounting for Depreciation**

Q. **WHAT ISSUE REGARDING ACCOUNTING FOR DEPRECIATION WAS CONTESTED IN THIS CASE?**

A. The issue that Staff, Qwest and RUCO contested is whether Qwest's depreciation rates should be based on the lives and survivor curves the Commission prescribed in Decision No. 62507 on May 4, 2000 in Qwest's last depreciation case or on newly prescribed lives and survivor curves. Qwest and RUCO testified that the depreciation rates should reflect a technical update of the lives the Commission prescribed in Decision No. 62507 while Staff proposed the use of longer lives.

Q. **WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING FOR DEPRECIATION?**

A. In pertinent part, Section 4 of the Agreement provides:

> "The Parties agree that Qwest will use the depreciation rates and amortizations shown on Attachment B. This results in approximately a $255 Million reduction in the annual intrastate depreciation expense for each year of the first five years, and approximately a $225 million annual reduction below the test year level in the intrastate depreciation expense thereafter."

The rates and amortizations shown on Attachment B reflect substantially longer projection lives than those the Commission prescribed in Qwest’s last depreciation case.

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9 Docket No T-01051B-97-0689.
10 Docket No. T-01051B-03-0454, Direct Testimony of Dennis Wu, page 2, lines 1 through 9.
11 Docket No. T-01051B-03-0454, Direct Testimony of Marylee Diaz Cortez, page 23, lines 12 through 16.
case. The result of these longer lives and other changes to which Qwest agreed
decrease Qwest’s unadjusted 2003 test year Arizona intrastate depreciation
expense by 57%. Qwest’s use of the longer lives will be ongoing.

Q. HOW DOES THE DEPRECIATION EXPENSE REDUCTION PRESCRIBED BY
THE AGREEMENT COMPARE WITH THE DEPRECIATION EXPENSE
REDUCTION THAT STAFF PROPOSED IN TESTIMONY?

A. The following table sets forth the amount of Arizona intrastate depreciation expense
change proposed by Qwest and Staff, and the amount prescribed by the Agreement.

<table>
<thead>
<tr>
<th>Proposed Test Year Depreciation Expense Adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qwest</td>
</tr>
<tr>
<td>($155) million</td>
</tr>
</tbody>
</table>

As the table shows, the Agreement calls for a $4 million greater reduction in
depreciation expense than Staff proposed. The reduction in test year depreciation
expense prescribed in the Agreement reduces Qwest’s calculated revenue
requirement $119.6 million.\(^{13}\) A schedule showing this revenue requirement effect is
set forth in Qwest Corporation—Exhibit PEG-S01.

\(^{13}\) The assumptions used to compute this amount include the 9.5% rate of return to which the parties
agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.
V. STIPULATED RATE OF RETURN ON ORIGINAL COST RATE BASE

Q. PLEASE EXPLAIN THE STIPULATED RATE OF RETURN ON ORIGINAL COST RATE BASE.

A. Arizona Administrative Code (A.A.C.) R14-2-4-103 calls for the filing of two different calculations of rate base, one on the original cost basis and one on a fair value basis. Using an 11.18% rate of return on its calculation of original cost rate base, Qwest calculated a revenue deficiency of $275.0 million. Substituting the 9.5% rate of return stipulated in the Agreement for the 11.18% that Qwest used reduces Qwest’s calculated revenue deficiency by $49.8 million. A schedule showing this revenue requirement effect can be found in Qwest Corporation—Exhibit PEG-S01.

The 9.5% rate of return is the same as the rate of return Staff applied to its calculation of original cost rate base.

VI. UNSTIPULATED RATEMAKING ADJUSTMENTS

Q. PLEASE EXPLAIN THE UNSTIPULATED RATEMAKING ADJUSTMENTS.

A. Staff and Qwest contested a variety of ratemaking issues upon which they reached no stipulation or agreement. The parties reserve their right to contest these unstipulated ratemaking issues in any future Arizona ratemaking proceedings.

Specifically, footnote 1 of the Agreement provides:
"The agreements set forth in Sections 1 and 2 regarding the quantification of fair value rate base, a reasonable rate of return and the amount of the revenue deficiency are made for purposes of settlement only. The Parties stipulate that the agreements regarding quantification of fair value rate base, a reasonable rate of return, revenue requirement, and revenue deficiency should not be construed as admissions against interest or waivers of litigation positions or claims by any Party relating to the calculation of these amounts. The Parties also stipulate that except as specifically set forth in Sections 3 and 4 of the Agreement, each Party reserves the right to pursue its advocacy in regard to any such controversy in other proceedings."

Sections 3 and 4 of the Agreement address the stipulated jurisdictional accounting issues, which the parties have agreed not to contest in future ratemaking proceedings. The difference between the Agreement’s calculation of revenue requirement and Qwest’s calculation of revenue requirement attributable to unstipulated ratemaking issues is $103.8 million. A schedule setting forth this revenue requirement effect can be found in Qwest Corporation—Exhibit PEG-S01.

VII. EXPANDED REPORTING OBLIGATIONS

Q. DOES THE SETTLEMENT AGREEMENT EXPAND QWEST’S FINANCIAL REPORTING OBLIGATIONS?

A. Yes. In pertinent part, Section 3 of the Agreement provides:

"The Parties agree that Qwest will provide Staff with a confidential copy of its year-to-date December 1990s report for Arizona, prepared in the normal course of business, or any substantively identical replacement. Qwest will provide this report at the same time it files its annual report with the Commission. Staff will treat the 1990s report as confidential, the same treatment required under Commission rules for its annual report."
Qwest Corporation—Confidential Exhibit PEG-S02 provides examples (showing calendar years 2001 through 2004) of the annual reporting that Qwest will provide in accordance with Section 3 of the Agreement.

Q. WHY IS THE PROVISION OF THE 1990s REPORT FOR ARIZONA AN EXPANSION OF QWEST'S REPORTING OBLIGATIONS?

A. The 1990's report provides separated results of operations. The Commission's rules do not call for the regular periodic filing of separated results of operations. Qwest does not routinely provide this information except as part of a rate case filing under A.A.C. R14-2-103.

VIII. EXPANDED RENEWAL OBLIGATIONS

Q. DOES THE SETTLEMENT AGREEMENT EXPAND QWEST'S OBLIGATIONS WITH REGARD TO THE FILING OF AN APPLICATION FOR EXTENSION, REVISION OR TERMINATION OF THE PLAN?

A. Yes. At Section 18, the Agreement contains essentially all of the filing requirements for extension, revision or termination of the Renewed Price Cap Plan that are found in Qwest's current Price Cap Plan. However, the Agreement also adds a new obligation to file a rate case under certain circumstances. In pertinent part, Section 18 of the Agreement provides:

"Qwest shall initiate extension, revision or termination of the Renewed Price Cap Plan by submitting an application to the Commission for review by the
Commission, Staff, RUO, and any other interested parties at least 9 months prior to the expiration of the Renewed Price Cap Plan. Qwest shall serve its application upon all Parties to this Settlement Agreement.

If Qwest's application is for an extension, revision or termination that would increase Arizona regulated revenues in aggregate by more than a de minimis amount, then Qwest shall file a rate case under A.A.C. R-14-2-103, at least 9 months prior to the expiration of the Renewed Price Cap Plan. The timeframes established herein for filing shall not alter Commission rules (A.A.C. R14-2-103) with respect to processing times. The procedural rules and timeframes established under A.A.C. R14-2-103 §§ 7 through 11 thereof shall apply."

The current Price Cap Plan includes no requirement to file a rate case. The Revised Price Cap Plan does in cases where Qwest's application for an extension, revision or termination would increase Arizona regulated revenues in aggregate by more than a de minimis amount above the increased revenues that the parties agreed upon as part of this Agreement and that are permitted by the Renewed Price Cap Plan.

Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?

A. Yes.
BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

IN THE MATTER OF QWEST CORPORATION'S
FILING OF RENEWED PRICE REGULATION
PLAN

IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS

DOCKET NO. T-01051B-03-0454

DOCKET NO. T-00000D-00-0672

PHILIP E. GRATE
EXHIBITS OF
DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT
ON BEHALF OF
QWEST CORPORATION

SEPTEMBER 6, 2005
<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>EXHIBIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule showing the elements of revenue requirement representing the difference between Qwest's position in testimony and the Agreement.</td>
<td>PEG-S01</td>
</tr>
<tr>
<td>Confidential copy of Qwest's year-to-date December 1990s report for Arizona for the years 2001, 2002, 2003 and 2004 modified to reflect ratemaking adjustments for accounting for OPEBs and internal-use software as stipulated in the Agreement and further modified to include ratemaking adjustments for a $72 million directory revenue imputation and for state and local taxes.</td>
<td>PEG-S02</td>
</tr>
</tbody>
</table>
Calculation of the elements of revenue requirement representing the difference between Qwest's position in testimony and the Settlement Agreement.

### 1) Detail of Differences: ($ 000's)

<table>
<thead>
<tr>
<th>Ln</th>
<th>Adjustment #</th>
<th>Adjustment Description</th>
<th>Revenue Requirement Per Settlement</th>
<th>Qwest (1) Revenue Requirement Per Testimony</th>
<th>Difference Between Qwest Position in Testimony vs the Settlement Agreement</th>
<th>Running Total RevReq</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Total</td>
<td>Total Revenue Requirement (Rejoiner Testimony of Philip E. Grate pg 21)</td>
<td>A 417,448</td>
<td>B 417,448</td>
<td>C=A-B 0</td>
<td>D=D1 + Sum C 355,449</td>
</tr>
<tr>
<td>2</td>
<td>Per Books</td>
<td>Per Books Revenue Requirement at Qwest 11.18% ROR</td>
<td>(49,757)</td>
<td>(49,757)</td>
<td></td>
<td>305,692</td>
</tr>
<tr>
<td>4</td>
<td>All</td>
<td>Effect of Stipulated ROR of 9.50% on Original Cost Rate Base</td>
<td>23,397</td>
<td>17,608</td>
<td></td>
<td>255,231</td>
</tr>
<tr>
<td>5</td>
<td>PFA-02</td>
<td>PFA-02 Post Employment Benefits Other Than Pensions</td>
<td>(13,010)</td>
<td>(143,180)</td>
<td></td>
<td>135,632</td>
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<tr>
<td>6</td>
<td>PFA-03</td>
<td>PFA-03 REVISED SOP98 Adoption</td>
<td>(262,780)</td>
<td>(19,842)</td>
<td></td>
<td>285,849</td>
</tr>
<tr>
<td>7</td>
<td>PFA-01 &amp; PFN-11</td>
<td>PFA-01 Depreciation and PFN-11 Depreciation Synchronization</td>
<td>(83,497)</td>
<td>(20,335)</td>
<td></td>
<td>31,800</td>
</tr>
<tr>
<td>8</td>
<td>All Other</td>
<td>Net of all issues not stipulated in Settlement Agreement</td>
<td></td>
<td></td>
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<tr>
<td>9</td>
<td>Sum Lns 3 thru 9</td>
<td>Revenue Requirement Proposal</td>
<td>(31,800)</td>
<td>(355,449)</td>
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<td>(323,649)</td>
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<td>10</td>
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<td></td>
<td></td>
<td>(31,800)</td>
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</tbody>
</table>

(1) Qwest Revenue Requirements for PFA-01, PFA-02, PFA-03 and PFN-11 are sourced from Exhibit PEG-RJ05 in Rejoiner Testimony of Philip E. Grate, but revised to reflect Staff factors for ROR and Revenue Multiplier. This avoids a double count of differences due to Staff factors already included in Ln 6.

### 2) Summary of Differences (Summary of Column C in Table 1): ($ Millions)

<table>
<thead>
<tr>
<th>Difference Between Qwest Position in Testimony vs the Settlement Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stipulated Jurisdiction Accounting Issues</td>
</tr>
<tr>
<td>Stipulated Rate of Return on Original Cost Rate Base</td>
</tr>
<tr>
<td>Unstipulated Ratemaking Issues</td>
</tr>
<tr>
<td>Total Revenue Deficiency Difference</td>
</tr>
<tr>
<td>ACCOUNT DESCRIPTION</td>
</tr>
<tr>
<td>---------------------</td>
</tr>
<tr>
<td>LOCAL SERVICE</td>
</tr>
<tr>
<td>ACCESS SERVICE</td>
</tr>
<tr>
<td>LONG DISTANCE SERVICE</td>
</tr>
<tr>
<td>MISCELLANEOUS</td>
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<tr>
<td>TOTAL REVENUE</td>
</tr>
<tr>
<td>COSTS OF SERVICES AND PRODUCTS</td>
</tr>
<tr>
<td>MAINTENANCE</td>
</tr>
<tr>
<td>ENGINEERING</td>
</tr>
<tr>
<td>NETWORK OPERATIONS</td>
</tr>
<tr>
<td>NETWORK ADMINISTRATION</td>
</tr>
<tr>
<td>ACCESS</td>
</tr>
<tr>
<td>OTHER</td>
</tr>
<tr>
<td>TOTAL COST OF SERV AND PROP SELLING, GENERAL &amp; ADMINISTRATIVE</td>
</tr>
<tr>
<td>CUSTOMER OPERATIONS</td>
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<tr>
<td>CORPORATE OPERATIONS</td>
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<tr>
<td>PROPERTY AND OTM OPERAT TAXES</td>
</tr>
<tr>
<td>UNCOLLECTIBLES</td>
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<tr>
<td>TOTAL SEGREG AND ADMINIST</td>
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<tr>
<td>OTHER OPE INCOME &amp; EXPENSE</td>
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<tr>
<td>DEPRECIATION AND AMORTIZATION</td>
</tr>
<tr>
<td>UNIVERSAL SERVICE FUND</td>
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<td>LINK OF AMERICA</td>
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<tr>
<td>TOTAL OPERATING EXPENSES (L12+L17-L18+L19+L20+L21)</td>
</tr>
<tr>
<td>INCOME FROM OPERS BEFORE TAXES (L5-L22)</td>
</tr>
</tbody>
</table>

**INCOME TAXES**

24 FEDERAL

25 STATE AND LOCAL

26 NET OPERATING INCOME (L23-L24-L25)

27 INTEREST EXPENSE

28 MONOPOLY INC & KFP

29 NONOPERATING INCOME TAX

30 PURPLE SRT & NONRES NET INCOME

31 EXTRAORDINARY ITEMS

32 NET INCOME (L26-L27-L28-L29-L30-L31)

33 NET INCOME AVAILABLE FOR TOTAL CAPITAL OBLIGATIONS
## Redacted
<table>
<thead>
<tr>
<th>Account Description</th>
<th>Adj.</th>
<th>Rate Making</th>
<th>Adj.</th>
<th>Rate Making</th>
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<th>Rate Making</th>
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<th>Rate Making</th>
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<td>Local Service</td>
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<td>Miscellaneous</td>
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<td>Network Operations</td>
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<td>Network Administration</td>
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<td>Other</td>
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<td>Total Cost of SERV and PROD</td>
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<td>Selling, General &amp; Administrative</td>
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<td>Customer Operations</td>
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<td>Corporate Operations</td>
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<td>Property and Other Operating Taxes</td>
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<td>Other Operating Income &amp; Expense</td>
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<td>Depreciation and Amortization</td>
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<td>Universal Service Fund</td>
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<td>Line Up America</td>
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<tr>
<td>Income from GFPS Before Taxes</td>
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<td>State and Local</td>
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</tbody>
</table>

| Interest Expense    |                             |
| Non-operating Income Tax |                     |
| Juris Diff & Nonrep Net Income |         |
| Extraordinary Items  |                             |

| Net Income Available for Total Capital Obligations | |

**CONFIDENTIAL**

1990 REPORT PROCESSOR

For Year 2001

**Arizona Corporation Commission**

Docket No. T-010518-B-03-0454

Docket No. T-000000-00-0672

Qwest Corporation

Testimony of Phillip E. Grate

September 6, 2005

Confidential Exhibit PEX-902

**REDACTED**
## 1990 REPORT PROCESSOR
For Year 2001

### REDACTED
Philip E. Grate, of lawful age being first duly sworn, deposes and states:

1. My name is Philip E. Grate. I am State Finance Director for Qwest Corporation in Seattle, Washington. I have caused to be filed written testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Philip E. Grate

LORI L. WHITE
Notary Public

My Commission Expires: 7/10/07