

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

**IN THE MATTER OF THE IMPLEMENTATION)
AND ENFORCEMENT OF QWEST)
CORPORATION'S AMENDED ALTERNATIVE) Case No. 05-00094-UT
FORM OF REGULATION PLAN.)**

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COMMUNICATIONS

**REPORT OF QWEST CORPORATION REGARDING INVESTMENT AND
REQUEST FOR NEGOTIATION**

Introduction and Background

Qwest Corporation ("Qwest") submits its report regarding its future investments under the Amended Form of Regulation Plan ("AFOR") as directed by the Public Regulation Commission's ("Commission" or "PRC") in its Final Order in Case No. 04-00237-UT ("Final Order"). The Final Order says:

Starting by no later than May 20, 2005, and within twenty (20) days of the end of each regular calendar quarter thereafter, Qwest shall file in this docket reports detailing by project and amount how it will comply with its AFOR investment commitment for the remaining duration of the AFOR.

Qwest has and intends to continue to comply fully with the spirit of the AFOR. However, it is financially impossible and imprudent for Qwest to increase its total investments in New Mexico to \$788 million by next March, although Qwest believes that it should achieve that goal by late 2009. In an effort to establish an open and constructive dialogue, taking cognizance of Qwest's and the Commission's legal positions and rights, this report candidly assesses Qwest's investments over the next year by applying, as it should, sound business and policy principles that govern the making and timing of investments. This report also invites the Commission to engage with Qwest in negotiations to resolve the dispute over AFOR investment levels in a manner

that recognizes prudent criteria for investments employed by Qwest, while delivering to its New Mexico customers services that they need and want.

Many factors are involved in the decision by a telecommunications provider to make or not make an investment in its infrastructure and network. This decision-making process includes the following interrelated considerations: (1) will the investment efficiently promote and/or improve service quality; (2) will the services generated through the investment be purchased by customers; (3) will the provider be able to recover, or put another way, earn a reasonable return on, the investment; (4) related to Number 2, do growth and development projections support estimates of customer demand; and (5) will the investment require that the provider obtain and pay for additional rights-of-way, such as easements, in order to actually install the new or augmented facilities. An additional overlay to this analysis, as it applies to Qwest in New Mexico, of course, is whether the investment would be consistent with the goals and objectives of the AFOR – i.e., to provide services consistent with the service quality benchmarks and to provide advanced DSL and ISDN services to the enumerated wire centers. While these criteria sound straightforward, they are complex to implement and are highly interrelated. Accordingly, prudent management and business practices dictate careful and thorough modeling and analysis of investment decisions.

The Final Order suggests that the only criterion governing investment under the AFOR is whether Qwest's JR-21 reports will reflect investments in the aggregate amount of \$788 million by March 2006. Putting aside the physical impracticability of achieving this investment level by that date, application of this criterion alone would result in Qwest making millions of dollars of imprudent and uneconomic investment that would

not achieve the goals and objectives of the AFOR, let alone demonstrate responsible management of Qwest's business.

In addition, the Commission wants Qwest to deploy advanced and redundant facilities in the hope that these investments will spur growth of business and residential markets; however, there is no rigor behind these assumptions and hopes and, indeed, Qwest's projections and analyses suggest the contrary – i.e., such growth is unlikely to occur.

It is not practical, and not possible, for Qwest to file a report listing reasonable and prudent investments that total \$788 million over the term of the AFOR.¹ Indeed, even if the Commission directs Qwest to make imprudent and uneconomic investments, which it should not given its legal mandate to oversee prudent and efficient operation of the company, it is physically impossible to reach an investment level of \$788 million by the end of the AFOR. This is due to time constraints and the absence of a sufficient number of network engineers and technicians necessary to design and install facilities in an amount that would total \$788 million by March 2006. On top of this, many “wish list” investments likely involve the acquisition of new rights-of-way, a time-consuming and expensive process in many instances.

Thus, Qwest hereby submits its report to reflect the practical realities facing it in New Mexico. This report provides an estimate of the amount of reasonable and prudent investments Qwest can make over the course of the next year and the estimated period within which Qwest currently projects it could reach a total of \$788 million. This report

¹ Qwest also reserves all its rights and objections to the Final Order, and hereby incorporates the Complaint filed in the United States District Court for the District of New Mexico, Civil Action No. CIV-05-530 JP/DJS, and the Notice of Appeal filed in the Supreme Court for the State of New Mexico, Case No. 29,288.

describes Qwest's fulfillment of the goals of the AFOR, particularly its service quality and advanced services components. This report also describes the unreasonableness and imprudence of investments suggested during the proceedings. Finally, and perhaps most importantly, this report invites the Commission and its Staff to confer and cooperate in the formulation of a realistic plan of investment that incorporates the policies underlying the AFOR and the economic realities facing the company.

Investment Estimates

During the hearings in this matter, the Commission issued a bench request similar to the directive contained in the Final Order for Qwest to submit a report by May 20. When Qwest submitted Confidential Attachment B in response to the Commission's bench request, it estimated that the going-forward investment required to maintain and operate its New Mexico network is \$62 million per year. Given that figure, and incorporating in this report by reference all of the caveats recited in notes 1 through 4 of Confidential Attachment B, Qwest anticipates that current service quality and customer needs in New Mexico will result in an investment of about \$576 million through the end of the AFOR. This total would have been about \$650 million had the Commission allowed the inclusion of wireless capital investment, QCC capital investment, and all capitalized IT costs. Moreover, and with the same caveats, Qwest anticipates that it will have achieved the \$788 million investment threshold by late 2009. This is simply an estimate because it does not take into account any incremental projects not currently planned or anticipated and does not address unforeseen, and thus unknowable, changes such as those that had an impact on the investment levels in the AFOR, as discussed at the hearings. For instance, the \$62 million annual estimate does not include the capital

investment required for a diverse, dedicated high bandwidth circuit for the Los Alamos laboratory that is currently under discussion between representatives of the laboratory and Qwest.

Fulfillment of the AFOR Objectives

Qwest's advanced services deployments (DSL) in central offices have reached a level almost two and a half times the deployments required under the AFOR. Beyond these central office deployments, Qwest has deployed literally hundreds of remote terminals not required by the AFOR, thereby bringing DSL availability for New Mexico residences and businesses from no more than 35 percent in March 2001 to above 65 percent currently.² This well exceeds the average percentage of availability across the country, approximately 50 percent, which the testimony in the hearing established³.

Some parties and commenters suggested during the investigation that DSL should be deployed ubiquitously in the state. In general, the Qwest DSL planning and evaluation process assesses the potential subscriber penetration for a location and compares that penetration to the estimated capital costs to deploy DSL technology at the site, whether it is central office-based or a remote terminal. It is in Qwest's interests to deploy DSL service as broadly and rapidly as it can economically do so. As a result of continuing technological improvements, Qwest is now able to go into areas that were once uneconomic, and the company expects this trend to continue. Qwest continually evaluates its DSL penetration in New Mexico with these factors in mind, and it intends to continue to deploy DSL as circumstances permit.

² See Torrence Rebuttal Testimony, p. 26.

³ Id.

The Final Order suggests that potential investments Qwest should make include ubiquitous replacement of lead cable that, due to extreme weather conditions in some parts of New Mexico in the recent past, has resulted in some service outages. A ubiquitous replacement of cable in New Mexico would be an extraordinarily unproductive and uneconomic expenditure of millions of capital dollars. Lead cable plant can and does operate effectively, but on occasion, either severe weather or other exogenous factors may result in damage to the cable. An outage can be repaired and service restored fully by rehabilitation of a relatively small portion of cable. Replacement of an entire section of cable would be a wasteful expenditure of capital with no additional improvement in service quality. The prudent and efficient method of addressing outages is to test the network, assess each problem as it occurs, and rehabilitate those portions of cable necessary to restore service. A technician's testing of the network upon an outage may reveal that the cable was not the cause, and thus repairs or capital expenditures other than cable rehabilitation are necessary to address the problem.

In the interest of full disclosure, Qwest brings to the Commission's attention the fact that Qwest may not achieve one of the service quality benchmarks for Period 4. The severe weather in New Mexico over the past several months produced extraordinary hail, wind and rain that, in turn, caused damage to the network, including portions of the cable plant and other facilities. Due to the relatively high and unanticipated number of outages caused by these conditions, on occasion Qwest did not immediately have sufficient technicians available to restore service within the benchmark 24-hour period. Qwest will continue to work diligently to deploy the appropriate number of technicians, rehabilitate

cable and repair other causes of outages. However, Qwest believes that the annual benchmark will not be achieved for Period 4. Nevertheless, any failure to meet the 24 hour benchmark will be due to extreme weather conditions, not a lack of investment, and the prudent solution is for Qwest to continue expending its resources and rehabilitating cable plant efficiently as described above.

Subject to the possibility that Qwest may not meet one of the service quality benchmarks for Period 4, Qwest's record of meeting and exceeding service quality metrics was also undisputed at the hearings and need not be recounted here. Qwest will work to continue to provide timely provisioning of services and high service quality according to the AFOR's benchmarks.

Imprudence and Impracticality of Original and Proposed Investment Objectives

Any analysis of prudent investment must incorporate a rigorous assessment of whether the investment will be profitable. The Commission, on page 33 of the Final Order, addresses Qwest's bidding for MCI and implies that if Qwest is willing to spend billions to acquire MCI, then it should be able to meet the AFOR investment levels. As press accounts and statements by Qwest management made clear during the auction of MCI, Qwest thoroughly analyzed its potential investment in MCI and concluded it would yield significant returns to and benefits for Qwest. Putting aside the relevance to the situation at hand of Qwest's potential investment to acquire MCI to the situation at hand, the fact is that Qwest must make the same rational and empirical determinations with respect to any investment in New Mexico. As Ms. Taylor's testimony during the hearings⁴ indicated and as Qwest here reiterates, even if it were physically possible, there is no conceivable way that Qwest can reach the \$788 million investment level by March,

⁴ See Taylor Direct Testimony, p. 14; 1 Tr. (Taylor), p. 178.

2006, and at the same time make prudent and economic investments. Thus, the Commission's directive that this report contain a list of projects to achieve this end is simply impossible to meet.

Because any project list that Qwest would create and submit in response to the requirement in the Final Order, beyond the current projections noted above, would be constructed solely to reach an aggregate investment level of \$788 million as fast as possible, it could not, by its very nature, reflect any determination by Qwest that the proposed projects are necessary, reasonable, prudent and useful to the company or its customers.

An example of imprudent and uneconomic investments suggested by parties would be the deployment of Voice Messaging Services to the four remaining central offices in New Mexico where it is not currently deployed. Qwest analyzes the return on investment for this service over a five-year period to determine the reasonableness of the investment. None of these prospective projects would break even or turn profitable within five years; in fact, in one case the project would lose increasing amounts of money annually, year over year. The average net loss per year generated by deploying VMS in all four central offices would be over \$200,000, and over the five years analyzed would be over \$1,000,000.

In sum, an unconditional directive to invest \$788 million and to reflect this amount in the company's JR-21 reports by March, 2006, should not be the issue. The issues are what additional investments, if any, are necessary to fulfill the objectives of the AFOR, and what other investments, if any, meet the criteria Qwest and other prudent

businesses apply in making investment determinations in the first instance . The parties should, therefore, devise a process to make these determinations.

Request to Develop Plan of Investment

Qwest invites the Commission and its Staff to collaborate with the company to create a rational plan for investment in New Mexico. Such a plan cannot be predicated solely on the goal of reaching a particular dollar figure of capital expenditure within an unrealistically compressed timeframe. Rather, such a plan should consider and propose worthwhile, realistic projects that would continue to improve the infrastructure in New Mexico and account for the economic realities facing Qwest in this competitive market. Alternatively, the parties could fashion other solutions that combine investments with other reasonable remedies that will benefit New Mexicans and the Qwest infrastructure. Qwest believes that opening a constructive dialogue with these goals and objectives will better serve the interests of all concerned than mandates that are simply impossible and impractical to meet and the protracted litigation that will ensue.

Therefore, Qwest respectfully requests that the Commission direct its Staff to meet with Qwest to discuss a framework for negotiating and resolving these investment issues, and that Qwest be given the opportunity to submit a proposal addressing future investments in New Mexico in conjunction with possible modifications of other aspects of the AFOR.

Respectfully submitted,

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