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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION Arizona Corporation Commission
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7
8 IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.
9

DOCKET NO. T-01051B-03-0454

10 IN THE MATTER OF THE
11 INVESTIGATION OF THE COST
OF TELECOMMUNICATIONS
12 ACCESS.

DOCKET NO. T-00000D-00-0672

13
14 **RUCO's RESPONSE TO EMERGENCY MOTION TO SUSPEND THE INFLATION MINUS
PRODUCTIVITY FACTOR ADJUSTMENT**

15 RUCO opposes Qwest Corporation's ("Qwest") Emergency Motion to Suspend the
16 Inflation Minus Productivity Factor Adjustment ("Motion").
17

18 **INTRODUCTION**

19 Qwest's current price cap plan requires annual adjustments each April 1st to reflect
20 inflation minus productivity. Under the existing plan as interpreted by the Commission in
21 Decision Nos. 66772 and 67047, the next adjustment would be required on April 1, 2005.
22 Qwest has requested certain modifications to its price cap plan in this proceeding (the "Price
23 Cap Review Docket"). Qwest's Motion seeks to suspend the inflation minus productivity
24 adjustment pending a final order in the Price Cap Review Docket.

1 The parties recently began a process to attempt to negotiate a settlement of the Price
2 Cap Review Docket. While Qwest's Motion suggests that "the pursuit of settlement is
3 jeopardized by the looming April 1 rate reduction," the reasons it cites for suspension of the
4 adjustment are unrelated to the settlement process. Qwest does not claim that the delay of the
5 proceeding due to settlement discussions is cause for its Motion.¹ Instead, Qwest claims that
6 a rate reduction would be confiscatory in light of the pre-filed testimony in the Price Cap
7 Review Docket that, based on a traditional revenue requirements analysis, Qwest is
8 experiencing a revenue deficiency. Further, Qwest alludes to a possible "yo-yo" effect of rates
9 being decreased due to the inflation minus productivity adjustment, then increased after the
10 conclusion of the Price Cap Review Docket. Neither of these bases to suspend the adjustment
11 is related to any delay due to settlement negotiations.

12 Qwest previously raised both these arguments to the Commission, and the
13 Commission has previously rejected them. In addition, Qwest's Motion speciously and
14 contradictorily argues that a traditional rate of return analysis merits a suspension of the April
15 1st adjustment, while at the same time Qwest's testimony in this docket claims that rate of
16 return regulation is irrelevant in a competitive market.

17
18 **SUSPENSION OF THE APRIL 1ST ADJUSTMENT WOULD UNDERMINE THE**
19 **COMMISSION'S RECENT DECISIONS CONFIRMING THAT IT IS LEGALLY REQUIRED.**

20 Two times in the past year the Commission has ruled that the current price cap plan
21 requires annual inflation minus productivity adjustments—Decision Nos. 66772 (February 10,
22 2004) and 67047 (June 18, 2004). Qwest appealed both of those decisions, and those

23
24 ¹ Even without the recent suspension of the procedural schedule to allow settlement negotiations to proceed, it would have been nearly impossible to conduct a hearing with 28 witnesses beginning February 10, 2005 and have the Commission enter an order by April 1, 2005.

1 appeals are currently pending before the Court of Appeals.² Qwest's Motion is an attempted
2 end-run around those two decisions. Qwest is now asking the Commission to suspend the
3 very mechanism which the Commission concluded was an "integral part" of the current price
4 cap plan that must remain in effect until the Commission approves a new or revised plan.³

5 The Commission has already rejected Qwest's argument that unverified claims of
6 under-earning justify the termination of the inflation minus productivity adjustment. Qwest
7 argued in its Motion to Clarify, or in the Alternative, to Terminate Price Cap Plan, that
8 continuation of the inflation minus productivity adjustment unconstitutionally prevented Qwest
9 from earning a reasonable return on its investment.⁴ The Commission rejected that argument
10 in adopting Decision No. 66772. Qwest reasserted the same argument in its Application for
11 Rehearing of Decision No. 66772.⁵ The Commission once again rejected that argument when
12 adopting Decision No. 67047. Qwest is now making the argument for the third time that a
13 continuation of a rate structure that results in under-earning is constitutionally impermissible.
14 The Commission should again reject Qwest's attempt to have the Commission modify the
15 existing rate structure prior to complying with the Arizona Constitution's requirements to find
16 fair value prior to adopting new rates.

17 In its original Motion to Clarify the price cap plan Qwest argued that its calculations
18 indicated that Qwest was under-earning by \$8.4 million based on a 2002 test year.⁶ Now, Staff
19 and RUCO have also pre-filed testimony concluding that the Company is under-earning based
20

21 ² Arizona Court of Appeals, Division One, Docket No. 1CA-CC 04-0001 (consolidated).

22 ³ Decision No. 67047 at 5.

23 ⁴ Motion to Clarify, or in the Alternative, to Terminate Price Cap Plan, Docket No. 01051B-03-0454, filed
November 7, 2003, at 13-14.

24 ⁵ Qwest Corporation's Application for Rehearing and an Immediate Stay of Decision No. 66772,
Docket No. T-01051B-03-0454, filed February 25, 2004, at 19-23.

⁶ Motion to Clarify, or in the Alternative, to Terminate Price Cap Plan, Docket No. 01051B-03-0454, filed
November 7, 2003, at 14. Qwest has subsequently filed updated schedules claiming under-earning of
\$322 million based on a 2003 test year original cost less depreciation rate base.

1 on a traditional revenue requirements analysis.⁷ It was premature for the Commission in
2 resolving the Motion to Clarify to reach a conclusion whether Qwest is under-earning based
3 merely on untested, pre-filed testimony of Qwest. It is equally premature for the Commission
4 to reach a conclusion today, prior to a hearing on the evidence offered by Qwest, Staff and
5 RUCO. To date, the Commission has not heard the evidence on the matter. The pre-filed
6 testimony has not yet been entered into the record, nor subjected to cross-examination by the
7 other parties, the Administrative Law Judge, or the Commissioners. Prior to entering an order
8 finding fair value and that the Company is under-earning, and thus concluding that the existing
9 price cap plan no longer results in just and reasonable rates, the Commission cannot modify
10 the existing rate structure of the price cap plan with its annual inflation minus productivity
11 adjustments.⁸

12 The Commission has already recognized that termination of the inflation minus
13 productivity adjustment would "raise concerns under *Scates*."⁹ *Scates v. Ariz. Corp. Comm'n*
14 prohibits the Commission from modifying a utility's rate structure absent a concurrent finding of
15 fair value of the utility's property.¹⁰ A fair value finding is required even in the context of a
16 competitive market.¹¹ In its brief to the Court of Appeals in the appeal of Decisions 66772 and
17 67047, the Commission recognizes that that "the Commission could not stop the Basket 1
18 index adjustments...because they—like an automatic adjustment clause—are an integral part
19 of Qwest's rate structure under the Plan and thus cannot be modified without a fair value
20

21
22 ⁷ Direct Testimony of RUCO witness Marylee Diaz Cortez, Docket No. T-01051B-03-0454 *et al.*, filed
November 18, 2004, at 2 (under-earning of \$160 million); Direct Testimony of Staff witness Elijah Abinah,
T-01051B-03-0454 *et al.*, filed November 18, 2004, at 11 (under-earning of \$3.5 million).

23 ⁸ RUCO incorporates its Response to Qwest's Application for Rehearing of Decision No. 66772,
Docket No. 01051B-03-0454, filed April 5, 2004, as further discussion of this point.

24 ⁹ Decision No. 66772 at 6.

¹⁰ 118 Ariz. 531, 537, 578 P.2d 612, 618 (App. 1978).

¹¹ *US West v. Ariz. Corp. Comm'n*, 201 Ariz. 242, 34 P.3d 351 (2001).

1 finding."¹² Granting the Motion would not only be inconsistent with the Commission's recent
2 pronouncements in its decisions interpreting the existing Price Cap Plan, it would be contrary
3 to the legal position the Commission recently took on the pending appeals of those decisions.

4 The Commission also twice previously rejected the "yo-yo" argument included in
5 Qwest's current motion. The argument was originally put forth by AT&T in its response to
6 Qwest's Motion to Clarify the price cap plan.¹³ Qwest reiterated the point in its Reply.¹⁴ The
7 Commission rejected the argument by adopting Decision No. 66772.¹⁵ Qwest re-urged the
8 point in its Application for Rehearing and Immediate Stay of Decision No. 66772.¹⁶ By
9 adopting Decision No. 67047, the Commission again rejected the argument. There is no
10 reason for the Commission to change its position on the matter now.

11 Even if the Commission had not previously ruled unfavorably to Qwest on the "yo-yo"
12 argument, the Commission should reject it. Qwest will likely have the power to avoid the
13 potential rate decrease/rate increase impact that posits. Upon implementing an inflation minus
14 productivity adjustment on April 1, 2005, Qwest will be permitted to determine which services
15 in Basket 1 will have their prices decreased. Later, if the Commission adopts an order in the
16 Price Cap Review Docket modifying the price cap plan in some way that permits Qwest to
17 increase prices on certain Basket 1 services, Qwest will be permitted to determine which
18 Basket 1 services will have their prices raised in conformance with the Commission's order.
19 Qwest could determine to decrease prices for certain Basket 1 services (for example, the
20 charge for an unlisted number), but later increase prices for other services (for example,

21 _____
22 ¹² Commission's Answering Brief in 1CA-CC 04-001 *et al.* at 29 [excerpt attached as Exhibit A].

¹³ AT&T's Response to Qwest's Motion to Clarify, or in the Alternative, to Terminate Price Cap Plan, filed November 15, 2003, at 11-12.

¹⁴ Qwest's Reply to Comments Submitted on its Motion to Clarify, or in the Alternative, To Terminate Price Cap Plan, T-01051B-03-0454, filed December 1, 2003, at 4.

¹⁵ See *also* Decision No. 66772, Gleason dissent at 2.

¹⁶ Qwest Corporation's Application for Rehearing and an Immediate Stay of Decision No. 66772, Docket No. 01051B-03-0454, February 25, 2004, at 17-18.

1 custom calling services). The Commission should not suspend the inflation minus productivity
2 adjustment for fear of a price "yo-yo" when Qwest itself will likely have the ability to prevent
3 such a result.

4
5 **QWEST'S MOTION BASED ON TRADITIONAL REVENUE REQUIREMENTS ANALYSIS IS**
6 **INCONSISTENT WITH ITS POSITION THAT TRADITIONAL REVENUE REQUIREMENTS IS**
7 **AN INAPPROPRIATE BASIS ON WHICH TO SET RATES IN A COMPETITIVE**
8 **ENVIRONMENT.**

9 Qwest, Staff and RUCO have all filed testimony in this proceeding that a traditional
10 revenue requirements analysis reveals that Qwest is under-earning. However, Qwest has
11 claimed that the competitive pressures it faces are sufficient to allow the Commission to
12 establish its rates based on factors other than a traditional revenue requirements analysis.
13 Qwest's prefiled testimony states that "Qwest does not believe that traditional revenue-
14 requirement-based ratemaking is appropriate or sustainable in the increasingly competitive
15 telecommunications market in Arizona."¹⁷ Further, Qwest has not even proposed rate changes
16 to recover the revenue shortfall it claims to have.¹⁸ Qwest's request that the Commission
17 suspend the inflation minus productivity adjustment based on the results of a traditional
18 revenue requirements analysis conflicts with its position that a traditional revenue requirements
19 analysis is inappropriate because now Qwest faces significant competition.

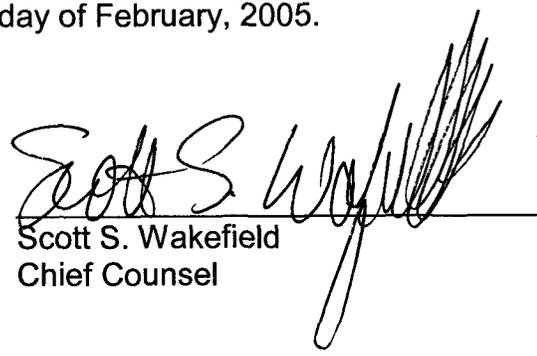
20 **CONCLUSION**

21 RUCO opposes Qwest's Motion and requests that the Commission deny it.

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24 ¹⁷ Direct Testimony of David Ziegler, T-01051B-03-0454 *et al.*, filed May 20, 2004, at 3.
¹⁸ *Id.* at 7-8.

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RESPECTFULLY SUBMITTED this 8th day of February, 2005.


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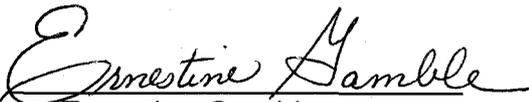
By 
Ernestine Gamble
Secretary to Scott Wakefield

EXHIBIT A

IN THE COURT OF APPEALS

STATE OF ARIZONA

DIVISION ONE

QWEST CORPORATION, a Colorado
corporation,

Appellant,

v.

ARIZONA CORPORATION
COMMISSION, an agency of the State of
Arizona,

Appellee,

and

RESIDENTIAL UTILITY CONSUMER
OFFICE, an agency of the State of
Arizona,

Intervenor-Appellee.

QWEST CORPORATION, a Colorado
corporation,

Appellant,

v.

ARIZONA CORPORATION
COMMISSION, an agency of the State of
Arizona,

Appellee

and

RESIDENTIAL UTILITY CONSUMER
OFFICE, an agency of the State of
Arizona,

Intervenor-Appellee.

1CA-CC 04-0001

1CA-CC 04-0002

(Consolidated)

Arizona Corporation Commission
Docket Nos. T-01051B-03-0454 and
T-00000D-00-0672
(Consolidated)

**ARIZONA CORPORATION COMMISSION'S
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Qwest tries to camouflage the collateral nature of some of these attacks by framing its claims as attacks on the *First Order* and the *Second Order*. Either the Commission's interpretation of the *Price Cap Order* and the Settlement Agreement is reasonable, or it is not. In either case, the *Price Cap Order* and the Settlement Agreement remain in effect until the Commission issues a new rate order.

B. The Commission cannot change a rate structure without finding fair value.

Qwest suggests that the Commission will claim that the first and second orders should be affirmed under its rate-making powers, regardless of the meaning of the Settlement Agreement and *Price Cap Order*.¹⁰⁹ We make no such claim. Qwest properly notes that the Settlement Agreement and the *Price Cap Order* can only be modified in an order that finds fair value. This concession makes all the more odd Qwest's various arguments that the Settlement Agreement should be declared void or voidable if its interpretation is not adopted, or that the Settlement Agreement or the *Price Cap Order* should be overturned as violating a host of constitutional and statutory requirements.

It is clear that a "rate structure" can be modified only in a rate order that finds fair value. See *Residential Utility Consumer Office v. Arizona Corp. Comm'n*, 199 Ariz. 588, 592-93 ¶¶ 19-21, 20 P.3d 1169, 1173-74 (App. 2001) ("*Rio Verde*"); *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 535-537, 578 P.2d 612, 616-618 (App. 1978). *Rio Verde* and *Scates* both held that an automatic adjustment mechanism could not be added or modified without a fair value finding, because to do so would change the "rate structure" of the utility.

¹⁰⁹ (Qwest Op. Br. at 35-40).

Id. Here the Commission could not stop the Basket 1 index adjustments (or modify its fixed productivity factor) because they – like an automatic adjustment clause – are an integral part of Qwest’s rate structure under the Plan and thus cannot be modified without a fair value finding.

Therefore, Qwest’s various claims that the *First and Second Orders* impose unjust and unreasonable rates, are confiscatory, or violate ratemaking statutes must fail because the Commission was merely interpreting a prior rate order and was, therefore, not required to make a fair value finding in the *First and Second Orders*.

Further, any fair value finding with respect to Qwest’s request for a modified or renewed plan would be premature. Qwest points to various documents it submitted to support its claim that its rates are confiscatory or unlawful. Qwest’s fair value can be found, and its rates can be changed, only at the end – not the beginning – of the case below. Much of the evidence Qwest submitted is being vigorously contested by Staff and RUCO. Qwest’s reliance on this evidence, before the Commission even has a chance to rule on it, highlights the interlocutory and unripe nature of these claims. Declining to rule on such disputed evidence before the hearing is consistent with how the Commission has processed rate proceedings in the past.

V. Qwest’s miscellaneous arguments are without merit.

A. The *First and Second Orders* do not violate Qwest’s due process or equal protection rights.

Qwest asserts, in footnote 102 of its brief, that its due process and equal protection rights are violated because it is subject to requirements that that its competitors are not. Qwest is the incumbent and dominant carrier in its Arizona