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BEFORE THE ARIZONA CORPORATION COMMISSION RECEIVED

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Arizona Corporation Commission

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

DOCKET NO. T-01051B-03-0454

**STAFF RESPONSE TO QWEST'S MOTION  
TO CLARIFY, OR IN THE ALTERNATIVE,  
TO TERMINATE PRICE CAP PLAN**

**I. Introduction**

On July 1, 2003, Qwest Corporation ("Qwest") filed a proposed revised price cap plan. On September 26, 2003, Qwest filed an amended revised price cap plan. Both filings contemplate significant changes to the current price cap plan that is in effect, and both filings appear to contemplate a rate increase.

On October 2, 2003, the Arizona Corporation Commission ("ACC" or "Commission") Staff filed a motion requesting a procedural conference to address various procedural issues raised by Qwest's filing. At the procedural conference, virtually all parties were in agreement that it would be difficult to process Qwest's proposed application, given the significant changes proposed therein, without the availability of restated Qwest Arizona financial statements. (Tr. at 18-26.) It was agreed at the procedural conference, that parties would await the filing by Qwest of a Motion on November 7, 2003, in which Qwest would propose a procedure for further processing of its application (until restated Arizona financials are available), or in the alternative, a request for termination of the plan.

On November 7, 2003, Qwest filed its Motion to Clarify, or in the alternative, to Terminate Price Cap Plan. In its Motion, Qwest does not address the important issue from Staff's perspective which is how the Commission, Staff and parties are to proceed to review

1 and analyze Qwest's application without the availability of reliable financials. Instead,  
2 Qwest focuses upon the narrow issue of what happens if the initial term of the plan expires  
3 before the Commission enters an order modifying, amending or terminating the plan. Qwest  
4 seeks clarification that after the expiration of the initial term of the Price Cap Plan, certain  
5 terms of the Plan would no longer apply. If the terms do apply, then Qwest requests that the  
6 Commission enter an order declaring that the Price Cap Plan is terminated as of March 30,  
7 2004.

8 Following is Staff's response to Qwest's Motion to Clarify or Terminate its Price  
9 Cap Plan.

## 10 **II. Discussion**

### 11 **A. Qwest's Filings Contemplate Many Major Changes to the Existing** 12 **Price Cap Plan Which Cannot Be Properly Analyzed Without** 13 **Qwest's Restated Financials.**

14 As already stated, Staff had anticipated that Qwest would respond, in its filing, to  
15 concerns of Staff and the parties about moving forward with Qwest's application without  
16 restated Arizona financials. The changes to the current plan proposed by Qwest are  
17 substantial, and as stated at the procedural conference, it will be necessary to review  
18 Qwest's restated financials in order to analyze Qwest's proposed modifications to the plan.

19 Qwest itself notes in its Motion, p. 3, that the financial information filed with the  
20 plan was based on its **unrestated** results for 2002, and therefore, is completely unreliable. It  
21 is anticipated that Qwest will also have to refile this information when its restated Arizona  
22 financials become available.

23 Moreover, it is clear that the changes proposed by Qwest will require what amounts  
24 to a filing under A.A.C. R14-2-103 ("R14-2-103"). This filing will take Qwest additional  
25 months to prepare once its restated financials become available.

26 Thus it is apparent why Qwest is concerned with the initial term of the plan ending  
27 before any Commission order can be entered. Given the predicament with Qwest's  
28 financials, it is inevitable that the initial term of the plan will probably expire before any

1 Commission order can be entered. However, Qwest alone is in control of its financials and  
2 when they will be available. Yet, instead of offering proposals for further processing  
3 pending the release of its R14-2-103 filing, Qwest incorrectly suggests that the Staff is  
4 unwilling to negotiate with it or is interpreting the provisions of the Plan in a way that was  
5 not intended by the parties.

6 To the contrary, Staff is willing to sit down at any time and negotiate with Qwest  
7 and the parties any terms or conditions proposed by Qwest that can be negotiated at this  
8 time without the availability of reliable financials or a R14-2-103 filing. So far, no one has  
9 suggested to Staff any topics that would be appropriate for negotiation, without the  
10 availability or need for financial information. In its Motion, Qwest briefly states that “the  
11 parties should continue to discuss and negotiate appropriate revisions to the Plan.” (Qwest  
12 Motion at 14). However, Qwest again does not indicate how these discussions are likely to  
13 be productive without reliable financial information. Further, as discussed below, Staff  
14 believes that it is interpreting the provisions of the Plan in accordance with the plain  
15 language of the Settlement Agreement and that it is also interpreting the Agreement in a  
16 manner consistent with the intent of the parties at the time the Agreement was entered into  
17 and as indicated at the hearing on this matter.

18 **B. The Current Plan Provides for its Continuation Until the Commission**  
19 **Enters an Order Modifying, Renewing or Terminating the Existing**  
20 **Price Cap Plan.**

21 Page 6 of the Settlement Agreement addresses the situation where the initial term of  
22 the Plan expires before any action is taken by the Commission. It states:

23 *Renewal or modification of the Price Cap Plan at the end of the initial*  
24 *term is subject to approval by the Commission. **Until the Commission***  
25 ***approves a renewal or modified Price Cap Plan, or orders termination***  
***of the Plan after its term, the Plan including the hard cap on Basket***  
***One Services set forth in paragraph 2(c)(i) shall continue in effect.***  
(Emphasis added).

26 As noted by RUCO in its Response, at pages 4-6 to Qwest’s Motion to Clarify, at  
27 the hearing both Staff and Qwest agreed as to the meaning of this provision. The language  
28

1 requires that the plan as a whole (all of its collective terms and conditions) continue in  
2 effect until the Commission orders a renewal, modification or termination of the plan.

3 Qwest now interprets this provision as well as other provisions of the plan as  
4 meaning that only certain parts of the plan will remain in effect. Qwest relies in part upon  
5 the testimony of witnesses at the hearing stating that the plan was for a three year term.  
6 (Qwest Motion at 9-10). However, no one is disputing the fact that the initial term of  
7 the plan was for a period of 3 years. What is in dispute is what happens to the Plan after  
8 the 3 year period if the Commission does not enter an order renewing, modifying or  
9 terminating the plan. This eventuality was clearly provided for on page 6 of the Settlement  
10 Agreement.

11 Qwest's interpretation would mean that it would still be entitled to all the benefits  
12 of the Plan including pricing flexibility, without having to continue to comply with those  
13 aspects of the plan intended to benefit consumers. In particular, Qwest opposes any further  
14 adjustments of the Price Cap Index for Basket 1 Services pursuant to 2(b) of the Price Cap  
15 Plan after March 30, 2004. The adjustment on April 1, 2004, must be made as part of the 3  
16 year plan. Further adjustments, if the Commission has not entered an order by the  
17 termination date of the plan, would be governed by the provision cited above on Page 6 of  
18 the Settlement Agreement. The Price Cap Index for Basket 1 services is such an integral  
19 part of the Plan, that removing it would effectively eviscerate the Plan. Additionally, as  
20 RUCO noted, the Plan provides that the price cap index adjustment is to be made  
21 "annually".<sup>1</sup> (RUCO Response at 4). Qwest's witness' express testimony filed in support  
22 of the Price Cap Plan Settlement Agreement was that the price cap index for Basket 1  
23 would remain in effect pursuant to the provision on Page 6 of the Settlement Agreement  
24 cited above. See RUCO Response at p. 4. This all weighs against the interpretation of the  
25 plan Qwest now offers.

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27 <sup>1</sup> This is in contrast to the language in the plan regarding access charge reductions which explicitly  
28 provides that three \$5.0 million dollar reductions were contemplated, after which the parties would  
address further reductions in their negotiations. Qwest states that "Staff has also indicated that it  
believes that the Settlement Agreement and Plan call for further annual reductions in access charges  
until the Plan is revised or terminated" (Qwest Motion at 11, fn. 2). This is not correct.

1 As discussed below, Staff believes that Qwest needs to file the information required  
2 by R14-2-103 to allow the plan to be modified or terminated at the end of the three year  
3 period, or the Plan by its own terms must remain in effect.

4 **C. Termination of the Plan is Not Possible Under Scates Without a Review**  
5 **of Qwest's Fair Value Rate Base and Rate of Return.**

6 If the Commission does not agree to Qwest's conditions, Qwest urges the  
7 Commission to enter an Order terminating the Plan as of March 30, 2004. (Qwest Motion  
8 at 13). Unfortunately, Staff does not believe that this is possible under Scates<sup>2</sup>. The  
9 Commission cannot just simply terminate the Plan, leave existing rate levels in effect, and  
10 eliminate all of the other provisions of the Plan. The Plan, including all of its terms and  
11 conditions, was designed to comply with Scates at the time it was adopted and for the  
12 length of time the Plan is in effect. Eliminating all of the provisions of the Plan, except for  
13 existing rate levels, has not been determined to comply with Scates.

14 Qwest argues that it is not earning a reasonable and fair rate of return under the  
15 Plan.

16 "Along with its July 1, 2003 filing, Qwest submitted financial information as  
17 required by the Settlement Agreement. Using the Commission's prescribed  
18 jurisdictional accounting (JR records). Qwest reported in Attachment D to its  
19 filing that Qwest's 2002 intrastate net income was a negative \$8.4 million. Qwest  
20 anticipates that its 2003 financial results will be similar to those for 2002.  
21 Qwest's earnings in Arizona were negative and its 2003 earnings are anticipated  
22 to be inadequate by any reasonable measure. Under these circumstances,  
23 continuation of the Price Cap Plan in its present form, without Qwest's consent,  
24 would most certainly prevent Qwest from earning a reasonable return on its  
25 investment in violation of Article 15, §3 and §14." (Qwest Motion at 14).

26 Unfortunately, however, Qwest cannot supply Staff or the Commission with any  
27 reliable financial statements to prove this assertion. Thus, if anyone is preventing Qwest  
28 from earning a reasonable return on its investment in violation of Article 15, §3 and §14 of  
the Arizona Constitution, it is Qwest itself.

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<sup>2</sup> Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P.2d 612 (Ct. App. 1978).

1 Qwest also argues in its Motion, that market conditions have changed  
2 dramatically since adoption of the Plan, and that the existing Plan does not reflect  
3 competitive realities. It must be modified or terminated if the parties are unable to agree  
4 on a new Price Cap Plan prior to the expiration of the Plan, since Qwest can no longer  
5 compete under the Price Cap Plan in its current form. Qwest Motion at 6. However,  
6 once again, since the revisions proposed by Qwest would produce a plan much different  
7 than the existing plan, which will undoubtedly result in revenue and rate increases given  
8 Qwest's assertions, an R14-2-103 analysis will be necessary. Despite being asked  
9 innumerable times by Staff when its Arizona restated financials will be available, Qwest  
10 has been unable to commit to any particular date.

11  
12 **D. The Commission Should Require Qwest to Immediately File the**  
13 **Information Required by R14-2-103 So That the Qwest's Proposed**  
14 **Modifications to the Plan Can Be Reviewed and a Modified Plan**  
**Approved, or, Alternatively So That the Plan Can Be Terminated by the**  
**Date Upon Which the Plan Expires.**

15 Qwest states in its Amended Revised Plan that "it proposes no rate changes in this  
16 filing", however, at the same time it states that it "has not earned a reasonable rate of return  
17 during the first term of price regulation in Arizona and seeks to remedy that situation while  
18 also benefiting customers with this proposal." *Id.* at 8. It is not difficult to read between  
19 the lines and figure out that while the Company is proposing no specific rate changes with  
20 its filing, specific rate increases as well as an overall revenue increase is contemplated by  
21 the Company through its proposed changes to the Plan.

22 Thus, the modifications proposed by Qwest to its current Price Cap Plan cannot be  
23 made without the information required by R14-2-103. Nor can the Plan be terminated and  
24 new rates instituted without the information required by R14-2-103. And, only Qwest can  
25 supply the information which is necessary under R14-2-103.

26 The Commission should order the Company to immediately file the information  
27 required by R14-2-103, as well as updated price cap information, since what it originally  
28 filed was based upon unaudited numbers which the Company itself concedes are unreliable.

1           Until Qwest files reliable financial information with the Commission in the form  
2 required under R14-2-103, the Commission cannot make any assessment of whether  
3 Qwest's revenue deficiency assertions are accurate or determine whether any increase in  
4 rates is warranted. Nor can the Commission determine whether Qwest's significant rewrite  
5 of the existing plan is reasonable and in the public interest.

6           In summary, Staff believes that the Price Cap Plan Agreement requires that unless  
7 otherwise provided in the Plan, all provisions of the Plan remain in effect upon the Plan's  
8 termination, until further order of the Commission. Qwest needs to immediately file the  
9 information required by R14-2-103 so that modification or termination of the Plan can be  
10 accomplished by the Plan's expiration date.

11           RESPECTFULLY submitted this 21<sup>st</sup> day of November, 2003.

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