

ORIGINAL



BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

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

Arizona Corporation Commission

DOCKETED

NOV 17 2003

2003 NOV 17 A 10:50

AZ CORP COMMISSION  
DOCUMENT CONTROL

DOCKETED BY 

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

)  
)  
)  
)  
)

Docket No. T-01051B-03-0454

AT&T's RESPONSE TO QWEST'S  
MOTION TO CLARIFY, OR IN  
THE ALTERNATIVE, TO  
TERMINATE PRICE CAP PLAN

AT&T Communications of the Mountain States, Inc. and TCG Phoenix  
(collectively, "AT&T") hereby respond to Qwest Corporation's ("Qwest") Motion to  
Clarify, or in the Alternative, To Terminate Price Cap Plan.

**I. INTRODUCTION**

Qwest argues that the Commission must either modify the Price Cap Plan by  
March 30, 2004, in a manner acceptable to Qwest or terminate the Plan by the same date.  
However, Qwest will agree to allow the present Plan to continue in effect past the  
expiration date if the Commission agrees to three conditions: 1) there will be no further  
adjustment of the Price Cap Index to Basket 1 Services pursuant to paragraph 2(b) of the  
Plan after March 30, 2004; 2) there will be no further annual reductions in access charges  
pursuant to the Plan; and 3) the procedures for changes in Qwest's rates and charges will

continue until superceded by a revised plan or a Commission order setting new rates and charges. Motion at 1.

Qwest's positions are essentially based on one issue -- whether the Plan terminates by its terms on March 24, 2004. However, the issues are more numerous, not quite so simple and are more important than the one issue Qwest does address. In fact, AT&T believes the arguments over the term of the Plan obscures some of the more important issues.

AT&T does not care if the present Plan continues in its present form or Qwest's returns to rate-of-return regulation. What AT&T does care about is whether Qwest's rates are just and reasonable, more importantly, Qwest's access rates.<sup>1</sup> Furthermore, AT&T wishes to make sure that the Commission is properly informed of the options available to it. AT&T believes the Commission has far more flexibility than Qwest acknowledges.

Finally, Qwest's initial and revised filings are inadequate. Without adequate financial information and the information required by R14-2-103, the parties cannot adequately respond to Qwest's filings or provide any recommendations.

## **II. ARGUMENTS**

### **A. The Commission's Authority to Set Rates**

The Commission's authority to set just and reasonable rates for public service corporations is without question. A.R.S. Const. Art. 15, § 3. What has been subject to debate is the *methodology* used by the Commission to set the just and reasonable rates. Those debates have arisen because of the Commission's constitutional obligation to

---

<sup>1</sup> As AT&T pointed out in Qwest's Section 271 case, Qwest has the ability to place AT&T and other interexchange carriers in a price squeeze. It was for this reason that Chairman Spitzer expressed his desire that the access case proceed on an expedited basis.

ascertain the fair market value of property of public service corporations. A.R.S. Const. Art. 15, § 14.

One of the more recent and often-cited cases regarding the method regarding fair value is *Scates v Arizona Corp. Comm'n.*, 118 Ariz 531, 578 P. 2d 612 (App. 1978), *reh. and rev. denied*. The Court held

We do hold that the Commission was without authority to increase the rate without any consideration of the overall impact of that rate increase upon the return of Mountain States, and without, as specifically required by our law, a determination of Mountain States' rate base.

*Id.*, at 537, 618. Generally, the Court's holding requires a traditional rate-of-return rate case. This was generally the law until recently.

The Arizona Supreme Court had an opportunity to review the Commission's fair value obligation in 2001. *US WEST v. Ariz. Corp. Comm'n.*, 201 Ariz. 242, 34 P. 2d 351 (2001), *en banc*. ("*US WEST*"). In 1995 the Commission adopted rules that established procedures for granting certificates of convenience and necessity to competitive local exchange carriers ("CLECs") and allowed, on one day's notice, price increases or decreases below or to a maximum rate for competitive services. R14-2-1101 to 1115. CLECs subsequently obtained certificates of public convenience and necessity. The fair value of the CLECs' Arizona – based property was not determined by the Commission using a traditional rate-of-return analysis. Qwest filed several lawsuits, arguing that Article 15 of the Arizona Constitution required the Commission to make fair value findings for each CLEC. *US WEST* at 352-353. The "trial court declared the fair value clause inapplicable because CLECs were engaged in a competitive, rather than a monopolistic, environment." *Id.* at 353. The Appellate Court reversed.

The framers may not have envisioned a competitive telecommunications market when they drafted article 15 of the Arizona Constitution. Fair value rate base determinations, and perhaps rate setting itself, may be anachronistic processes in a competitive market. Nevertheless, given that our supreme court has consistently held that the constitution requires fair value rate base determinations for public service corporations, but has never restricted such language to monopolies, the trial court erroneously disregarded constitutional authority in distinguishing this case from Simms and Scates...

*U S WEST* at 253, quoting *U S WEST Communications, Inc. v. Ariz. Corp Comm'n*, 198 Ariz. 208, 216-217, 8 P. 2d 396, 404-405 (App. 2000).

The Supreme Court reversed the judgment of the trial court, vacated the opinion of the court of appeals and remanded for further proceeding consistent with its opinion. ~~That opinion was a holding that a fair value determination was mandatory.~~ *Id.*, at 354. But the Court went on to decide what needs to be done with such a finding. The Court noted that cases historically followed the method in *Scates*, “[b]ut while the constitution requires the Arizona Corporation Commission to perform a fair value determination, only our jurisprudence dictates that this finding be plugged into a rigid formula as part of the rate setting process.” *Id.*, at 354-355. The Court noted that neither Article 15, Section 3, nor Section 14 require a rate-of-return analysis. *Id.*, at 355.

Ultimately, the Court held that for a monopoly, rate-of-return is still appropriate, but in a competitive environment the Commission has more flexibility.

We still believe that when a monopoly exists, the rate-of-return method is proper. Today, however, we must consider our case law interpreting the constitution against a backdrop of competition. In such a climate, there is no reason to rigidly link the fair value determination to the establishment of rates. We agree that our previous cases establishing fair value as the exclusive rate base are inappropriate for application in a competitive environment.

*Id.* Although a fair value determination is required, the Commission in a competitive environment has broad discretion to determine the weight to be given, or the use to be made of, the fair value determination. *Id.*

What this means is that the Commission must decide whether Qwest is a monopoly or not. If Qwest is a monopoly there is no question the Commission must do a *Scates* analysis if Qwest increases its rates. However, if Qwest is operating in a competitive environment, the Commission must still establish a fair value of Qwest's property but is not bound to a traditional rate-of-return analysis.

Although AT&T takes exception to Qwest's interpretation of the data regarding the extent of competition in Arizona, Qwest does maintain that the "competitive reality is that Qwest's competitors are well established in Arizona." Motion at 5. If the Commission, however, ultimately agrees with Qwest, it may develop and order a Price Cap Plan for Qwest over Qwest's objections.<sup>2</sup>

#### **B. The Current Plan**

Although arguably the Commission may not have been able to impose the Price Cap Plan on Qwest in March 2001, the Commission did perform a *Scates* analysis by adopting Qwest's and Staff's determination of Qwest's fair value, rate base, and rate of return. Docket No. T-01051B-00-0369, Order and Opinion, Decision No. 63487, at 4. A revenue requirement deficiency of \$23.3 million was also agreed to. *Id.*

The revenue deficiency was recovered by decreasing Basket 1 by \$14.4 million, reducing access charges by \$5 million in year one of the Plan and providing Qwest an

---

<sup>2</sup> Qwest argues that "[t]he Price Cap Plan was not, and could not have been imposed on Qwest. Motion at 4. This may have been true in March 2001 when the Plan was approved. However, after November 15, 2001, the date of the *US WEST* decision, the Commission obtained considerably more flexibility regarding how rates are established in a competitive environment.

opportunity to raise its rates by 42.7 million in Basket 3. Qwest could raise Basket 3 rates an additional \$10 million to recover the access rate reductions in years 2 and 3 of the Plan. *Id.*, at 5.

Basket 1 was capped and subject to the inflation/productivity index. Basket 3 Services had already been provided pricing flexibility and were subject to R14-2-1109. Docket No. F01051B-99-0105, Notice of Compliance Filing (April 19, 2001), Settlement Agreement, ¶ 4(1) (“Settlement Agreement”).<sup>3</sup> *Id.*

What the Commission had done essentially was base the Price Cap Plan on a traditional rate-of-return analysis. This was mandatory at the time pursuant to *Scates*. Although Qwest had some pricing flexibility, there was a maximum permissible amount that over-all revenues could be raised under the Plan. In other words, traditional rate-of-return regulation was embedded in the Plan, which arguably let it pass muster with *Scates*.

### **C. Fair Value Going Forward**

If the Commission decides not to implement and order a price cap plan for Qwest after the expiration of the current Price Cap Plan and Qwest reverts to traditional rate-of-return regulation, there is no debate regarding the type of fair value determination that must be performed. There is some question, however, regarding the manner and frequency of fair value determination for Qwest rate increases if a price cap plan in any form is adopted for Qwest going forward after review of the existing Plan.

As noted earlier, AT&T believes that the Commission arguably satisfied *Scates* under the current Plan based on the Commission’s decision to adopt a fair value, a rate of

---

<sup>3</sup> Contrary to Qwest’s assertions, Motion at 6, competitors’ rates are subject to a rate cap under R14-2-1109 and 1110.

return, a revenue requirement and the conditions contained in the Plan that capped rates. However, the Commission must do some kind of fair value analysis to renew the Plan, and must continue to do them periodically in the future if it orders a revised price cap plan for Qwest.

There are 3 likely scenarios:

- 1) Qwest returns to rate-of-return ratemaking, either on its own initiative or by order of the Commission.
- 2) Qwest and Staff, and possibly other parties, agree to a settlement for a revised price cap plan.
- 3) The Commission orders a new price cap plan based on the record evidence.

1. **Rate-of-Return Ratemaking**

As noted earlier, if Qwest returns to traditional rate-of-return ratemaking, *Scates* applies. The question is what the level of rates should be. Qwest argues the rates should be continued at their current levels. Motion at 15. However, there is no justification for this approach.

If Qwest is correct that its returns on investment in 2002 and 2003 were negative and continuation of the Plan would prevent it from earning a reasonable return on investment, Motion at 14, the Commission should require Qwest to make a complete filing under R14-2-103 and establish just and reasonable rates. Qwest's argument that its rates should continue at current levels is inconsistent with its argument that its return on investment is inadequate.

2. **Qwest and Staff Settlement Agreement**

Should Qwest and Staff agree to settle the renewed price cap plan proceeding, there is some question whether the Commission could legally avoid a *Scates* analysis, or

would want to, if any rate increases are permitted. It is AT&T's position that the Commission cannot make an informed decision without the evidence required by a R14-2-103 and *Scates*. Anything less is legally suspect without sufficient evidence in the record that Qwest is operating in a competitive environment.<sup>4</sup>

### 3. The Commission Orders a Revised Plan

The Commission arguably now has the authority to adopt a price cap plan for Qwest over its objections. However, if Qwest believes the current plan is inadequate and returns under the existing plan are negative, it only makes sense to do a *Scates* analysis and require Qwest to submit the evidence required by R14-2-103. It seems only reasonable to AT&T that the Commission would want this information to base its decision on. If the Plan is renewed, revised or modified, the Commission needs some baseline to determine the success of the existing Plan and to establish just and reasonable rates going forward, especially if Qwest's current rates are not just and reasonable. Doing a *Scates* analysis will also preclude any subsequent attacks by Qwest that the renewed, revised or modified plan did not start out with just and reasonable rates or that the Commission failed to do a fair value determination.<sup>5</sup> AT&T wishes to point out that, although Qwest did not propose any rate increases as a part of the renewed plan, it makes it clear that it is going to raise rates after the renewed plan is approved. ("Qwest proposes no rate changes in this filing. However, Qwest has not earned a reasonable rate of return during the first term of price regulation in Arizona and seeks to remedy that situation

---

<sup>4</sup> In the event a court later determines that Qwest is a monopoly subject to *Scates*, the analysis will have been completed.

<sup>5</sup> Qwest could argue it is still a monopoly. A court could find in Qwest's favor but support the Commission's authority to impose a price cap regime since the Commission determined fair value, a rate of return and revenue requirement that sets a limit on the overall rate increases Qwest can make during the term of the plan.

while also benefiting customers with this proposal.” Qwest Renewed Price Regulation Plan – Arizona at 8.) Under Qwest’s own theory, this would violate *Scates*.

To conclude, whether as part of a traditional rate case, to aid in evaluating any settlement or to establish a baseline for a renewed, revised or modified plan, AT&T recommends that the Commission order Qwest to meet the requirements of R14-2-103 and *Scates* before it proceeds.

#### **D. Rate Rebalancing**

The Commission cannot rebalance rates, or reduce access charges, unless it knows whether existing rates are just and reasonable and existing rates exceed their cost of service. It needs information to determine what services are being subsidized and which services are subsidizing those very same services.

Qwest has argued in the generic access proceeding that before access rates can be decreased that a fair value determination must be made and the rates must be set to allow it to earn a reasonable regulated rate or return base. Docket No. T-00000D-00-0672, Qwest Memorandum Regarding Constitutional Requirements for Changing Access Rates and Comment on Procedural Schedule at 2 & 4. However, it is unclear whether Qwest asserts that fair value determination must take the form of a *Scates* analysis, although language in its Memorandum suggests the Commission must do so.<sup>6</sup> Regardless, the

---

<sup>6</sup> Qwest never states the Commission must do a traditional rate-of-return analysis. It does seem to suggest that the Commission must do such an analysis even after *US WEST*. Qwest acknowledges that the Commission is not required to use fair value as the exclusive basis for setting rates; however, Qwest goes on to state that “the Commission must nevertheless ascertain the fair value of the corporation’s property and at least consider it in determining what rates will be sufficient to allow a reasonable *regulated rate of return* to a public service corporation.” *Id.*, at 4 (emphasis added). Qwest misreads *US WEST*. If the corporation is a monopoly, *Scates* applies. If it is not, the Commission must determine fair value. It need not establish a “regulated rate of return.” In fact, *US WEST* upheld the Commission’s decision not to require a regulated rate of return for the CLECs.

information is necessary to establish reasonable rate of return and will enable the Commission to properly *design* and rebalance rates.

**E. A Cap on Rates is Necessary**

Regardless of whether a *Scates* analysis is done, if the Commission adopts a price cap plan for Qwest, it must set caps on all rates. The cap serves several purposes. First and foremost, it prevents discrimination. At present, CLECs must establish maximum rates for all its services that are competitive. R14-2-1109. To increase rates above the caps the CLECs must make detailed filings. R14-2-1110. Qwest should not be free of the requirements of R14-2-1109 and 1110.

Second, the Commission must determine the fair value when an increase is made to rates. By establishing a cap, increases and decreases below the cap are presumptively reasonable. Therefore, by establishing a cap for a service, the Commission sets a trigger for when a fair value determination must be made.

Third, not all services are created equal. By establishing a cap for each rate, the Commission can review the rate increases of inelastic services more closely to determine if the rate increase is justified. This is especially true for wholesale services purchased from Qwest by CLECs as inputs into services sold by CLECs. Access is a good example.

**F. Qwest's Conditions**

First, AT&T believes the Commission should require Qwest to file the materials required by R14-2-103 and by *Scates*. Discovery should be permitted. A schedule should be set to permit the Commission to incorporate the finding and conclusions from the decision in the generic access proceeding. If the generic access proceeding is expedited for Qwest, this inquiry should not become a problem standing in the way of

access reform. Second, AT&T understands Qwest's concerns regarding its obligations under the Plan after March 30, 2004. The Commission should issue an order clarifying how Qwest should operate until a determination is made whether Qwest will return to traditional rate-of-return regulation or its Plan is renewed, amended or modified.

The Plan states that the initial term is 3 years. Settlement Agreement, Attach. A, ¶ 6(a). The Settlement Agreement (at 6) states that “[r]enewal or modification of the Price Cap Plan at the end of the initial term is subject to approval of the Commission. Until the Commission approves a renewal or modified Price Cap Plan, or orders a termination of the Plan after its term, the Plan including the hard caps on Basket One Services set forth in paragraph 2(a)(i) shall continue in effect.” Similarly, the Order approving the Plan states that “[c]ontinuation or modification of the plan is subject to Commission approval and the Plan remains in effect pending a Commission decision renewing, modifying or terminating it.” Decision No. 63487 at 6.

Qwest has made 2 index/productivity adjustments – one in April 2002 and one in April 2003. The adjustment Qwest seeks to avoid would be made on April 1, 2004, one day after the 3 year term of the Plan. It appears to AT&T that the language in the Plan would require Qwest to make the adjustment to Basket One Services on April 1, 2004. Not only does the Plan state that it remains in effect, where the Plan sought to limit future reductions, it did so explicitly (for example, with access charges). However, Qwest's Motion seeks to obtain a Commission order to waive or forego such future adjustments. AT&T believes the Commission has the power to make such a ruling, and should.

If Qwest can show, based on restated financials, that it has a negative return in Arizona, it does not appear wise to reduce residential rates any further before the rates for

all services can be reviewed and rates designed for the Company as a whole. Reducing residential rates further will adversely effect the negative return on investment and make it more difficult to rebalance rates and remove implicit subsidies, if any. The rate design principle of rate stability also should be taken into account. It makes little sense to reduce rates if those very same rates would have to be raised shortly thereafter.

AT&T does not read the current Price Cap Plan as mandating access reductions after year 3 of the Plan. The Plan only refers to reductions in years' 1, 2 and 3 of the Plan. AT&T's understanding is that further reductions will be addressed in the generic access investigation and in the context of the review of the current Plan.

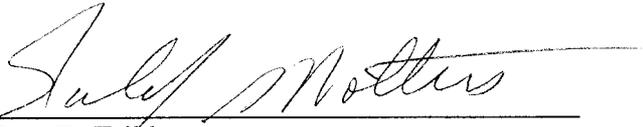
AT&T has no objection to continuing the procedures for changes in Qwest's rates and charges until superceded by an order of the Commission. This is consistent with the terms of the Decision adopting the current Plan.

### **III. CONCLUSION**

The Commission should order Qwest to file the information required by R14-2-103 and comply with *Scates*. This would eliminate much of the uncertainty around Qwest's filing. A schedule should be adopted that will allow the Commission to incorporate the results of the generic access investigation into the revised or renewed Plan.

Dated this 15<sup>th</sup> day of November, 2003.

**AT&T COMMUNICATIONS OF THE  
MOUNTAIN STATES, INC. AND TCG  
PHOENIX**

By 

Mary B. Tribby  
Richard S. Wolters  
1875 Lawrence St., Suite 1503  
Denver, Colorado 80202  
(303) 298-6741  
(303) 298-6301 (fax)  
rwolters@att.com

Joan S. Burke  
Osborn Maledon, P.A.  
2929 North Central Avenue, Suite 2100  
Phoenix, Arizona 85012-2794  
(602) 640-9356  
jsburke@omlaw.com

**CERTIFICATE OF SERVICE**  
(Docket No. T-01051B-03-0454)

I certify that the original and thirteen copies of AT&T's Response to Qwest's Motion to Clarify, or in the Alternative, to Terminate Price Cap Plan were sent by overnight delivery on November 14, 2003 to:

Arizona Corporation Commission  
Docket Control – Utilities Division  
1200 West Washington Street  
Phoenix, AZ 85007

and a true and correct copy was sent by overnight delivery on November 14, 2003 to:

Christopher Kempley, Chief Counsel  
Arizona Corporation Commission  
Legal Division  
1200 West Washington  
Phoenix, AZ 85007

Maureen Scott  
Legal Division  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

Ernest G. Johnson, Director  
Utilities Division  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

Judge Jane Rodda  
Arizona Corporation Commission  
400 W. Congress  
Tucson, Arizona 85701

and a true and correct copy was sent by U.S. Mail, postage prepaid, on November 14, 2003 to:

Timothy Berg  
Fennemore Craig, P.C.  
3003 North Central Avenue, Suite 2600  
Phoenix, AZ 85012-2913

Todd Lundy  
Qwest Corporation  
1801 California Street  
Denver, CO 80202

Scott S. Wakefield  
RUCO  
1110 West Washington St., Suite 220  
Phoenix, AZ 85007

Joan S. Burke  
Osborn, Maledon, P.A.  
2929 North Central Ave., Suite 2100  
Phoenix, AZ 85012-2794

Thomas F. Dixon  
WorldCom, Inc.  
707 17<sup>th</sup> Street, 39<sup>th</sup> Floor  
Denver, CO 80202

Thomas H. Campbell  
Michael T. Hallam  
Lewis and Roca  
40 N. Central Ave.  
Phoenix, AZ 85004

Michael W. Patten  
Roshka, Heyman & Dewulf, PLC  
400 East Van Buren St., Suite 800  
Phoenix, AZ 85004

Peter Q. Nyce Jr.  
Regulatory Law Office  
U.S. Army Litigation Center  
901 N. Stuart St., Suite 713  
Arlington, VA 22203-1644

Mark A. DiNunzio  
Cox Arizona Telecom, LLC  
20401 North 29<sup>th</sup> Ave.  
Phoenix, AZ 85027

Richard Lee  
Snively, King, Majoros, O'Connor &  
Lee, Inc.  
1220 L Street N.W., Suite 410  
Washington, DC 20005

---