BY THE COMMISSION:

In Decision No. 63487 (March 30, 2001), the Arizona Corporation Commission approved a Settlement Agreement which adopted a Price Cap Plan for Qwest Corporation (“Qwest”). The Price Cap Plan, which had an initial term of three years, provides inter alia, that Basket 1 services are capped and subject to an annual rate adjustment determined by an “Inflation minus Productivity” indexing mechanism. Under that mechanism when productivity exceeds inflation, rates for Basket 1 services decrease effective April 1 of the following year.

On July 1, 2003, Qwest filed its Renewed Price Regulation Plan (“Renewed Plan”) pursuant to the provisions of the Settlement Agreement approved in Decision No. 63487.¹

By Procedural Order dated November 17, 2003, the Commission determined that Phase I of the Access Charge Docket, which addresses Qwest’s access charges, should be considered in conjunction with the Renewed Plan. ²

¹ Docket No. T-01051B-03-0454 which is currently pending before us.
² On February 1, 2005, Qwest filed a notice in the docket that requested Commission Staff to schedule a series of settlement discussions. At a February 2, 2005 Procedural Conference, the Administrative Law Judge suspended the procedural schedule to allow the parties to engage in settlement discussions. During a March 3, 2005 Procedural Conference, the parties reported they were continuing to engage in settlement discussions.
On February 10, 2004, in response to a Qwest Motion to Clarify, Or In the Alternative, To Terminate Price Cap Plan, the Commission issued Decision No. 66772. In its Motion, Qwest had requested that the Commission clarify that after the expiration of the initial term of the Price Cap Plan on March 30, 2004, that: 1) no further productivity adjustment for Basket 1 Services would be made after March 30, 2004; 2) no further annual reduction in the level of access charges under the Settlement Agreement and the Price Cap Plan would be made after April 1, 2004; and 3) the procedures for changes in Qwest’s rates and charges, including the hard caps imposed on the specific Basket 1 Services, would continue to apply until superceded by a revised plan approved by the Commission or a Commission order setting new rates and charges for Qwest.

In Decision No. 66772 the Commission found that pursuant to the Continuation Clause in the Price Cap Plan, the Plan’s terms and conditions, including the productivity adjustment, continue in effect until the Commission modifies or terminates the Plan. The Commission found that Qwest must make the adjustment for the third year of the Plan effective April 1, 2004, and that the productivity adjustment remains in place pending Commission action on a new Plan.3

In Decision No. 67047 (June 18, 2004), the Commission addressed a Qwest Motion for Reconsideration of Decision No. 66772 and a Qwest Motion to Revise Productivity Factor. In Decision No. 67047, the Commission found that with respect to the productivity adjustment for Basket 1, Decision No. 66772 should be affirmed, and the adjustment for the third year of the Plan should be made on April 1, 2004. In addition, the Commission held:

Further adjustments after April 1, 2004, would be governed by the Continuation Clause of the Agreement and Basket 1 adjustments would remain in effect until the Commission approves a new or revised Plan.4

Qwest appealed both Decision Nos. 66772 and 67047, which appeals are currently pending before the Court of Appeals.

On February 3, 2005, Qwest filed an Emergency Motion to Suspend the Inflation Minus Productivity Factor Adjustment. In its current Motion, Qwest requests that the Commission suspend

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3 Decision No. 66772 at 10.
4 Decision No. 67047 at 6-7.
the application of the productivity adjustment that would be required on April 1, 2005 under the
terms of Decision Nos. 66772 and 67047. Qwest states that if required to make the adjustment, its
annual revenues would be reduced by $12 million annually.

The Residential Utility Consumer Office ("RU CO") filed a Response to Qwest's Motion on
February 8, 2005.

Commission Utility Division Staff ("Staff") filed a Response to the Motion on February 22,
2005.

Qwest filed a Reply on March 1, 2005.

Pursuant to Procedural Order dated February 16, 2005, oral argument on Qwest's Motion was
held on March 3, 2005, at the Commission's offices in Phoenix, Arizona.

Qwest argues that if it is required to make the April 1, 2005 adjustment, it would jeopardize
the settlement discussions that are currently on-going concerning Qwest's Renewed Plan. Qwest
believes that an automatic reduction is not supported by the evidence in this case, as all testimony has
been filed and no party is recommending a revenue reduction. Furthermore, Qwest argues that any
rate reduction is very likely to be reversed in several months when the Commission ultimately
approves a new plan and the resulting "yo-yo" effect on rates may be confusing for consumers,
expensive for the Company to administer, and bad public policy. Qwest asserts that the Commission
can suspend any further Basket 1 reduction until it issues its final decision concerning modification,
amendment or termination of the Price Cap Plan and can then determine whether any further
adjustment or true-up will be necessary.

RU CO opposes Qwest's Motion and requests that the Commission deny it. RU CO argues
that suspending the April 1 adjustment would undermine the Commission's Decisions that confirm
the adjustment is legally required. According to RU CO, the Commission has twice rejected Qwest's
argument that claims of its under-earning justify the termination of the adjustment. RU CO also
argues that the Commission cannot modify the existing rate structure prior to complying with the
Arizona Constitution's requirements to find fair value prior to adopting new rates. To date, RU CO
asserts, although pre-filed testimony from all parties indicates that under traditional rate of return
analysis, Qwest is under-earning, it is still premature for the Commission to reach a conclusion prior
to a hearing on the evidence. If the Commission were to suspend the adjustment and not order a true-
up relating back to April 1, 2005, to give effect to the adjustment when it ultimately considers the
Renewed Plan, RUCO argues it would be engaging in impermissible retroactive rate making.

RUCO also asserts that the Commission has twice rejected Qwest’s argument that requiring it
to make the adjustment would result in “yo-yo” rates that would confuse consumers. RUCO urges
the Commission to reject this argument again. RUCO claims that upon making the April 1
adjustment, Qwest will be permitted to determine which services in Basket 1 will have their prices
decreased, and later, if the Commission adopts an order in the Renewed Plan Docket modifying the
price cap plan that allows Qwest to increase prices on certain Basket 1 services, Qwest will be
permitted to determine which Basket 1 services will have their prices raised in conformance with the
Order.

Staff supports the suspension of the April 1, 2005 adjustment as long as the pending
consolidated appeals of Decision Nos. 66772 and 67047 are suspended for the same period of time.
Staff notes that it does not support the termination of the adjustment. Staff states that while it agrees
with many of RUCO’s arguments in opposition to the Motion, Staff does not believe those arguments
are applicable to consideration of a suspension rather than a termination of the adjustment. Staff
agrees that termination of the adjustment, which is an integral part of the Plan, could violate Scates.\(^5\)
Staff believes, however, that temporary suspension of the adjustment does not raise the same
implications under Scates and that the Commission has the flexibility to temporarily suspend the
adjustment pending the outcome of the docket considering the Renewed Plan. Staff believes that
suspension is appropriate based upon the fact that settlement discussions are underway and the
likelihood that any settlement reached between the parties would be a comprehensive settlement
which addresses both the April 1, 2005, adjustment as well as the consolidated appeal now pending in
the Arizona Court of Appeals. Staff’s support for the suspension is conditioned upon Qwest agreeing
to suspend the procedural schedule of the consolidated appeal of Decisions 66772 and 67042.\(^6\) Staff
states the consolidated appeal could result in the reversal of the most recent reduction made April 1,

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\(^6\) At the March 3, 2005 Procedural Conference, Staff provided a copy of a Court of Appeals Order dated February 24,
2005, suspending the appeal pursuant to the stipulation of the parties.
2004. Staff believes that suspension of the consolidated appeal maintains the status quo during settlement discussion and litigation of the case, if necessary.

In response, Qwest argues that preserving the status quo without prejudicing any party will allow the parties to move forward with productive settlement negotiations. Qwest states that because it is not requesting termination of the adjustment, whether the parties are able to resolve the docket through settlement or a fully litigated hearing, the Commission can then address the value, if any, of continued application of the adjustment (on April 1, 2005 and in the future) on a permanent basis, and after considering all of the evidence. Further, Qwest argues, as all parties' pre-filed testimony indicates that Qwest's current rates produce a revenue requirement deficiency, further rate reductions on April 1, 2005 serve no useful purpose and would be illegal and confiscatory. Qwest claims that the transcript of the Commission's June 9, 2004 Special Open Meeting (at which time the Commission considered Decision No. 67047) shows that in the event the docket was not resolved prior to April 1, 2005, the Commission expressed concerns that it did not want to limit its ability to consider the issue of whether the April 1, 2005 adjustment was appropriate.

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. However, the Commission certainly has the discretion to suspend the April 1, 2005 reduction, to accommodate comprehensive settlement discussions in this case. We do not believe that a mere suspension of the April 1, 2005 reduction would violate Scates7, or the principle that the Commission cannot modify rates absent a fair value finding. We are not terminating the April 1, 2005 adjustment. The liability associated with the April 1, 2005 adjustment will continue to accrue. We will address the accrued liability for the April 1, 2005 adjustment in the final rate order in this Docket.

We also do not believe that suspension of the April 1, 2005, reduction is by itself retroactive ratemaking. The Commission by suspending the adjustment is not declaring its earlier finding or

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Order to be unreasonable and is not instituting any new rates with retroactive impact.

We can also see that adjusting rates for basic services downward now, and then adjusting
them again in the opposite direction in the near future as a result of final rates being set in the
Renewed Plan, could cause consumer confusion. Therefore, we believe that a suspension of the
adjustment is appropriate.

Our Decision granting Qwest’s Motion is motivated solely by a desire to avoid consumer
confusion and to accommodate comprehensive settlement discussions in this case. Qwest’s claim
that it is under-earning under traditional rate of return analysis has no bearing on our Decision. That
is an issue to be determined through the evidentiary hearing process. Further, in no way does our
conclusion indicate one way or the other how the Commission will decide the issue of whether there
should be a productivity adjustment when we consider Qwest’s Renewed Plan currently before us.

Having considered the entire record herein and being fully advised in the premises, the
Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. In Decision No. 63487 (March 30, 2001), the Commission approved a Settlement
Agreement in Qwest’s then pending rate case which adopted a Price Cap Plan for Qwest.

2. On July 1, 2003, Qwest filed its Renewed Price Regulation Plan pursuant to the
provisions of the Settlement Agreement approved in Decision No. 63487.

3. By Procedural Order dated November 17, 2003, the Commission determined that
Phase I of the Access Charge Docket, which addresses Qwest’s access charges, should be considered
in conjunction with the Renewed Plan.

4. In Decision No. 66772 the Commission found that under the terms of the Price Cap
Plan approved in Decision No. 63487, the terms and conditions, including the productivity
adjustment, continue in effect until the Commission modifies or terminates the Plan. The
Commission found that Qwest must make the adjustment for the third year of the Plan effective April
1, 2004, and that the productivity adjustment remains in place pending Commission action on a new
Plan.
5. In Decision No. 67047, the Commission found that with respect to the productivity adjustment for Basket 1, Decision No. 66772 should be affirmed, and thus the adjustment for the third year of the Plan should be made on April 1, 2004. In addition, the Commission held “Further adjustments after April 1, 2004, would be governed by the Continuation Clause of the Agreement and Basket 1 adjustments would remain in effect until the Commission approves a new or revised Plan.”

6. Qwest appealed both Decision Nos. 66772 and 67047, which appeals are currently pending before the Court of Appeals.

7. On February 3, 2005, Qwest filed an Emergency Motion to Suspend the Inflation Minus Productivity Factor Adjustment. In its current Motion Qwest requests that the Commission suspend the application of the productivity adjustment that is required on April 1, 2005 under the terms of Decision Nos. 66772 and 67047.

8. Qwest states that if required to make the adjustment, its annual revenues would be reduced by $12 million annually.

9. RUCO filed a Response to Qwest’s Motion on February 8, 2005.

10. Staff filed a Response to the Motion on February 22, 2005.

11. Qwest filed a Reply on March 1, 2005.

12. Pursuant to Procedural Order dated February 16, 2005, oral argument on Qwest’s Motion was held on March 3, 2005, at the Commission’s offices in Phoenix, Arizona.

13. Pursuant to the Stipulation of the parties, the Arizona Court of Appeals entered an Order that suspends the procedural schedule for Qwest’s appeal of Decisions Nos. 66772 and 67047.

14. The productivity adjustment required to be made on April 1, 2005 under the terms of Qwest’s current Price Cap Plan is an integral part of the rates we approved in Decision No. 63487.

15. We reaffirm our findings and conclusions in Decision Nos. 66772 and 67047. Pursuant to the terms of the Price Cap Plan we approved in Decision No. 63487, the liability relating to the productivity adjustment on Basket 1 Services continues until the Commission approves new rates or terminates the Plan.

16. Evidence presented concerning whether Qwest would be under-earning under traditional rate of return regulation has not yet been admitted or subjected to cross examination.
Thus, it is premature to state that Qwest is under-earning or to make a determination as to the effect on rates.

17. A suspension of the April 1, 2005 productivity/inflation adjustment is appropriate to allow for comprehensive settlement discussions between the parties and to avoid customer confusion.

18. There may be consumer confusion if Qwest is required to make the April 1, 2005 productivity adjustment and then has to adjust rates again several months later to give effect to a final Commission Order on its Renewed Plan.

19. It is in the public interest to allow Qwest to suspend the implementation of the April 1, 2005 productivity adjustment until final rates are set in this docket, as long as the consolidated appeals are suspended for a similar time period, at which time the Commission will address issues surrounding the April 1, 2005 adjustment. However, the liability associated with the April 1, 2005 adjustment will continue to accrue, in accordance with the terms of the Continuation Clause of the Price Cap Plan.

20. 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.

CONCLUSIONS OF LAW

1. Qwest is a public service corporation within the meaning of the Arizona Constitution, Article XV, and under Arizona Revised Statutes, Title 40, generally.

2. The Commission has jurisdiction over Qwest and the subject matter of Qwest's Motion.

3. Pursuant to Arizona Constitution Article 15, Section 14, the Commission must determine the fair value of a utility's property before modifying its rates. Suspension of the April 1, 2005 adjustment by itself does not constitute a change in rates but merely delays collection, and therefore, does not violate Scates.

4. Suspending the April 1, 2005 productivity adjustment by itself does not violate the prohibition on retroactive ratemaking because the liability associated with the April 1, 2005
adjustment continues to accrue.

5. It is in the public interest to grant Qwest’s Motion to suspend the April 1, 2005 productivity adjustment to the extent discussed herein and for the reasons set forth herein.

ORDER

IT IS THEREFORE ORDERED that Qwest Corporation’s Emergency Motion to Suspend the Productivity Adjustment to Basket 1 required on April 1, 2005, is granted to the extent discussed herein and for the reasons set forth herein.

IT IS FURTHER ORDERED that the liability associated with the April 1, 2005 adjustment will continue to accrue, in accordance with the terms of the Continuation Clause of the Price Cap Plan.
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IT IS FURTHER ORDERED that Qwest shall demonstrate that final rates approved in this docket result in ratepayers receiving the full value of the April 1, 2005 productivity adjustment as if it had been effective April 1, 2005.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 14th day of April, 2005.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT

DISSENT

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