STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: QWEST CORPORATION	DOCKET NO. RPU-01-10

ORDER APPROVING NEW PRICE REGULATION PLAN

(Issued February 4, 2002)

PROCEDURAL BACKGROUND

The Utilities Board (Board) approved a price regulation plan for U S WEST Communications, Inc., n/k/a Qwest Corporation (Qwest), effective November 7, 1998. The plan was to last for three years and was approved pursuant to the provisions of Iowa Code § 476.97, specifically subparagraphs (3)"a"(5) and (6). Under the approved plan, Qwest had an option to renew the plan for one additional term of up to three years upon written notice to the Board at least 90 days prior to the expiration date of the plan. Qwest also had the option of submitting a new plan for Board approval.

On August 8, 2001, Qwest filed written notice to renew the original price regulation plan for an additional three years. The original renewed plan became effective on November 7, 2001, the anniversary date of the original plan. On November 6, 2001, Qwest filed a "Renewed Price Regulation Plan" (New Plan) that it had negotiated with the Consumer Advocate Division of the Department of Justice (Consumer Advocate). In the New Plan, Qwest made certain changes to the original

price plan, some of which are merely updates and some are substantial changes to the terms of the original plan.

Additionally, the original plan is currently on judicial review to interpret language concerning the correct gross domestic product price index (GDPPI) to use for calculating the inflation rate and whether the plan prohibits selected price decreases to accomplish a required decrease under the plan. Consumer Advocate filed a petition for judicial review after the Board, in Docket No. TF-00-250 (RPU-98-4), found that the original plan was ambiguous and interpreted the plan to allow the use of the GDPPI from the federal website, which was available after the printed version, and found that the statute and original plan allowed selected decreases of basic communications services (BCS) prices to accomplish a required decrease.

Iowa Code § 476.97(2) states that the Board may approve, modify, or reject a proposed price regulation plan after notice and an opportunity for hearing and gives the Board 90 days to make a decision whether to accept, modify, or reject a plan. On November 30, 2001, the Board issued an order docketing the New Plan, establishing a briefing schedule, presenting questions for the parties to answer, and giving the parties until December 10, 2001, to request an evidentiary hearing. The 90-day period ends February 4, 2002.

Frontier Communications of Iowa, Inc. (Frontier), was granted intervention in this proceeding. No party requested an evidentiary hearing. Qwest, Consumer

Advocate, and Frontier filed briefs as scheduled. The issue of whether to reject, modify, or approve the New Plan is now before the Board.

BOARD CONCERNS

The Board in the November 30, 2001, order stated that the New Plan raised serious legal questions that needed to be addressed by the parties. The most significant change made to the original plan was the addition of Part III.G, which is set out below.

> III.G. Decreases Due to Competition. Qwest can decrease any BCS rate in a particular exchange or exchanges to a level, which exceeds cost to respond to competition. Under no circumstances will an exchange-by-exchange rate reduction for a BCS service result in increases in BCS rates for other exchanges nor shall it reduce the amount of reduction otherwise applicable for other exchanges. Any decreases in BCS rates on an exchange-by-exchange basis may be used to offset any annual inflation-less-productivity offset decreases, which would otherwise be applicable for a given exchange.

The Board stated that it was concerned that this provision may, on its face, violate the pro-competitive statutory policy set out in Iowa Code § 476.95(2), may be unreasonably discriminatory in violation of Iowa Code § 476.5, and may be de facto deregulation of BCS prices contrary to the requirements for deregulation in Iowa Code § 476.1D.

The Board raised a second issue concerning the language in part III.C. of the New Plan. The New Plan changed the language from the original plan that specified which Gross Domestic Product Price Index (GDPPI) should be used to calculate the

inflation rate for calculating an increase or decrease under the price regulation plan. The original plan in part III.D stated that the GDPPI used to calculate the inflation rate used for determining whether Qwest could increase or decrease its BCS prices was to be taken from "the most recently available monthly edition of the U.S. Department Of Commerce's Survey of Current Business, Table 7.1." The Board, in TF-00-250, found this language required the use of the most recent available information of economic indicators, whether from a printed or electronic format, for determining whether Qwest would be required to adjust its BCS prices. The Board found that information from the Department of Commerce's website was the most recently available GDPPI prior to the November 7, 1999, anniversary date of the plan. Consumer Advocate has taken the position on judicial review that the GDPPI has to come from the printed version of the Survey of Current Business and cannot come from the website.

Part III.C of the New Plan requires that the calculation of the inflation rate use the 2nd quarter values of the GDPPI found in the September edition of the Survey of Current Business. This requirement is not consistent with the Board's decision in Docket No. TF-00-250 and may be inconsistent with the intent of the statute. As the Board stated in TF-00-250, the intent of the statute is that increases or decreases in BCS prices should track as closely as possible the most recently available economic conditions. By requiring the use of the printed September Survey of Current Business, the New Plan does not use the most current GDPPI. The September printed edition of the Survey of Current Business will have the August GDPPI values

and will have only the "advance" values for the 2nd quarter. This will make the GDPPI values potentially out of date and subject to change prior to November 7.

The Board also pointed out in the November 30, 2001, order that the New Plan did not change the language that the Board interpreted to allow selected decreases of BCS prices to accomplish a required decrease. Part III.D of the New Plan concerning when and how Qwest may decrease BCS prices contains the same provisions that are in the original plan. These are the provisions that Consumer Advocate argues on judicial review require across-the-board decreases and the provisions that the Board found in Docket No. TF-00-250 allowed selected decreases.

In the November 30, 2001, order, the Board presented five questions to the parties to be addressed in their briefs. The five questions and the parties' positions are set out below.

PARTIES POSITIONS

1. Does the language in part III.C.1 of the New Plan, filed on November 6, 2001, meet the requirements of the statute for calculating the inflation rate?

Qwest: Basically Qwest stated that the earlier edition of the Survey of Current Business is used so that Qwest can have sufficient time to file proposed tariffs to implement a decrease under the plan of over two percent prior to the anniversary date of the plan. Qwest stated that it could accept using the website index values

from the end of October if the Board allowed the use of a September to August revenue calculation period.

Consumer Advocate: Consumer Advocate agreed with Qwest that use of the September Survey of Current Business would allow Qwest to file the proposed tariffs and have them reviewed before the anniversary date of the price plan.

Frontier: Frontier did not address this issue.

2. Does part III.G violate the pro-competitive policy established by Iowa Code § 476.95(2)?

Qwest: Qwest stated that this provision will allow it to lower its BCS prices if a competitor offers service in an exchange at a lower price than Qwest's current tariffed rates. Qwest argued that preventing it from being able to reduce its BCS rates on an exchange-by-exchange basis would turn the statute on its head. Qwest used the analogy of competing gasoline stations to illustrate how competition should work and cites Iowa Code § 551.1 for the proposition that telephone rates may vary from locale to locale.

Consumer Advocate: Consumer Advocate stated that the intent of Part III.G is to allow Qwest to respond to competition from an alternative provider of any BCS by lowering Qwest's price for that basic service without allowing Qwest to recoup any of the foregone revenues from any other basic service within the targeted exchange or any other exchange.

Frontier: Frontier cited the Board to Iowa Code § 476.95(3) as providing support for Part III.G. Frontier argued that subsection (3) directs the Board to

"encourage competition" by addressing the movement of prices toward cost. Frontier then stated that competition of telecommunications services will only occur when providers of local exchange service have the ability to offer the most favorable terms, including lower prices, for their services, and there would not be true competition unless Frontier is able to lower prices in an exchange to meet any price offered by a competitor.

3. Does part III.G violate the provisions of Iowa Code § 476.1D by allowing the reduction of selected basic communications services rates in individual exchanges without a finding by the Board that the service is subject to effective competition and that market forces are sufficient to ensure just and reasonable rates?

Qwest: Qwest argued that Part III.G is not an attempt to deregulate BCS services since the rates that would be lowered in an exchange would be filed as tariffs. Qwest stated that the Board might be regulating different prices for the same service in different exchanges, but the rates would still be subject to Board regulation.

Qwest then referred to the discussion of Consumer Advocate witness Habr in Docket No. INU-01-1. That case involved a request by Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom (Iowa Telecom), to deregulate its retail and access services in nine exchanges. Witness Habr testified that under the language in III.G Iowa Telecom could lower rates in an exchange without a proceeding to establish that effective competition existed, and that III.G contained a cost standard. Qwest stated that this testimony demonstrated the differences between III.G and 476.1D.

Consumer Advocate: Consumer Advocate contended that III.G does not deregulate rates since any rate lowered by Qwest under its provisions would still be contained in tariffs approved by the Board.

Frontier: Frontier stated that services or rates are not deregulated since III.G, which contains the same language as was approved in its renewed price regulation plan, only allows for the reduction of BCS rates in an exchange and those rates would still be filed in tariffs approved by the Board. Since the lowered rates would remain in tariffs, Frontier argued that there is no need for the Board to find that there is effective competition and asserted that market forces are sufficient to ensure just and reasonable rates.

4. Does part III.G violate the statutory prohibition in Iowa Code § 476.5 against unreasonable discrimination in prices by a rate-regulated telecommunications utility?

Qwest: Qwest stated that III.G is not unreasonably discriminatory since the rates will be tariffed and Qwest has always had different rates for different services in different exchanges depending on location of the customer and size of the calling area of an exchange. Qwest argued that the presence of another provider in an exchange distinguishes that exchange from other exchanges. Qwest then used the analogy of grocery stores to illustrate its position and stated that if two telecommunications providers compete for customers in an exchange, the prices in that exchange would be lower than where there was only one provider in an exchange. Qwest again cited to Iowa Code § 551.1 for support of the proposition that prices may differ by locale to meet competition.

Consumer Advocate: Consumer Advocate stated that the provisions of § 476.5 will continue to apply to BCS prices even where Qwest has lowered rates in an exchange to meet competition. Consumer Advocate stated that it will continue to be unlawful to charge non-tariffed rates for service in an exchange.

Frontier: Frontier stated that any rates charged for BCS would be tariffed and there would be no unreasonable preference or advantage if rates were lowered in one exchange pursuant to III.G. Frontier argued that the presence of different rates for the same service in different exchanges does not result in unreasonable preferences in violation of § 476.5.

5. Are the phrase "level which exceeds cost" and the term "competition" so ambiguous as to make them legally unenforceable?

Qwest: Qwest contended that 199 IAC 38.5 contains a clear definition of costs for local exchange carrier pricing so that there is nothing ambiguous about the phrase "level which exceeds cost." Qwest pointed out that rule 38.5 contains an imputation standard for pricing and "level which exceeds cost" is met by pricing that meets the imputation test. Qwest then stated that it has reduced BCS rates under the original price plan language that allowed it to decrease any BCS price upon a showing that it met the imputation standard, and these rates have been accepted as being above cost. Qwest stated that the imputation language could be used to meet the cost requirements of III.G for reducing rates in a single exchange.

Qwest suggested that the term "competition" is easily understood and is not ambiguous. Qwest pointed out that the legislature has used the term frequently as in

Iowa Code §§ 476.95 and 476.97 without definition. Qwest then contended that competition occurs when another provider of basic telecommunications services offers service in an exchange where Qwest is offering service. Qwest suggested that III.G merely allows Qwest to compete with the other provider prior to the time that it might seek deregulation of its services in the exchange. Qwest then pointed out that the Board approved the same language found in III.G in the renewal of Frontier's price regulation plan.

Consumer Advocate: Consumer Advocate stated that the provisions in III.G "level which exceeds cost" and "competition" were negotiated in the context of the costing standards in Board rule 38.5. Consumer Advocate pointed out that subrule 38.5(2) establishes an incremental cost standard for local exchange services and rates must meet the imputation test of subrule 38.5(3). Consumer Advocate then contended that "competition" in the context of the III.G means to respond to the competition of rivals and not market structure, and these terms are sufficiently meaningful to make them enforceable.

Frontier: Frontier contended that neither the phrase "level that exceeds cost" nor the word "competition" is so ambiguous in the price plan as to be unenforceable. Frontier suggested that it is not necessary for the Board to establish definitions in the price plan. Frontier then pointed out that the legislature did not define competition in § 476.95(3) where the Board is to address issues involving competition and moving prices toward costs. Frontier pointed out that chapter 476 contains additional references to competition without a precise definition.

Frontier then pointed out that the Board has cost standards in rule 38.5 and these rules provide context and guidance for considering the terms in the price plan. Finally, Frontier stated that it would be inconsistent for the Board to reject III.G in Qwest's price plan and thus III.E in the Frontier price plan because the terms cost and competition are so ambiguous as to be legally unenforceable. Instead, Frontier proposed that the Board wait until Frontier files a proposed tariff to reduce a BCS rate in an exchange and then the Board may seek to determine whether the new proposed rate exceeded the cost for providing the service, and could confirm that the proposed tariff was filed in response to competition within the exchange.

BOARD DISCUSSION AND DECISION

ISSUE 1. The Board has reviewed the parties' positions on the first issue and has come to the conclusion that the use of the GDPPI values from the September Survey of Current Business is acceptable based upon the additional information presented in this docket that was not presented to the Board in Docket No. TF-00-250. In that docket, the Board found that language in the price plan was ambiguous and interpreted the plan to comply with the intent of the statute to use the most recently available information for the calculation of an inflation factor so that any price increase or decrease would most accurately reflect the economy. Qwest and Consumer Advocate have both agreed in this docket that an earlier specifically established date for the GDPPI values is required to accommodate those instances

where a required decrease would be more than two percent for a year. These facts were not presented to the Board in Docket No. TF-00-250.

If a 2 percent or greater decrease is required under the New Plan, Qwest will have to file tariffs that reduce rates and Qwest will need the additional time to prepare and file those tariffs to be effective on November 7. In addition, the language in III.C that specifically designates the September edition of the Survey of Current Business as the source of GDPPI values cures the ambiguity that exists in the original price plan.

ISSUE 2. The Board has considered the positions of the parties with regard to the provisions in Part III.G of the New Plan which would allow Qwest to decrease BCS rates in one or more exchanges rather than on a company-wide basis to a level that exceeds cost to respond to competition. The Board will approve the language in III.G as part of the New Plan since the evidence in this docket is not sufficient to show that the provisions violate any statute or Board rule. The only evidence the Board has in this record is in support of the language. The Board offered any interested party who might oppose the provisions an opportunity to intervene and file a brief, and no such interventions were filed. In approving the language in III.G, the Board is also adopting the procedure proposed by Frontier for considering proposed tariffs filed pursuant to III.G.

Even though the Board is approving the New Plan, it still is concerned that the provisions in III.G are anti-competitive and violate the policy set out by the legislature in Iowa Code § 476.95(2). That statutory policy provides that:

> (2) In rendering decisions with respect to regulation of telecommunications companies, the board shall consider the effects of its decisions on competition in telecommunications markets and, to the extent reasonable and lawful, shall act to further the development of competition in those markets.

For competition to develop in the Qwest exchanges, competitive local exchange carriers (CLECs) will have to decide that the opportunity exists in those exchanges to provide services at a rate that is profitable and presumably lower than the incumbent's prices. The Board is concerned that III.G could act as a barrier to a CLEC entering a Qwest exchange since Qwest could at any time lower its rates to meet the CLEC's rates and thus prevent the CLEC from developing a customer base.

The Board raised its concerns about the provision being anti-competitive in the November 30, 2001, order and gave interested persons an opportunity to intervene and file briefs concerning the potentially anti-competitive language. No CLEC or other telecommunications carrier intervened to oppose the language in III.G. The only intervenor was Frontier and Frontier has a similar provision in its price plan.

The only other party to the proceeding is Consumer Advocate and Consumer Advocate negotiated and approved the language before it was filed. Consumer Advocate also supported the provisions in III.G in Docket No. INU-01-1 through the testimony of witness Habr. From witness Habr's testimony and the position taken in this docket, the Board accepts that Consumer Advocate believes that price decreases, without the opportunity for offsetting increases, outweigh any potential anti-competitive result of the provisions in III.G.

Additionally, the Board finds that the parties are right that the standards set out in Iowa Code § 476.1D for deregulation of telecommunications services are not applicable to the rates that would be reduced under III.G. The Board also finds that any tariffs filed under III.G would not violate the anti-discrimination provisions of Iowa Code § 476.5.

The Board has considered whether the cost standards in 199 IAC 38.5 are applicable to III.G. Subrule 38.5(2) requires that each local exchange carrier shall price each of its services above the total service long-run incremental cost of providing each service. Total service long-run incremental cost for a service or group of services is defined in subrule 38.1(2) as equal to the utility's total cost of producing all of its services including the service or group of services in question, minus the utility's total cost of producing all of its services excluding the service or group of services in question.

The Board finds that while the standard established for long-run incremental cost might have application with regard to a company-wide service, it does not necessarily apply with regard to determining the cost of a service in a single exchange, or group of exchanges. The definition in subrule 38.1(2) speaks in terms of the total cost of the utility and the total cost of the service in question. The Board is not convinced based upon the briefs that this costing standard can be applied to rates for only a part of the company's service territory.

The Board has considered the provisions of Iowa Code § 551.1 to determine whether it supports Qwest's position that the legislature has approved different prices

for telecommunications carriers to meet competition. The Board does not find the language of that section to be on point. Qwest has taken a rather loose interpretation of this somewhat convoluted statute. The statute basically prohibits companies from predatory pricing to eliminate a competitor, and specifically excepts out the prices charged by rate regulated telecommunications carriers. In fact, if the statute did not except out Qwest as a rate regulated utility, the statute might be interpreted to prevent Qwest from selectively lowering its rates.

Frontier proposed as an alternative to rejecting III.G that the Board could suspend a proposed tariff that would decrease a BCS rate in one exchange or a group of exchanges and conduct an evidentiary hearing concerning the cost of providing the service and whether there was competition in the exchange or exchanges. This approach appears to be consistent with Dr. Habr's testimony in Docket No. INU-01-1. The Board considers this to be a reasonable approach to any review of proposed tariff decreases of BCS rates to meet competition in an exchange or group of exchanges under both the Qwest New Plan and the Frontier Price Plan. If Qwest or Frontier files proposed tariffs to reduce BCS prices under the terms of III.G, it will be required to file evidence of competition before the proposed tariffs are approved. If a competitor objects, the rate will be suspended and supporting cost studies will be required to be filed.

ISSUE 3. The Board has determined that it will not address the failure of the New Plan to resolve the ambiguity concerning whether Qwest can selectively reduce BCS rates to accomplish a required decrease under the New Plan. The issue is on

judicial review and has been briefed and argued in the District Court, and the court will interpret the language.

ORDERING CLAUSE

IT IS THEREFORE ORDERED:

1. The "Renewed Price Regulation Plan" filed by Qwest Corporation on November 6, 2001, is approved. The anniversary date of the plan will be November 7.

2. Any rate reduction under part III.6 of the approved plan shall comply with the filing requirements in the body of this order.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

Dated at Des Moines, Iowa, this 4th day of February, 2002.