BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF INVESTIGATION
INTO U S WEST COMMUNICATION,
INC.'S COMPLIANCE WITH CERTAIN
WHOLESALE PRICING REQUIREMENTS
FOR UNBUNDLED NETWORK ELEMENTS
AND RESALE DISCOUNTS.

DOCKET NO. T-00000A-00-0194

NOTICE OF FILING

Arizona Corporation Commission Staff ("Staff") hereby files the Public Version of Staff's Initial Post-Hearing Brief in the above-referenced matter. Copies of the Proprietary version are being provided to the Hearing Division and those parties who are signatories to the Protective Agreement herein.

RESPECTFULLY SUBMITTED this 4th day of September, 2001.

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(PUBLIC VERSION)

STAFF'S INITIAL POST-HEARING BRIEF

I. INTRODUCTION

This Docket was opened in the first quarter of the year 2000 to examine a number of issues relating to U S WEST Communications' (nka “Qwest”) pricing of its wholesale services and products offered to its competitors. Phase I of this Docket was instituted to comply on an expedited basis with the FCC's geographical deaveraging requirements contained in 47 C.F.R. Section 51.507(f). Phase I concluded on July 25, 2000, with an Opinion and Order by the Commission (Decision No. 62753) adopting interim geographically deaveraged unbundled network element (“UNE”) rates.

Phase II of this Docket was designed to address new and/or modified obligations imposed on Qwest by subsequent FCC Orders and judicial decisions, and to establish permanent geographical deaveraged rates. A subsequent Procedural Order provided that Qwest’s existing UNE rates would also be reviewed in Phase II. The Phase II evidentiary hearing concluded on July 31, 2001.

There were essentially two alternative costing models put forth by the parties in Phase II for the Commission’s consideration. Qwest sponsored its own model referred to as the Integrated Cost Model (“ICM”). The second model, known as the HAI 5.2a Model, formerly known as the Hatfield Model, was sponsored by AT&T/XO/WorldCom (hereinafter collectively referred to as the CLECs). The Model selected by the Commission will have a direct impact upon the level of UNE rates Qwest is ultimately authorized to charge its competitors. Staff endorses the use of the HAI 5.2a Model as
a starting point for determining UNE rates. Qwest’s ICM Model, and in particular one of its
subcomponents known as the LoopMod, is similar to an earlier version of the Model (the “RLCAP”) which the Commission rejected in Decision No. 60635.⁴¹ The problems identified with Qwest’s Model are legion and would result in inflated UNE rates creating an impenetrable barrier to competition in the local service market in the State of Arizona. Indeed, the rates produced by this Model and proposed by Qwest in this Docket are overall much higher than the existing wholesale rates in Arizona. Presently, Arizona has some of the highest UNE rates in the Qwest region. Staff’s expert utilized the HAI 5.2a as a starting point, and recommends that the Commission do so as well as it did in Decision No. 60635, since this Model is a more accurate indicator of forward-looking costs than Qwest’s LoopMod.

Simply put, the Qwest Models are based upon the embedded network and embedded costs in direct contravention of FCC rules. In addition, as will be discussed at length in Staff’s Brief, unlike the TELRIC standard, the Qwest Model does not presume or incorporate the most efficient provision of service. Qwest’s Models actually build in significant inefficiencies which result in inflated prices to the CLECs. Interestingly, when Qwest runs the HAI 5.2a Model with what it considers to be “reasonable inputs”, it comes up with a statewide average loop rate of $19.61, which is far below the $25.95 loop rate which its LoopMod produces. Tr. p. 1024.

Equally important as the Model, are the inputs that are utilized in the Model, to determine forward-looking costs. The Commission Staff’s expert recommends using the inputs adopted in Decision No. 60635 as a starting point. Staff believes that the current record establishes that by and large these same inputs are as appropriate today as they were when the Commission adopted them in 1998. For those inputs not set by the Commission in Decision No. 60635, Staff’s expert, Mr. William Dunkel, recommends that the Commission utilize the FCC inputs. As discussed at length below, Qwest’s proposed inputs are greatly in excess of those adopted by the Commission in Decision No. 60635, and do not comply with the Total Element Long Run Incremental Cost (“TELRIC”) standard established by the FCC.

Once the statewide average UNE rate is determined, the Commission must also establish the basis for setting permanent geographically deaveraged UNE rates. All parties to this proceeding, including Staff, proposed the use of three cost zones for Arizona. Beyond that, the proposals of Staff and the CLECs departs dramatically from the most recent proposal by Qwest. Qwest’s most recent proposal is patently unreasonable and would result in a substantial wholesale rate increase for over 80 percent of all access lines in Arizona, by placing only two small wirecenters (or only approximately 5 percent of all access lines) in Zone 1. The Commission should reject Qwest’s most recent geographical deaveraging proposal which is clearly designed to thwart competition in the State of Arizona.

In addition to the loop rates, there are many other important rates at issue in this proceeding as well. Qwest’s rates for collocation, Line Sharing, Subloop, Dark Fiber, UNE-P, among others, are also being established in this case. However, once again the rates that Qwest is proposing are not TELRIC compliant. They are based upon inflated vendor labor rate percentages, engineering, material and overhead costs. They are the antithesis of a least cost, efficient network, and accordingly, should be rejected.

Qwest also treats its own xDSL provider more favorably than it treats unaffiliated xDSL providers. Staff demonstrated in its prefilled testimony and at the hearing that Qwest is assessing charges on unaffiliated xDSL providers which its own xDSL provider does not pay. The only possible explanation for this discriminatory treatment is that Qwest has made available to its xDSL affiliate backdoor arrangements that are not available to the CLECs. This is unfair and gives Qwest license to impose a myriad of charges on unaffiliated providers, which its own affiliated provider does not have to pay, resulting in an unfair advantage to its affiliate.

Finally, on July 25, 2001, Staff and Qwest entered into a stipulation in which Qwest specifically adopted the testimony of Staff Witness William Dunkel on the avoided cost discount issue. Under the settlement, the current wholesale discounts would continue in effect. No party has objected to the settlement between Staff and Qwest., and Staff urges the Commission to adopt it.
II. BACKGROUND

The Telecommunications Act of 1996\(^2\) ("1996 Act" or "Federal Act") imposes upon the Incumbent Local Exchange Carrier ("ILEC") a myriad of obligations designed to promote the development of competitive markets. Specifically, under 47 U.S.C. Section 251(c) an ILEC must permit any requesting Competitive Local Exchange Carrier ("CLEC") in the ILEC's local market to interconnect with the ILEC's existing local network, and to use that network to compete for local telephone service provision. Second, the ILEC must provide a requesting CLEC with access to the elements making up the ILEC's network on an individual or unbundled basis. Third, the 1996 Act requires an ILEC to make available any of its retail services to a CLEC on a wholesale basis so the CLEC may resell Qwest's finished services to its customers. See 47 U.S.C. Section 251(c)(2)-(4)(1994 ed., Supp. III). Fourth, the ILEC must allow for physical collocation of the equipment necessary for interconnection or access to unbundled network elements at the ILEC's premises, and when that is not practicable, the ILEC must provide for virtual collocation.

The pricing standards for interconnection and network element charges are set forth in Section 252(d) of the 1996 Act. That Section provides in relevant part:

\[\text{(1) INTERCONNECTION AND NETWORK ELEMENT CHARGES—} \]

Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section—

(a) shall be—

(i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and

(ii) nondiscriminatory, and

(b) may include a reasonable profit.

The FCC's pricing provisions for interconnection and unbundled network elements are based upon a forward-looking economic cost methodology that is based on TELRIC. The costs are to be based upon an ILEC's existing wire center locations using the most efficient technology available in the industry regardless of the technology actually used by the ILEC and furnished to the

competitor. See 47 C.F.R. Section 51.505(b)(1). State commissions must employ TELRIC to
determine the price an ILEC may charge its competitors for the right to interconnect with the ILEC
and/or to use the ILEC's network elements to compete with the ILEC in providing telephone service.

At the time that Decision No. 60635 was entered, the FCC’s rules implementing large
portions of Section 252 of the 1996 Act, including its pricing provisions, had been vacated by the
Eighth Circuit Court of Appeals on jurisdictional grounds. Iowa Utilities Board v. FCC, 120 F.3d
753 (8th Cir. 1997). Subsequently, as a result of the United States Supreme Court’s Decision in
AT&T v. Iowa Utilities Board, 119 S.Ct. 721 (1999), those rules were reinstated. The Eighth Circuit
subsequently vacated 47 C.F.R. Section 51.505. See Iowa Utilities Board v. FCC, 219 F.3d 744 (8th
Cir. 2000). The Eighth Circuit’s decision has been stayed and is currently pending before the United
States Supreme Court.

Several appeals of the Commission’s original arbitration decisions and Decision No. 60635
were also filed with the Federal District Court for the District of Arizona. The Federal District
Court’s Decision upheld certain of the Commission’s determinations and remanded others back to
1999). In addition, several of the District Court’s rulings were appealed to the Ninth Circuit Court
of Appeals, where they are currently pending. Included in the issues remanded back to the
Commission for further consideration was the need to establish additional resale discount rates, after
considering the range of cost savings for different categories of services.

In addition, the FCC has issued several subsequent orders which impose additional
unbundling and other obligations on Qwest which require review by this Commission. (CITE to
Advanced Services Order and UNE Remand Order).

Phase II of this Docket was designed to address these new obligations imposed on Qwest by
subsequent FCC Orders and judicial decisions and to establish permanent geographically deaveraged
UNE rates. The parties agreed to defer switching costs to a later phase of this case. See Procedural

...
III. DISCUSSION

A. The Commission Should Adopt the HAI 5.2a Model As The Starting Point for Determining Appropriate Loop Rates in This Proceeding.

Qwest proposed the use of the LoopModule ("LoopMod"), a component of the Qwest Integrated Cost Model ("ICM"). The CLECs proposed the use of the HAI 5.2a Model (formerly known as the Hatfield Model). After evaluating both models, Staff believes that use of the HAI 5.2a Model will produce results most consistent with TELRIC. The ACC used the Hatfield Model as the basis for its determinations in the first Consolidated Cost Docket in Decision No. 60635.

In that Decision, the ACC rejected the U S WEST Model for the following reasons:

The U S West models are based upon embedded costs and technology, and do not consider particular demographics and geology of the State of Arizona. Although the U S WEST models were supposed to represent forward-looking models, the results were similar to its embedded cost studies. This result was in spite of U S WEST's own acknowledgment that its existing system embodied different technologies installed over many years and did not represent the most efficient current technology.

Decision No. 60635 p. 7. Qwest Witness Million acknowledged on cross-examination that while there have been modifications to the Qwest Model since Decision 60635, it is essentially the same model that the Commission rejected in Decision 60635. Tr. p. 770. Consistent with the Commission's earlier finding in Decision 60635, Staff's analysis once again indicated that Qwest's Model is simply not consistent with TELRIC principles, or with the way that costs are actually incurred, nor is the Model consistent with future expected costs. While Qwest Witness Fitzsimmons admits that TELRIC is supposed to use the least cost, most efficient currently available technology (Qwest-29, p. 17), the record in this proceeding is clear that Qwest's Model and its inputs assumes much less efficiency than actually exists in the real world.

One example of this, as will be discussed later at length, is that in the real world, Qwest buries cable or conduit before the streets are paved, but the Qwest cost model pretends that Qwest buries cable and conduit after the streets are paved, which of course is much more expensive. This creates a large built-in fictional cost which Qwest does not incur in the real world.

Besides the Model itself, the inputs used in the Model also have a significant impact upon the rates resulting from the Model. Like the Qwest Model, Qwest's proposed inputs are based upon
an embedded network, rather than the TELRIC standard, which requires that the rates Qwest charges to competitors be based upon forward looking costs using the most efficient technology available.

B. The Record Does Not Support Qwest's Proposed Overhead Factor

In its cost studies in this proceeding, Qwest uses a number of overhead factors which result in increasing the cost by 32 percent over direct cost. Staff-32; Schedule WD-23. In Decision 60635, the ACC considered information from four different studies pertaining to overhead costs. In that Decision, the ACC adopted an overhead cost factor "including attributed, joint and common costs, of 15 percent". The ACC’s selection of a 15 percent overhead factor was not remanded by the Court. U S WEST v. Jennings, 46 F.Supp.2d 1004, 1011-1012 (D.Ariz 1999).

However, in this proceeding, Qwest has alleged that when the ACC adopted the 15 percent factor that was for corporate common overhead costs (Account 6700) only, and did not include "attributed" costs, such as network operations. Tr. pps. 505, 1007 and 1154. However this Qwest contention is simply wrong. The ACC Decision clearly states:

Therefore, we will adopt an overhead cost factor, including attributed, joint and common costs, of 15 percent.

Decision No. 60635 p. 13.

In addition, Qwest’s claim that the 15 percent factor was only for common costs, and did not include "attributed" does not make sense. Part of the evidence that the Commission considered in its Order was:

U S WEST claimed that only the five percent factor was Overhead, while the 22 percent is attributed cost.

Decision No. 60635 p. 13.

It is highly unlikely that the Commission would have adopted a 15 percent Overhead factor when Qwest itself was urging adoption of only a five percent Overhead factor. Therefore, 15 percent factor adopted by the Commission clearly had to include not only corporate common overhead costs, but "attributed" costs as well, exactly as the ACC Decision specifies.

In addition, Staff and other parties also identified many problems with Qwest’s calculation of these overhead expenses, including, but not limited to, the following:

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4 Decision No. 60635, p. 13.
- Qwest has direct charges for power when a CLEC receives power from Qwest when a CLEC receives power from Qwest for collocation. In addition, Qwest’s cost studies also include a “power” loading factor that applies to all collocation facilities. Ms. Gude acknowledged that the Qwest cost study improperly applies this power factor to non-powered collocation facilities. However, Ms. Gude claimed that it would “not be efficient from a time or cost perspectives” to calculate a power factor that applied to only the facilities that actually used power.

- Ms Gude argued that the rent collocators pay only covers their own space, but they use “cable racking” outside of their own space, and therefore they should be charged land and building factors to cover that outside space. However, there are also cable racks that pass through the area for which the CLECs pay the full rent. Cables in those racks may be used by others. Yet, on cross examination, Ms. Gude indicated that she did not know of collocators receiving any credit on their rent for the fact that other cables may be passing through the space for which they pay the full rent. Tr. p.992. This is a one sided adjustment. It is inappropriate for collocators to be charged “rent” for other areas that their cables pass through, but not receive any credit or rent offset for the fact that other companies’ cables pass through the area for which they pay the full rent.

- It also appears from the rebuttal testimony of Ms. Gude p. 7, that Qwest may have inappropriately included costs associated with its 271 case in certain overhead accounts. In footnote 4 on page 7 of her rebuttal testimony, Ms. Gude refers (for illustration purposes) to the complex activity occurring in the Statement of Generally Available Terms workshops, where she states that “many hours have been undertaken for this category of costs.” Staff believes that it is inappropriate of Qwest to be including any costs associated with its 271 case, whether that be for the Third-Party Independent OSS Test or SGAT workshops or any other 271 related costs, in overhead accounts which it then charges back to the CLECs. Qwest is required to comply with 47 U.S.C. Section 271 in order to obtain the benefits associated with its entry into the long distance market. Accordingly, to charge any of these costs back to the CLECs is inappropriate.

Finally, Qwest Witness Fleming mischaracterized Staff’s position on overhead costs.

Exhibit 5 of Mr. Fleming’s Rebuttal Testimony (Qwest-8) had columns that Mr. Fleming had labeled “Dunkel’s modifications.” However, during cross-examination, Mr. Fleming admitted that he had calculated all of the numbers in those columns, and Mr. Dunkel did not calculate any of the figures in those columns. Tr. p. 469. On that Exhibit, Mr. Fleming alleged that Staff Witness Dunkel’s proposal included “no Power, Land, Building, and IDC factors used.” In addition, it stated that Staff Witness Dunkel included “no HVAC nor Electric inputs”, and “does not include Aerial Support, Cable Racking, or Lighting.” Qwest-8, Ex. 5. On cross-examination, Mr. Fleming admitted that Staff Witness Dunkel actually did include these costs. Tr. p. 465. Totally excluding all of these costs was not Mr. Dunkel’s recommendation, and not what Mr. Dunkel had done in his calculations. Tr. p. 469. Mr. Dunkel stated:
I recommend the more reasonable calculation than the company used... but I did not exclude these costs. The recovery of these costs are included in the rates which I propose on Rebuttal Schedule WD-17.

Staff-32, p. 4.

In summary, the Commission should reject Qwest's proposal to significantly increase its overhead costs.

C. The Commission Should Adopt the Inputs Used By the Staff Which Rely Upon the ACC Inputs in Decision 60635 and the FCC Inputs Contained in its Tenth Report and Order Since Qwest's Proposed Inputs Are Based Upon Historical Data.

Each Model utilizes literally hundreds of inputs. Tr. p. 66. The Staff utilized the inputs adopted by the ACC in Decision 60635 where specified, and the FCC-determined inputs, for those not adopted/specified in the ACC Decision. The FCC inputs were those adopted by that agency in In the Matter of Federal-State Joint Board on Universal Service; CC Docket No. 96-45, FCC 99-304, Tenth Report and Order (Rel. November 2, 1999). The FCC conducted an extensive proceeding, in which various parties presented their positions pertaining to the various inputs. Based upon the extensive record before it, the FCC adopted specific inputs. Staff-30, p. 72. Staff believes that the ACC inputs contained in Decision 60635 are reasonable, and, if ACC inputs are not available, then the FCC inputs provide the most reliable source for inputs in the Model. Both sets of inputs were based upon extensive records developed before both agencies. Qwest has not presented reliable data to support any significant changes to any of the inputs already determined to be appropriate by the ACC in Decision No. 60635 and the FCC in its Tenth Report and Order in CC Docket No. 96-45.

An example of the inappropriate assumptions made by Qwest are best illustrated when considering its proposed inputs for structure sharing and placement costs.

1. Structure Sharing

Structure sharing refers to the degree to which outside plant structures will be shared by the ILEC, cable operators, electric utilities and others including competitive local exchange carriers and interexchange carriers. Qwest's model incorporates a **PROPRIETARY** structure sharing factor for buried facilities. On cross-examination, Ms. Torrence indicated that what this effectively assumes is that Qwest will pay for **PROPRIETARY** of the costs of trenching for distribution
I cables in new standard residential subdivisions out of its own pocket. Tr. 911-912. This is unrealistic and is very close to the structure sharing factor proposed by Qwest in the First Consolidated Cost Docket which the Commission rejected. Decision No. 60635 p. 20. In standard residential subdivisions, not only are the buried cables and other underground facilities placed prior to the surface obstructions, but the trench is generally provided by the developer at no cost to Qwest during the development of a new residential subdivision. In real world, Qwest would generally be paying nothing for the trench in new standard residential subdivision. Tr. 913.

The above discussion focuses on residential subdivisions because they have the highest weighting in Qwest's study. As shown on Staff-5, the standard residential subdivision ("DG3") represents **PROPRIETARY** of the lines in the Qwest LoopMod cost model. The Qwest LoopMod cost model includes a total of five density groups. None of the other four density groups have a weighting in excess of **PROPRIETARY** in the model. Tr. 903-904.

Qwest's proposed structure sharing percentages for aerial and underground facilities are also very similar to those rejected by the Commission in Decision 60635. Id. p. 20. Qwest's proposed structure sharing percentages are based entirely upon historical or embedded cost data and bear no relationship to the least cost forward-looking TELRIC standard, mandated under the Federal Act and FCC rules.

2. **Placement Costs**

Placement costs refer to the various types of placement activities, such as trenching or boring, and the frequency with which Qwest will encounter particular placement activities. In Decision No. 60635, the Commission adopted the Hatfield Model's method for calculating placement costs (Id. p. 19) and the Staff urges the Commission to adopt the HAI 5.2a once again.

The Qwest model greatly exaggerates placement costs in downtown business districts, in feeder, and other areas. As they did in the residential subdivision, Qwest assumed that they would have to place the underground facilities after the surface obstructions were in place. Qwest assumed that a high percent of installation costs would require them to cut and restore concrete, asphalt, or sod, or bore under such surface obstructions. Qwest Witness Torrence admitted that in the Qwest
LoopMod, Qwest assumed that of the total length of distribution cables would have to be replaced either by cutting and restoring concrete, cutting and restoring asphalt, cutting and restoring sod, or boring under such surface obstructions in standard residential subdivisions (DG-3 in Qwest’s LoopMod study). Tr. p. 910.

However, in discovery, Qwest acknowledged that Qwest’s own practice was to place the buried cables prior to the time that the streets, and other surface obstructions were in place.

Yes, in new subdivisions where the developer coordinates with utilities, outside plant facilities are generally placed prior to the placement of streets and landscaping.

The Qwest Witness also admitted that in the real world it is generally true that in residential subdivisions,

...you do not cut and restore concrete, you do not cut and restore asphalt, or cut and restore sod and bore under the length because those obstructions are not there are the time you place the distribution cable.

Tr. 914, 915.

In addition, on cross-examination, Qwest’s Witness Torrence acknowledged that in downtown areas, feeder is generally in “conduit.” Tr. p. 919. Conduit is essentially a form of buried pipe that creates what amounts to small tunnels underground. Qwest Witness Torrence also acknowledged that with conduit, they install new cables by pulling them through the conduit, and they do not have to dig up the ground when placing a new cable in conduit. Tr. p. 919. Qwest generally places the conduit before a road or street is paved because that is more economical. Tr. p. 920.

In short, in the real world, before roads are paved, Qwest places conduit under where those roads will be. In the future, when Qwest needs to run cables under the downtown streets or under highways, they will pull the cable through the conduit. They do not have to cut through the pavement, nor bore under the pavement, or otherwise dig up the length of the cable in order to install new cable where they have conduit. The buried distribution cables in residential subdivisions are designed to last the life of the subdivision. That is, the Company does not come back later to add additional distribution cables. Tr. pp. 916-918. In fact, Ms. Torrence indicated that Qwest’s practice
is to install enough distribution facilities to avoid having to come back later and tear up the surface obstructions when residential customers want additional lines.

Qwest’s LoopMod cost study improperly assumes the highway or downtown street is paved first, and the, at a huge additional expense, Qwest would cut through and patch the existing roads, or bore under the. These costs are mostly fictional, are not what generally occurs in the real world, nor are they costs that are generally expected to be incurred in the future. The costs of “placement” represents approximately **PROPRIETARY** of the total investments in the model. Staff-30, p. 68.

Qwest argues that the placement methods it used in its LoopMod analysis, such as using boring for a high percent of the distribution cable length, is based upon the placement methods that Qwest used in a trial in Omaha. As indicated in Staff-8, the Omaha trial involved replacing copper distribution pairs with fiber or coax. As Mr. Buckley admitted on cross-examination, this is not the way the standard telephony network is designed. Tr. 204. Moreover, Qwest found the Omaha experience of replacing twisted copper buried distribution cables with coax or fiber distribution to be prohibitively expensive. These substantial costs resulted from working around or through the surface obstructions that exist in a developed neighborhood. As a result of that experience and the significant expense involved, Qwest has no plans for the widespread replacement of the distribution cables in existing residential neighborhoods. The trial apparently convinced Qwest to not actually perform such installations on a widespread basis in the future, because they are prohibitively expensive. Qwest also claimed that it observed the practices of a cable company in North Dakota and AT&T Broadband. However, the installations Qwest observed did not involve the installation of twisted copper pair cable. Tr. at pps. 203 and 209. The inclusion of these costs in the LoopMod of twisted copper pair cable is not reflective of the forward-looking costs that are actually expected to be incurred.

Copper twisted pair is the forward looking distribution cable used in both the Qwest LoopMod and HAI cost models. There is no need to go into existing neighborhoods at great expensive to install twisted copper distribution cable after the streets, sidewalks, driveways, lawns, bushes, etc. are laid. It is already there, and was generally installed prior to the time the streets were
placed. As previously discussed, at the time a residential subdivision is developed, Qwest puts in two or three distribution pairs per household. However, there are approximately 1.17 lines in service per household in Arizona. Therefore, there is plenty of existing distribution copper cable in place in Arizona to accommodate growth. Tr. 913-918.

As a result of criticism by the Staff and others, in their Rebuttal testimony, Qwest made one change in their placement method, but that change was only a token change, and had little impact. On page 2, lines 14-15 of Qwest-21, Mr. Buckley adjusted “DG-5” (very low density group) in the Qwest LoopMod cost model to include more “plowing” for placing facilities. However, as Mr. Buckley admitted on cross-examination, Mr. Buckley’s DG-5 adjustment impacted little over one percent of the distribution lines in Arizona. Tr. 187-189. This was a token adjustment that did not impact the major problem. For example, Mr. Buckley did not change the placement methods assumed for standard residential subdivision (DG-3), which represents over **PRQPRIARY** of Qwest’s lines in Arizona Tr. at pps. 903-904.

Once again, Qwest proposed inputs assume a large fictional cost which Qwest does not incur in the real world. Qwest’s proposal should be rejected.

3. **FCC Inputs**

In testimony filed late in the proceeding, Mr. Fitzsimmons attacked the Staff’s run of the Model and whether it correctly utilized the FCC inputs. However, Mr. Fitzsimmon’s attack was based upon an incorrect understanding of the inputs used in the run contained in the Staff’s Supplemental Testimony, and therefore, Mr. Fitzsimons attempt to discredit the Staff’s run should be disregarded.

In the HAI 5.2a run that accompanied Mr. Dunkel’s Direct Testimony, Mr. Dunkel had used the FCC inputs exactly as shown in the “Input” tab of the actual FCC run that the FCC used to determine universal service fund (USF) eligibility for Qwest in Arizona. Staff-32, p. 1. In Mr. Fitzsimmons’ Rebuttal Exhibit WLF-3, he provided values for inputs that he alleged were the correct FCC determined input values, and recommended that the Staff run the values shown in his “FCC Scenario Value” column on that Exhibit WLF-3. Qwest-29, Ex. WLF-3. For example, for “SAI indoor investment 12” (50 lines), the Staff Direct run had used a value of “98”, and Mr. Fitzsimmons
alleged that the correct FCC value was “220”. In response to Mr. Fitzsimmon’s Testimony, Mr. Dunkel reran the HAI 5.2a model using the “FCC Scenario Values” shown on Qwest-29, Ex. WLF-3. For example, for the “SAI indoor investment 12” (50 lines), the run utilized in Staff’s Supplemental Testimony (Staff-32) used the value of “220,” not the “98” value that had been used in the run contained in Staff’s Direct Testimony. The overall impact was minor, resulting in a 12 cent difference per loop.

Staff Witness Dunkel stated:
Since this issue has little effect, and to avoid further controversy My Rebuttal Schedule WD-19 utilizes what Qwest identified as the “FCC Scenario Value” in puts as shown on Exhibit WLF-3.

Staff-32, p. 1.

Staff’s run contained in its Supplemental Testimony used every number form Qwest-29, Ex. WLF-3 that Mr. Fitzsimmons claimed was the correct FCC number.

Following Staff’s Supplemental Testimony, Mr. Fitzsimmons filed Surrebuttal Testimony (Qwest-36), in which Mr. Fitzsimmons again argued that using the “98” value for the SAI indoor investment 12 (50 lines) was the incorrect value, and that the “220” value should be utilized. Qwest-36, Table 1, p. 6. Mr. Fitzsimmons’ Surrebuttal Testimony totally ignored the fact that Staff’s Supplemental Testimony clearly stated that Staff was not using the “FCC Scenario Value” inputs from Qwest-29, Ex. WLF-3. In addition, Staff had provided Qwest with a disk that showed the input values used in the Staff Supplemental Testimony run. Therefore, it is unclear whether Mr. Fitzsimmons simply did not review Staff Witness Dunkel’s Supplemental Testimony or whether he did not understand it.

The simple fact is that none of the figures in the column headed “Dunkel run of HAI 5.2a” in Table 1, page 6 of Qwest-36, accurately represent the inputs that are used in Staff’s Supplemental Testimony run, which is the one which the Staff is recommending that the Commission adopt. In all cases, Staff’s Supplemental run used the same numbers that are shown in the “FCC Tenth Report and Order” column on Mr. Fitzsimmons’ Table 1. The changes that Mr. Fitzsimmons recommended on Table 1, page 6 of Qwest-36 are the changes that had been previously made by the Staff, and were already incorporated in Staff’s recommendations. On cross-examination, Mr. Fitzsimmons
acknowledged that Mr. Dunkel’s Surrebuttal run of the cost model used the inputs from the FCC column of his Rebuttal Exhibit WLF-3. Tr. 1875.

D. **Staff’s Proposal For Permanent Geographical Deaveraging is Reasonable.**

Utilization of the HAI 5.2a Model as a starting point, along with the input values recommended by Staff result in a statewide average loop rate of $12.35. Staff’s proposed statewide average loop rate of $12.35 is almost identical to the proxy rate originally proposed by the FCC for Arizona in its *Local Competition Order* which was $12.85. See 47 C.F.R. Section 51.513.

Staff is further recommending that the $12.35 statewide average loop rate be deaveraged into the following zones and rates:

<table>
<thead>
<tr>
<th>Zone</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zone 1</td>
<td>$9.93</td>
</tr>
<tr>
<td>Zone 2</td>
<td>14.60</td>
</tr>
<tr>
<td>Zone 3</td>
<td>35.41</td>
</tr>
</tbody>
</table>

Staff’s proposed deaveraging incorporates the AT&T/XO/WorldCom proposal that would minimize the deviation between the average cost for a zone and the individual wire center costs in those zones. This program groups the wire centers so as to make as small a total difference as possible between the cost of each wire center and the average cost for the zone which includes that wire center. Staff-30, p. 74. This procedure makes sense and is less arbitrary than many other methods of dividing the wire centers between zones. Staff-30, p. 74. Staff’s expert used the AT&T/XO/WorldCom program to group the wire centers by minimizing the deviation between the individual wire center costs and the average zone costs. Staff-30, p. 74.

Qwest’s latest deaveraging proposal was contained in the June 27, 2001 Rebuttal Testimony of Teresa K. Million. Qwest-18. Qwest proposed a statewide average loop rate of $25.95, deaveraged into the following three zones:

<table>
<thead>
<tr>
<th>Zone</th>
<th>Cost</th>
<th>No. of Lines</th>
<th>Percentage of Lines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zone 1</td>
<td>$16.89</td>
<td>145,780</td>
<td>5.6%</td>
</tr>
<tr>
<td>Zone 2</td>
<td>$22.57</td>
<td>1,658,501</td>
<td>63.1%</td>
</tr>
<tr>
<td>Zone 3</td>
<td>$34.34</td>
<td>823,336</td>
<td>31.3%</td>
</tr>
</tbody>
</table>
In addition, a separate grooming charge of $1.50 would apply in each Zone. Currently, the grooming charge is not a separate charge, but is included in the Company’s present statewide average loop rate of $21.98.

When compared to Qwest’s current loop rates\(^5\), one can quickly see that what Qwest is actually proposing is a substantial rate increase on a significant percentage of its wholesale access lines. According to Staff’s calculations over 80 percent of access lines would experience a significant wholesale price increase. This is inappropriate and Staff urges the Commission to reject Qwest’s permanent geographical deaveraging proposal.

**E. Qwest’s Line Sharing Rate Is Unreasonable**

Line sharing allows CLECs to place a digital signal, such as for high speed Internet access, on the high frequency portion of the loop ("HFPL") while Qwest places the normal voice telephone service on the low frequency portion of that same loop. Staff-30, p. 19.

Qwest proposes a $5.00 per line monthly line sharing loop charge. However, it is unclear how Qwest arrived at this specific $5.00 charge. Staff-30, p. 36. While Qwest Witness Fitzsimmons correctly notes that the loop cost is a common or joint cost, and the recovery should be spread among the services that use that common cost, he does not provide any specific guidance as to how that rate should be calculated. Qwest-36, p. 7.

Qwest’s proposed $5.00 charge for line sharing is equal to approximately 20 percent of the Qwest calculated unbundled loop cost. The zone unbundled loop rates that Staff recommends produce a statewide average loop rate of $12.35. Twenty percent of the statewide average unbundled loop rate of $12.35 that Staff proposes is $2.47, which is Staff’s recommendation for the line sharing loop charge.\(^6\)

**F. Qwest Discriminates Against Unaffiliated xDSL Providers Compared to its Own xDSL Provider**

Qwest treats its affiliated xDSL\(^7\) provider, Broadband Services Inc. ("BSI"), much differently.

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\(^5\) Qwest’s current statewide average loop rate is $21.98. Its interim geographically deaveraged loop rates are: Zone 1 - $18.96 (approximately 90 percent of access lines); Zone 2 - $34.94 and Zone 3 - $56.53.

\(^6\) Staff-32, Schedule WD-17, p. 11; See also Staff-30, p. 75.

\(^7\) DSL and xDSL services are generic names for a whole family of high-speed digital services that are provided over copper loops.
than it treats unaffiliated xDSL providers. For example, Qwest proposes a $2.68 recurring per line per month charge for modifying its Operational Support Systems ("OSS")⁸ to implement a "long term" solution to line sharing. This charge would apply to all unaffiliated xDSL providers that utilize line sharing. However, it would not apply to Qwest’s affiliate xDSL provider, BSI, in spite of the fact that BSI does utilize line sharing. Such discrimination is not acceptable. Under the FCC’s affiliate transaction rules, if there are tariffed rates for goods and services, including published UNE rates, then an affiliate is supposed to pay those tariff rates. Under Qwest’s proposal, a published UNE rate applies to all unaffiliated xDSL providers that line share, but would not apply to Qwest’s DSL affiliate that line share. If there is no tariff rate, then the affiliates are also supposed to pay that prevailing company price. Under Qwest’s proposal, there would clearly be a prevailing company price that would apply to all unaffiliated xDSL providers for line sharing, but would not apply to Qwest’s affiliate. In addition, Qwest’s current line sharing agreement with xDSL providers states that for any xDSL subsidiary “Qwest will provision line sharing to the separate subsidiary at the same rates Qwest is using to provide line sharing to other telecommunications carriers.”⁹ However, under Qwest’s proposal, it would be charging unaffiliated xDSL providers the above-referenced rate, but would not be charging that rate to its affiliated xDSL affiliate that utilizes line sharing.

However, if the line sharing OSS cost is collected in a charge¹⁰ that applies to all line sharing xDSL providers, including the Qwest affiliate, BSI, a charge of $0.10 per shared line per month will recover the costs. This is Staff’s recommendation.

There is another form of discrimination between the unaffiliated and affiliated xDSL providers. Unaffiliated xDSL providers must pay Qwest numerous collocation charges. However, Qwest’s xDSL affiliate does not pay the charges on this list, but instead has a very simple charge that it pays for collocation, as shown on page 3 of Schedule WD-10 of Mr. Dunkel’s Direct Testimony. Staff-30.

Qwest’s attempts to explain these discriminatory treatments did not stand up to cross-

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⁸ OSS are programs that the Company uses for service ordering, installation, repair and switch activation. Staff-30, p. 32.
⁹ Staff-30, pps. 32-33.
¹⁰ Staff-30, Schedule WD-11.
examination in the hearings. On page 62 of Ms. Million’s Rebuttal Testimony (Qwest-18), Ms. Million claimed:

It is highly likely that BSI pays as much or more than the CLECs do for the same activities.

In discovery, Staff asked for evidence or workpapers in support of this claim. See, Staff-23. On cross-examination, Ms. Million admitted that none of the documents provided by Qwest in response in that request would allow Staff to verify Ms. Million’s claim. Tr. pps. 812-813. In addition, BSI line sharing orders can allegedly be processed by Qwest without using the same OSS that the unaffiliated xDSL providers utilize only because of “back door” arrangements between Qwest and its affiliated xDSL provider that are not available to unaffiliated xDSL providers. Tr. pps. 1183-1184.

Staff recommends that the tariff charges or prevailing charges for a particular service that apply to the unaffiliated xDSL providers should also apply to the Qwest affiliated xDSL provider, or that Qwest make the same arrangements it provides to its affiliate, available to the CLECs.

G. The Loop Cost is Not Caused By Basic Local Exchange Service.

Qwest Witness Fitzsimmons claimed that the loop facility costs are caused by basic exchange service. Qwest Witness Gude testified that residential basic exchange service is subsidized by other services. These claims are incorrect. It is important to recognize that the loop facility cost is not “caused” by just basic exchange service. Even Mr. Fitzsimmons acknowledged on cross-examination that the cost of the loop facility is jointly caused by the high and low frequency portions of the loop. In addition, Mr. Fleming acknowledged that a CLEC considers the revenues from the full package of services it will be providing to its customers when it makes a decision to provide service.

A Qwest executive succinctly stated that a telephone company decision to install the loop facility is based on the expectation of receiving all revenues that will be derived over that loop

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11 Staff-30, Schedule WD-11.
12 Qwest-29, pps. 66-71.
13 Qwest-27, p. 55.
14 Tr. pps. 1870-74, See also Qwest-29, pps. 67-68.
15 Qwest-8, p. 6.
facility. These are annuity businesses and services. Once I have that line, which is a $12.95 [a
month] relationship with you today, I can visualize how I'm going to get that to be a $60 relationship
tomorrow. That's how we think. It's not just that product. It's what the product means for our
relationship. In the voice world today that $12 to $14 access line really represents anywhere from
$60 to $80 a month as we add those vertical features. The same thing in the data world. That's how
many of us in the business think about it.16

There is no valid reason that just one of the services that shared what is effectively the
combined local/toll loop, should support the full cost of that loop facility. The simple fact is that the
loop facilities are shared by many services, and it is the entire family of services which is responsible
for those costs, not just basic exchange service. When a customer orders service, they are ordering
a whole family of services. The loop is not caused just by basic exchange, or by any one member
of the family of services that share the loop facility. It is caused by the entire family of services that
use the loop and benefit from the loop.17

H. Qwest's Proposed Collocation, Line Sharing and CLEC-to-CLEC UNE Rates
Are Based Upon Unsupportable and Inflated Labor Rates, Engineering,
Material and Overhead Costs Which Results in Inflated Charges to Qwest's
Competitors.

1. The Mix of Qwest/Vendor Installations

Qwest performed a study of 41 actual collocation jobs. Many of the rates that Qwest
proposes for collocation, line sharing, and CLEC-to-CLEC UNE services were based on the labor,
material, and engineering costs for various functions derived from this study of 41 jobs. Qwest-8,
pps. 50 and 81. However, the study of 41 collocation jobs was an unrepresentative study that does
not reflect the average cost actually incurred for collocation installations. In the real world, the vast
majority of collocation installations are done by Qwest's own personnel. However, Qwest excluded
all jobs which were done by Qwest personnel from their study of 41 collocation jobs. Excluding
these jobs created unrepresentative and inflated collocation costs. The mix of vendor vs. Qwest
Technologies Installation ("QTI") installations that was included in the study is nowhere near

36.
17 Staff-30, p. 24.
reflective of the real world mix. Using the proper mix of Qwest installation vs. outside vendor is important, because the cost for vendor installation is much higher than the installation cost using Qwest personnel. In Arizona in the year 2000, Qwest’s internal installation organization, QTI installed 79 percent of the collocation jobs, and only 21 percent of the Qwest Arizona collocation jobs were installed by outside vendors, as shown on Staff-11. Tr. 471-475. Data for the year 2001 to date shows that 83 percent of the collocation jobs have been done by QTI, and only 17 percent of the collocation jobs have been done by outside vendors. However, in the study of the 41 "actual" collocation jobs, Qwest excluded all of the collocation jobs that were installed primarily by QTI. All of the 41 jobs studied included the use of contract labor. Qwest-8, p. 58.

Qwest’s calculations overstate the average collocation cost. The cost for a QTI installation is much lower than a similar installation by an outside installer. Staff-33 shows that if Qwest installers are used, it costs **PROPRIETARY** per foot to place a certain size cable. However, if outside vendors are used, the cost is **PROPRIETARY** per foot for the same cable placement. This is over **PROPRIETARY** as much if an outside vendor is used for installations than if QTI performs the installation. Clearly the mix of Qwest vs. outside vendor installation has a huge impact on the costs that result from the study.

Moreover, Qwest acknowledged that the study of 41 vendor jobs was not representative. Therefore, Qwest adjusted their labor costs to assume 50 percent Qwest labor and 50 percent vendor labor. Mr. Fleming testified that his proposed 50/50 split of contract vendor labor and Qwest labor represented a “balancing of vendor and QTI labor.” (Tr. p. 476). However, on cross-examination, Mr. Fleming was presented with Staff-11, which demonstrates that in the real world in Arizona, QTI installed 79.3 percent of the collocation jobs in 2000, and 82.8 percent in 2001. Tr. 472-475. On cross-examination, even Mr. Fleming acknowledged that in light of this Arizona data, one could conclude that Qwest’s collocation studies should be further adjusted to include “more Qwest labor” relative to contract vendor labor to be more reflective of what is actually being experienced in Arizona. Tr. p. 528.

The Staff calculation correctly used 80 percent of the labor as provided by QTI, and 20 percent as provided by contract labor, which is consistent with what is actually occurring in Arizona.
It makes little sense to assume a 50/50 split for labor, when the actual data demonstrates that the collocation jobs in Arizona use much more Qwest labor than vendor labor.

For power labor, Qwest is using 25 percent QTI labor, and 75 percent vendor labor. Staff-32, p. 3. In cross-examination, Mr. Fleming acknowledged that the 75 percent vendor weighting for power was an error. Tr., p. 369. This correction has not been made in the Qwest studies. Tr., p. 383. Staff’s studies do use 80 percent QTI and 20 percent vendor weighting for all labor. The mix of installation by QTI as compared to outside vendor is summarized by the table below:

**Mix of Colocation Jobs - Arizona**

<table>
<thead>
<tr>
<th>Installed by QTI</th>
<th>Installed by Outside Vendor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual 2000</td>
<td>Actual 2001</td>
</tr>
<tr>
<td>79%</td>
<td>21%</td>
</tr>
<tr>
<td>83%</td>
<td>17%</td>
</tr>
<tr>
<td>2. Staff uses</td>
<td>80%</td>
</tr>
<tr>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>3. Qwest uses labor:</td>
<td>25%</td>
</tr>
<tr>
<td>Power Installations</td>
<td>25%</td>
</tr>
<tr>
<td>All Other Installations</td>
<td>50%</td>
</tr>
</tbody>
</table>

It is clear from the table above that the weighting of QTI vs. outside vendor collocation installations as proposed by Staff is reflective of the real world mix. It is also obvious that the weighting that Qwest uses in its cost calculations does not reflect the real world mix. Failure to reflect the actual installation mix results in many of Qwest’s costs and rates being greatly overstated. A large number of Qwest’s proposed collocation rates, line sharing rates, and CLEC-to-CLEC rates were based upon the inaccurate QTI vendor mix shown above.

The TELRIC methodology assumes the efficient provision of services:

Only forward-looking, incremental costs shall be included in a TELRIC study. Costs must be based on the incumbent LEC’s existing wire center locations and most efficient technology available.

Local Competition Order at para. 690.

Including installation costs that are **PROPRIETARY** times the cost that you can actually have the facility installed for is not efficient provision of service, and therefore, violates TELRIC principles. Staff-30, p. 9.
2. Engineering Costs

Some of Qwest’s non-recurring cost studies include engineering costs that Qwest obtained from its study of the 41 collocation jobs. Qwest-8, pps. 40 and 50. As previously discussed, these 41 jobs are not representative of all collocation installations, because they exclude QTI installations. Therefore, the engineering costs from the 41 jobs Qwest selected were constructed primarily by vendors, the engineering costs that Qwest uses in its cost studies are based primarily on the costs of outside vendor provided engineering. Tr., p. 475. Of the 41 jobs Qwest included in its study, only **PROPRIETARY** of the engineering costs are QTI engineering costs, and the **PROPRIETARY** of the engineering costs are vendor engineering costs. However, this is not reflective of the actual situation in Arizona. As discussed above, the actual situation in Arizona is that 79 percent to 83 percent of Qwest’s collocations are installed by QTI, and only 21 percent to 17 percent are installed by outside vendors. When QTI personnel perform the installations, the engineering is done by Qwest engineers located in Denver. The Qwest engineers have electronic blueprints showing the location of virtually all objects in the central office, which allow them to efficiently engineer the routings and locations for the installation of additional facilities. Staff-30 p. 21.

Qwest did not adjust the engineering expense derived from their 41 jobs to reflect the actual mix of Qwest vs. outside vendor engineering. The engineering costs from the 41 jobs were directly included in the Qwest cost studies (Qwest-8, p. 51), and therefore the Qwest proposed rates are biased and are not reflective of the actual average engineering cost incurred for collocation.

In addition, Qwest’s “engineering’ cost for “splitter” collocation includes the cost of an engineer conducting a “field survey”. However, when the Staff toured the Phoenix Main central office as part of its research for this proceeding, Qwest’s Interconnection Manager for Arizona and New Mexico and QTI’s installation manager both clearly stated that the engineers do not generally conduct a “field survey.” The engineers are actually located in Denver, and generally do not conduct a “field survey.” Instead, they have detailed electronic drawings similar to “blueprints”, on which they draw in the new facilities. Those documents are then forwarded to the installation personnel in Arizona for installation. Staff-30, p. 21.
Another problem is that Qwest proposes a line splitting “Engineering Fee” of $1,274.63, which includes what Qwest claims are the costs to engineer a bay and the associated cabling, racks, bracing, ground wires, and associated facilities. The engineering costs that the Company has calculated are “per bay” engineering costs. However, Qwest proposes charging the non-recurring charge for every splitter installation, even if it is for only one “shelf.” However, the bay will hold eight line splitters. (The bay has eight “shelves”). Once a bay has been installed, there is no need to engineer the installation of that “bay” when a CLEC is just using an additional “shelf” in that bay. Therefore, that full “bay” engineering cost should not be recovered from a project which is using a shelf or shelves in a bay which the CLEC has already paid to have engineered. Staff recommends a non-recurring line splitting engineering charge of $560 for the order of a CLEC that requires a bay. Tr., pps. 1171-1176. This engineering charge includes the cost of engineering the bay, associated racks, cables, shelves, braces, and other supporting facilities. In addition, in order to allow the CLEC to utilize any or all of the remaining shelves in the bay, the Staff recommends that an engineering charge of $120 apply to any subsequent “filling the bay” orders placed at a later time that require Qwest to install additional cables or similar activities (but do not require the engineering/installation of a new bay). Staff-30, pps. 20-22.

In summary, the engineering costs proposed by Qwest are not representative of all collocations installations and therefore should be adjusted downwards accordingly.

3. **Material Costs**

The materials costs that Qwest used in calculating many of its collocation, line sharing and CLEC-to-CLEC rates are the material costs from the same 41 collocation jobs previously discussed. As previously discussed, these jobs are not representative of the average collocation installations, because all of those 41 jobs were outside vendor installation. Tr., p. 475. Staff-22 clearly demonstrates that the outside vendors that were providing the labor are also providing a portion of the installation materials for these projects. Tr., pps. 804-806. This is not the valid basis for materials. Qwest is one of the largest purchasers of telecommunications equipment, and has used that purchasing power to negotiate discounts of telephone equipment. Staff-30, Schedule WD-3, p. 3. For example, for one item, Qwest included a material cost of $85.46 in their collocation and line
sharing studies, but Qwest's internal documents show that the Qwest discounted material cost for that same item was $44 during this same time period. Tr., pps. 1131-1133. The evidence indicates that the materials are available at costs lower than shown in Qwest's collocation studies, even without Qwest's huge telecommunications purchasing power. Staff-22 demonstrates a vendor charged Qwest $0.98 for each flat washer. Tr. pps. 804-807.

Qwest's material costs do not reflect the forward looking most efficient provision of service in all cases and therefore, Qwest's material cost should be adjusted to comply with TELRIC pricing standards.

4. **Qwest's Proposed Rent Charges for Collocation Are Overstated**

Qwest's proposed collocation costs also assumed that Qwest would have to run separate air conditioning ducts to each collocation cage. These proposed charges are over and above what Qwest would be charging the CLEC for rental space in the Qwest-owned building. However, in the real world, buildings have air conditioning ducts appropriately placed in the entire equipment room in the Qwest building. Qwest does not run separate air conditioning ducts to each collocation cage. Therefore, the costs of air conditioning ducts and other required equipment are properly included in the rate Qwest charges the CLEC for rent. Due to this fact, Staff recommends that no additional charges apply for air conditioning ducts. Staff's proposed rent charge includes all appropriate charges for air conditioning.\(^{18}\)

I. **Attachment A – Price List**

Staff's proposed rates are shown on Attachment A. Three points bear mention with regard to Exhibit A. First, for rates not shown or commented upon by Staff's expert, the rates should be at least 13 percent below the rates proposed by Qwest, just to allow for the difference in overhead factors between those used by Qwest and the 15 percent overhead factor adopted by the ACC in its prior Decision. Any adjustments to direct costs would be in addition to this adjustment. Second, Staff believes that some of the non-recurring charges appearing on the Price List may be excessive and may be based more upon perceived "risk" to Qwest than any legitimate reason for requiring such large upfront payments. The non-recurring charges appearing in the table have been proposed by

\(^{18}\) Staff-30, p. 24.
Qwest. While included to reflect what Qwest claims are its costs, Staff is not in any way endorsing the level or magnitude of the non-recurring charges appearing on Attachment A. Third, Qwest is still proposing considerable Individual Case Base ("ICB") Pricing. The Company should be required to eliminate ICB pricing in favor of specific charges where at all possible.

J. Avoided Cost Discount

On July 25, 2001, Staff and Qwest entered into a stipulation in which Qwest agreed to keep the current wholesale discounts in effect. This issue was remanded by the Arizona District Court. In Jennings v. U S WEST, the Court stated:

"...The ACC must at least consider the range of cost savings for different categories of services, as well as the potential for abuse through selective ordering tactics, and determine whether additional discount rates are needed. Whether the ACC has, or can even obtain, the information needed to more accurately identify the cost savings attributable to various services will also be a factor in deciding whether to establish additional discount rates.

Because the decision does not adequately explain the result reached, or demonstrate that the ACC considered all relevant factors, the issue of resale discounts is remanded for further consideration. The court expresses no opinion regarding the proper result on remand.

46 F.Supp.2d at 1006.

While Qwest Witness Gude had proposed additional discounts for various services, the overall impact was a significant reduction in the wholesale discounts applicable to residential services. Qwest’s proposal would reduce the current average composite discount, which is **PROPRIETARY** percent **PROPRIETARY**. Staff-30, p. 55. Qwest’s proposal cannot be supported. Under the guise of disaggregating the discounts, Qwest was actually trying to greatly reduce them. Staff-30, p. 44.

Further, while Qwest argued that it relied upon the same studies in seven other jurisdictions, Staff would note that the avoided cost discount for residential basic exchange service adopted by the commissions averaged 14.9 percent. The avoided cost study that Ms. Gude has filed in this proceeding, found that a mere 4.19 percent discount for residential basic exchange service was appropriate. Clearly, whatever the other commissions based their avoided cost discount on was very different than the avoided cost study filed in this proceeding by Ms. Gude. Staff-30, p. 56. A case in point is the Washington Order relied upon by Ms. Gude which does not indicate that the
Company’s judgments were used at all, but instead indicates that the avoided cost discount was based primarily on the Washington Staff proposal:

The Commission’s review of direct, avoidable cost indicates that Commission Staff’s estimates of the ratio of avoidable costs for product management, sales, and product advertising are appropriate. With respect to customer services, the Commission also finds Commission Staff’s ratio to be reasonable, except that the customer service costs related to non-recurring charges in excess of revenue are 100 percent avoidable. Otherwise, we adopt Commission Staff’s presentation on call completion and number service.


A comparison of the wholesale discounts Qwest proposed for Residential Basic Exchange Service in this proceeding, to the discounts approved for this service in the States in which Qwest claims the Commissions adopted/relied on its data and cost studies in setting the resale discounts is illuminating.

### Residential Basic Wholesale Discount:

| Arizona-Qwest Proposed | 4.19% |

### Discounts in Effect:

<table>
<thead>
<tr>
<th>State</th>
<th>Discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Colorado</td>
<td>13.00%</td>
</tr>
<tr>
<td>Iowa</td>
<td>10.27%</td>
</tr>
<tr>
<td>Nebraska</td>
<td>22.50%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>15.05%</td>
</tr>
<tr>
<td>South Dakota</td>
<td>15.49%</td>
</tr>
<tr>
<td>Utah</td>
<td>12.20%</td>
</tr>
<tr>
<td>Washington</td>
<td>16.00%</td>
</tr>
</tbody>
</table>

As stated in his testimony, Staff Witness Dunkel found that the Commission does not have the information needed to more accurately identify the cost savings attributable to various services, nor can it obtain it. The USOA records, ARMIS reports, and other standard records as kept by the Company do not show the avoided cost by product line. Qwest had prepared studies in which they proposed costs by product lines, and what portion of those costs would be avoided by product line. However, Staff Witness Dunkel’s testimony indicates that the allocation of costs to product lines,
and the determination as to what portion of those costs would be avoided was largely based upon "managerial judgment." Considering this and other factors, Mr. Dunkel testified:

In short, there is no factual basis on which to establish a more accurate disaggregation of the avoided cost discounts than was established in Decision No. 60635.

Staff-30, p. 55.

Accordingly, Staff Witness Dunkel’s recommendation was to continue the existing discounts. The existing discounts are 12 percent for residential basic exchange service, and 18 percent for all other services to which the discount now applies. Staff recommends that the Commission adopt the stipulation entered into between Qwest and Staff which would maintain the existing wholesale discounts at their current levels.

IV. CONCLUSION

For all of the reasons discussed above, the Commission should adopt the HAI 5.2a Model as a starting point for determining loop rates in this case. Unlike the Qwest LoopMod, the HAI 5.2a Model reflects forward-looking costs using the most efficient technology available. The Commission should reject Qwest’s proposed overhead factor and its LoopMod inputs since they are based upon embedded costs and otherwise assume significant inefficiencies which result in inflated prices to the CLECs which will only act to stifle competition in the Arizona local exchange market. The Commission should also reject Qwest’s proposed rates for collocation, line sharing and CLEC-to-CLEC UNE rates because they are based upon unsupportable and inflated labor rate percentages, engineering, material and overhead costs which result in inflated charges to Qwest’s competitors.

RESPECTFULLY SUBMITTED this 4th day of September, 2001.

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