IN THE MATTER OF INVESTIGATION INTO QWEST CORPORATION'S COMPLIANCE WITH CERTAIN WHOLESALE PRICING REQUIREMENTS FOR UNBUNDLED NETWORK ELEMENTS AND RESALE DISCOUNTS.

QWEST CORPORATION'S MOTION FOR RECONSIDERATION OF PHASE IIA OPINION AND ORDER AND MOTION FOR CLARIFICATION

Qwest Corporation ("Qwest") moves the Arizona Corporation Commission (the "Commission") to reconsider its Phase IIA Opinion and Order (Decision No. 65451), issued on December 12, 2002, (the "Phase IIA Order") as explained below. In addition, Qwest requests clarification relating to the rates that apply to certain switching rate elements that the Phase IIA Order does not address.

I. INTRODUCTION

As Qwest has noted in briefing submitted in this proceeding, the Telecommunications Act of 1996, 47 U.S.C. §§ 151, et seq., (the "Act") requires the Commission to set switching rates "based on the cost . . . of providing [switching]."¹ This cost must be determined by applying the FCC's TELRIC ("total element long run incremental cost") pricing rules. TELRIC requires that rates be based on the "most efficient technology proven" to be "operationally

feasible, currently available,"² and "compatible with the most basic geographical design of the existing network"³ – a definition supported by both AT&T and the FCC. As set forth below, a number of the rulings in the Phase IIA Order relating to switching fail to comply with these basic requirements. If adopted, these rulings will produce switching rates that are neither cost-based nor TELRIC-compliant.

Improperly relying on the FCC's universal service cost model, the "Synthesis Model," to estimate switching costs, the HAI model adopted by the Phase IIA Order excludes large amounts of investment that any efficient carrier must incur to provide switching. On multiple occasions, the FCC has specifically cautioned state commissions not to use the Synthesis Model for unbundled network element ("UNE") rate-setting.⁴ However, because doing so yields the lowest possible costs (and, thus, rates), the CLEC sponsors of HAI have instructed its designers to base all of the switching investment in the HAI switching module – and investment is the primary cost-driver in the module – on the Synthesis Model. As a result, the model excludes switching investment that is essential to providing unbundled switching.

This investment includes the costs associated with adding switch upgrades and growth lines to switches – costs that the FCC has recognized are appropriate to include in setting TELRIC switching rates. Even AT&T's and WorldCom's witnesses conceded that the costs of upgrades are essential switching costs for any carrier that desires to remain competitive.⁵ In

² Reply Brief of AT&T Corp. at 16-17, AT&T v. Iowa Utilities Board, (U.S. July 23, 2001) (Nos. 00-590, 00-511, 00-555, 00-587 & 00-682) (emphasis added).

³ Brief for the Petitioners FCC and the United States at 9, Verizon Communications, Inc. v. FCC., (U.S., Apr. 9, 2001) (Nos. 00-511, 00-555, 00-587, 00-590 & 00-602) (emphasis added).

⁴ See, e.g., Memorandum Opinion and Order, Joint Application by BellSouth Corporation, et al., for Provision of In-Region, InterLATA Services in Georgia and Louisiana, CC Dkt. No. 02-35, FCC 02-147 (rel. May 15, 2002) ("BellSouth Georgia/Louisiana 271 Order") ¶¶ 73, 82; Memorandum Opinion and Order, Application by Verizon New England Inc., et al., for Authorization to Provide In-Region, InterLATA Services in Maine, CC Dkt. No. 02-61, FCC 02-187 (rel. June 19, 2002) ("Verizon Maine 271 Order") ¶ 29, n.107 (same).

⁵ See Tr. at 316 (Chandler Cross); Tr. at 352 (Kelley Cross).
addition, the Phase IIA Order improperly rejects the ALJs' recommendation to modify HAI to include essential, unavoidable billing costs that any efficient carrier must incur in providing unbundled switching. While the Commission referred this issue to Phase III of the docket, in the interim, it improperly imposed switching rates that include little or none of these costs.

Finally, the Phase IIA Order does not address several recurring and nonrecurring charges associated with switching that Qwest presented in the hearing. Qwest respectfully requests that the Commission clarify the Phase IIA Order by confirming that Qwest's proposed rates for these rate elements are adopted or, alternatively, by referring these rate elements to Phase III and leaving Qwest's proposed rates in place at least until completion of that phase of the docket.

II. ARGUMENT

A. The Commission Should Reconsider Its Order Relating To Billing Costs For Switching.

In their Recommended Opinion and Order, the ALJs ruled that the HAI model should be adjusted to account for the costs of billing associated with switch usage.6 This ruling was compelled by the evidence. As the sponsors of the HAI model with the burden of proving the costs they were proposing, AT&T/WorldCom failed to demonstrate that billing costs are included in the model's cost estimates for switching. Their witness who sponsored the model, Richard Chandler, "assumed" that billing costs are included but was unable to identify any specific types or amounts of such costs.7 The documentation accompanying the HAI model is equally unenlightening about the model's treatment of billing costs. Without any substantial evidence in the record establishing that billing costs – which all parties agree should be included in TELRIC estimates – are included in HAI, the ALJs properly ruled that the model must be adjusted to account for these costs.

6 See Recommended Opinion and Order at 19.

7 Tr. at 326-27 (Chandler Cross).
The Commission reversed the ALJs' ruling on this issue, despite acknowledging that substantial question exists concerning whether HAI includes billing costs associated with switch usage. Thus, it adopted HAI for the purpose of establishing billing inputs, but deferred to Phase III of this docket the issue of "what appropriate billing costs are, and are not included in the HAI model." This ruling is error and is not supported by substantial evidence.

As reflected by the Commission's deliberations during the open meeting of December 9, 2002, the Commission's ruling rests on a single page taken from the HAI model's documentation that purports to list switching costs that the model includes. The CLECs and Staff initially relied on a cost entry for "carrier-carrier customer service" listed on that page as proof that HAI includes billing costs. Significantly, prior to the open meeting and the exceptions phase of this docket, the CLECs and Staff had never cited this page as evidence of the billing costs that are purportedly included in HAI. Indeed, during the open meeting, it became readily apparent that the listing of $1.69 per line per year – a paltry $0.14 per month – likely does not include billing costs. "Carrier-carrier customer service" includes costs associated with communications and interactions between Qwest and CLECs – there is nothing in the record that suggests these costs include costs of billing. Thus, the Staff witness, William Dunkel, eventually acknowledged during the open meeting that it is "murky" whether this listing actually includes billing costs.9

Equally suspect is the listing on the same page for "billing bill inquiry" ($1.22 per line per month), which the Commission also relied on to reverse the ALJ ruling. There is no explanation of the meaning of this entry anywhere in the record, and participants in the December 9 open meeting could only speculate as to the nature of this cost. On its face, this entry appears to be unrelated to the key cost-drivers of the billing costs associated with switching – the costs of collecting calling volumes, compiling bills, and documenting charges.

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8 Tr. at 326-27 (Chandler Cross).

9 See Transcript of Special Open Meeting (Dec. 9, 2002) at 76-77 (Dunkel).
Accordingly, there is no evidentiary basis for the Commission's ruling that HAI should be used for the billing costs associated with switching. The evidence presented at the hearing and the arguments offered during the open meeting only confirm that there is substantial doubt concerning whether HAI includes these costs. AT&T and WorldCom clearly failed to meet their burden of proving that these costs are in their cost model, and the Commission should not excuse this failure of proof.

The Commission should resolve this issue by restoring the ALJs' ruling that required modification of HAI to include billing costs. Alternatively, the Commission should defer this issue to Phase III but should require the modification ordered by the ALJs at least until the conclusion of Phase III.

B. The Commission Should Reconsider the Phase IIA Order to Include Costs Associated with Growth Lines.

The Phase IIA Order rejects "Qwest's proposed 'growth additive' rates," which properly account for costs associated with so-called growth lines. As grounds for this decision, the Commission states that Qwest's proposed growth rates "do not properly reflect TELRIC principles associated with an efficient provider" because such costs "would unfairly burden current customers by requiring them to in effect subsidize future customers." That statement reflects a basic misapplication of TELRIC principles.

First, adding capacity to a switch in the form of growth lines is not only an efficient way to operate a network but also an imperative for any carrier operating in a competitive market. As Qwest witness, Robert Brigham, explained, to avoid the necessity of adding incremental capacity to a new or existing switch by purchasing growth lines, a carrier must either continuously replace its switches or purchase more initial lines than are needed when purchasing new switches.

10 Phase IIA Order at 8.
11 Phase IIA Order at 8.
12 See Ex. Qwest-2 (Brigham Surrebuttal) at 28.
Each of these alternatives is far less efficient than purchasing a switch with sufficient capacity to serve current demand plus a reasonable allowance for administrative needs, equipment modularity, and growth, and adding new lines when required by growth in demand. The FCC's repeated endorsement of this approach underscores the reasonableness of Qwest's proposed approach.  

Second, contrary to the Commission's assertion, the FCC and the United States Court of Appeals for the D.C. Circuit have concluded that inclusion of growth lines in switching cost studies complies with TELRIC principles. In its *Bell Atlantic New York 271 Order*, the FCC explicitly rejected AT&T's argument "that TELRIC does not permit recovery of the cost of 'augmented switches,' which are existing switches with capacity upgrades." AT&T appealed this issue to the D.C. Circuit, which similarly rejected AT&T's claim, concluding that "the Commission reasonably concluded" that "inclusion of growth additions . . . did not violate TELRIC." Joint Intervenors' repeated attempt to raise this same issue in subsequent section 271 cases have been similarly rebuffed. The Phase IIA Order fails to address these directly relevant decisions of the FCC and D.C. Circuit Court of Appeals. The Commission should join

13 See Memorandum Opinion and Order, *Joint Application of BellSouth Corporation, et al., for Provision of In-Region, InterLATA Services in Alabama, Kentucky, Mississippi, North Carolina, and South Carolina*, WC Dkt. No. 02-150, FCC 02-260 (rel. Sept. 18, 2002) ("BellSouth Alabama/Kentucky 271 Order") ¶ 84 (noting that "it may not be cost-effective to acquire all of the projected switching capacity needed over the life of the switch at the outset"); see also BellSouth Georgia/Louisiana 271 Order ¶ 82 (same); Memorandum Opinion and Order, *Application by Verizon New Jersey Inc., et al., for Authorization to Provide In-Region, InterLATA Services in New Jersey*, WC Dkt. No. 02-67, FCC 02-189 (rel. June 24, 2002) ("Verizon New Jersey 271 Order") ¶ 43 (same).


15 See *AT&T Corp. v. FCC*, 220 F.3d 607, 617-18 (D.C. Cir. 2000).

16 See, e.g., BellSouth Georgia/Louisiana 271 Order ¶ 82; Verizon New Jersey 271 Order ¶ 43; Verizon Massachusetts 271 Order ¶ 33; Memorandum Opinion and Order, *Joint Application by SBC Communications, Inc., et al., for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, CC Dkt. No. 00-217, FCC 01-29 (rel. Jan. 22, 2001) ("SBC Kansas/Oklahoma 271 Order") ¶ 77.
the FCC and the D.C. Circuit by including in base switching rates the cost not merely of new switches, but also of additional lines required to meet demand.

Contrary to the claims of AT&T and WorldCom, there is nothing "unfair" or "uneconomic" about developing costs based on purchases of both new switches and additional lines. Indeed, in proceedings in California, AT&T conceded that using a mix of new and growth lines to determine costs is appropriate.17

Adding capacity to a switch in the form of growth lines is not only an efficient way to operate a network but also an imperative for any carrier operating in a competitive market, especially so where, as here, that market is also characterized as a "high growth market."18 No carrier would survive without the ability to add growth lines to meet new demand. And, no responsible carrier would want to or be permitted to deny service to a new end user on the ground that it is imprudent to add, and pay for the addition of, higher-cost growth lines19 to an existing switch to meet that new customer’s needs.20

C. The Phase IIA Order’s Exclusion of Switch Upgrade Costs Is Clear Error.

Conceding that switch upgrades "may be a cost of doing business," the Phase IIA Order nevertheless excludes such costs from switching rates in Arizona.21 According to the


18 See Phase IIA Order at 9 (quoting the Commission's First Cost Docket Order (Decision No. 60635 [1/30/98]) and Phase II Opinion and Order (Decision No. 64922 [6/12/02])).

19 The FCC has confirmed that growth lines cost more than new or initial lines because "vendors offer a higher discount rate for new switches and a lower discount for growth." BellSouth Alabama/Kentucky 271 Order ¶ 83; see also BellSouth Georgia/Louisiana 271 Order ¶ 82 (noting that "the [FCC] has taken notice that other states have concluded that costs should be recovered based on carrier vendor contracts that applied a larger discount for new switches and smaller discounts for growth").

20 See Ex. Qwest-2 (Brigham Surrebuttal) at 27-29.

21 See Phase IIA Order at 10.
Commission, these costs are "speculative" and their inclusion is contrary to the FCC's *Inputs Order*. The exclusion of switch upgrade costs in the Phase IIA Order is error and should be reconsidered for several reasons.

First, that carriers incur upgrade costs is not "speculative." To the contrary, the record shows that carriers in Arizona reasonably incur switch upgrade costs as a part of the ongoing costs of doing business. On behalf of AT&T and WorldCom, both Mr. Chandler and Mr. Kelley agreed that switch upgrades are a legitimate cost of doing business. During the hearing, Mr. Chandler admitted that switch vendors routinely issue switch upgrades approximately every two years and that to stay competitive and current with legal requirements, telecommunications carriers routinely purchase these upgrades. Mr. Kelley also recognized that switch upgrades are essential in the telecommunications industry. Indeed, the record establishes that Qwest has been forced to invest substantial sums in switch upgrades and any efficient provider would continue to incur these upgrade costs in the future. In the four years ending December 2000, Qwest spent over $235 million upgrading its digital switches, which translates to $3.71 per line per year.

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22 See Phase IIA Order at 9-10.

23 See Ex. AT&T-10 (Kelley Rebuttal) at 3. Switch upgrades generally stem from either increased demand for greater switch functionality or, more commonly, legislative and regulatory mandates that are part of the environment in which the providing carrier operates. Specifically, demand increases or legislative mandates force Qwest to upgrade its operating system software. This software upgrade, in turn, often requires corresponding operating hardware upgrades such as additions to existing processing capacity, memory, and storage. After multiple upgrades, the capacity of the processor is often exceeded requiring additional hardware upgrades. These are simple lifecycle costs of switches that are within the TELRIC definition of "replacement costs." See Ex. Qwest-2 (Brigham Surrebuttal) at 23-24.

24 See Tr. at 315-16 (Chandler Cross).

25 See Tr. at 353 (Kelley Cross).

26 See Ex. Qwest-2 (Brigham Surrebuttal) at 23-25.

27 See Ex. Qwest-2 (Brigham Surrebuttal) at 24.
In the face of this evidence, Joint Intervenors and the Recommended Opinion and Order turn once again for support to the FCC's Inputs Order. However, as Qwest has repeatedly noted during this proceeding, the FCC has made it clear that the Synthesis Model cannot be relied upon for use in determining the costs of interconnection and UNEs. The FCC had good reasons for rejecting the use of the Synthesis Model to determine the costs of and rates for unbundled switching. Specifically, the FCC's Inputs Order algorithm does not include the ongoing upgrade investments necessary to keep a switch technologically current once it is installed. As set forth in Appendix C of the Inputs Order, the FCC's algorithm results from a regression analysis performed on data from depreciation rate reports filed by LECs for switches installed from 1983 to 1995 and upon similar data from LEC reports to the RUS. However, a large portion (70 percent) of the nearly 3,600 observations were excluded from the study data so that only 1,085 observations were actually employed. Most of the excluded observations were from switches installed more than three years prior to the reporting of their book-value costs. The FCC only tried to reflect the cost associated with the purchase of a new switch; the investment associated with upgrades was intentionally omitted. Although this sort of "rough justice" may be acceptable for the purpose of allocating universal service support, as the FCC and the courts have confirmed, it clearly is not appropriate for developing UNE rates.

Second, the HAI model also does not include the cost of vertical features implemented after 1995 or any of Qwest's applications software expenses after 1992. By excluding these costs from the data that the FCC used to estimate its switch expenses, the FCC set an improper cost for switches that does not include the cost of features. As mentioned above, the FCC relied on data from 1983 through 1995 to develop its switching investment. These data, therefore, do not include vertical features costs after 1995. When questioned about the FCC's exclusion of data after 1995, Mr. Kelley admitted that because the FCC excluded these costs for the purposes of allocating universal service support, the HAI model likewise does not include vertical features.

28 See Phase IIA Order at 9-10.
Similarly, the FCC's algorithm does not account for the applications software costs that any provider incurs. The FCC admittedly created its switch costs using historical data, but it failed to include the cost for features and other application software. Thus, relying on FCC upgrade costs will not provide the proper estimate of life cycle expenses for software and features.

Third, because an efficient carrier building and operating a replacement network will incur switch upgrade costs, the HAI model's failure to recognize any upgrade expenses violates TELRIC. If the costs associated with switch upgrades are not included in TELRIC studies for switching, Qwest will not recover these legitimately incurred costs, even though it will incur upgrade costs on a forward-looking basis. Indeed, the Joint Interveners admit that excluding switch upgrade costs from the switching rates will allow CLECs to use upgrades for free until rates are adjusted by the Commission.

Finally, rather than "extending the life [of a switch] beyond the 10-year economic life assumed in the HAI model," switch upgrades must be assumed as part and parcel of that 10-year life cycle. If Qwest did not upgrade its switches, they would need to be replaced sooner than 10 years to serve customers and provide adequate service given rising demand for service and features.

In sum, upgrade costs should be included in the estimates of switching costs and the Commission should reconsider its decision to exclude these costs in the Phase IIA Order.

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29 See Tr. at 351 (Kelley Cross).

30 See Tr. at 354-55 (Kelley Cross).

31 See Phase IIA Order at 10.

32 See Ex. Qwest-2 (Brigham Surrebuttal) at 26-27.
D. The Commission Should Clarify The Rates For Certain Recurring And Nonrecurring Charges.

The Phase IIA Order does not address certain nonrecurring and recurring costs for switching that Qwest proposed in its cost studies and testimony. Qwest respectfully requests that the Commission clarify the status of these costs and related charges by confirming that Qwest is permitted to charge the rates it proposed for these elements. Alternatively, Qwest requests that the Commission refer these charges to Phase III and allow Qwest to assess its proposed charges at least until the completion of Phase III. The rates in question are: (1) nonrecurring costs and charges relating to installing and activating vertical features; (2) a nonrecurring "subsequent order charge" relating to features installed subsequent to initial port installation; (3) recurring and nonrecurring rates relating to digital line side ports; (4) recurring and nonrecurring charges for digital trunk ports; and (5) nonrecurring rates for DS0 analog trunk ports.

Qwest presented cost studies and supporting testimony for each of these switching rate elements, and none of the other parties offered testimony challenging Qwest's proposed costs and rates. As Qwest began its preliminary analysis of the Phase IIA Order, it realized that the Order does not address these rate elements. None of these rate elements is addressed in the HAI model, and, therefore, it is necessary to establish costs and rates for them by relying on Qwest's cost studies. Accordingly, the Commission should clarify that Qwest's proposed rates for these elements are adopted or, alternatively, should refer these elements to Phase III and order Qwest's rates to remain in effect at least until the completion of Phase III.

33 See, e.g., Ex. Qwest-1 (Brigham Direct) at 7-8 (identifying relevant cost studies), 15-18 (discussing features); Ex. Qwest-2 (Brigham Surrebuttal) at 14-16 (discussing features).
III. CONCLUSION

For the reasons stated, the Commission should grant the relief Qwest has requested.

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RESPECTFULLY SUBMITTED,

By: Timothy Berg
   Theresa Dwyer
   FENNEMORE CRAIG
   3003 North Central, Suite 2600
   Phoenix, Arizona 85012

   Mark Brown
   QWEST CORPORATION
   Public Policy and Law
   3033 N. Third Street
   10th Floor
   Phoenix, Arizona 85012

   John M. Devaney
   Norton Cutler
   PERKINS COIE LLP
   607 Fourteenth Street, N.W.
   Suite 800
   Washington, D.C. 20005-2011

Attorneys for Qwest Corporation

ORIGINAL and 13 copies of the foregoing hand-delivered for filing this 2nd day of January, 2003 to:

Docket Control
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007
COPY of the foregoing hand-delivered
this 19th day of January, 2003, to:

Maureen Scott
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

Lyn Farmer
Hearing Division
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

Ernest Johnson
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

COPY of the foregoing sent by regular mailed
this 9th day of January, 2003, to:

Steven J. Duffy
RIDGE & ISAACSON, P.C.
3101 North Central Avenue, Ste. 1090
Phoenix, Arizona 85012-2638

Richard S. Wolters
M. Singer-Nelson
AT&T
1875 Lawrence Street, Room 1575
Denver, CO 80202-1847

Michael W. Patten
ROSHKA HEYMAN & DEWULF
400 East Van Buren, #800
Phoenix, AZ 85004-2262

Michael Grant
Todd C. Wiley
GALLAGHER & KENNEDY
2575 E. Camelback Rd.
Phoenix, AZ 85016-9225
Thomas H. Campbell  
LEWIS & ROCA  
40 N. Central Avenue  
Phoenix, AZ 85007

Brian S. Thomas  
TIME WARNER TELECOM  
520 SW Sixth Ave., Suite 300  
Portland, OR 97204-1522

Thomas F. Dixon  
WORLDCOM  
707 17th Street  
Denver, CO 80202

Eric S. Heath  
SPRINT COMMUNICATIONS CO.  
100 Spear Street, Suite 930  
San Francisco, CA 94105

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

Ray Heyman  
ROSHKA HEYMAN & DeWULF  
400 East Van Buren, #800  
Phoenix, AZ 85004-2262

Rex M. Knowles  
XO Communications, Inc.  
111 E. Broadway, Suite 1000  
Salt Lake City, UT 84111

Megan Doberneck  
COVAD COMMUNICATIONS COMPANY  
7901 Lowry Boulevard  
Denver, Colorado 80230

Lisa Crowley  
COVAD COMMUNICATIONS COMPANY  
4250 Burton Drive  
Santa Clara, CA 95054
Greg Kopta  
DAVIS WRIGHT TREMAINE LLP  
2600 Century Square  
1501 Fourth Avenue  
Seattle, WA  98101-1688

Mary S. Steele  
DAVIS WRIGHT TREMAINE, LLP  
2600 Century Square  
1501 Fourth Avenue  
Seattle, WA  98101-1688

Dennis Ahlers  
Senior Attorney  
ESCHELON TELECOM, INC.  
730 Second Avenue South, Suite 1200  
Minneapolis, MN  55402

Steve Sager, Esq.  
MCLEODUSA TELECOMMUNICATIONS SERVICE, INC.  
215 South State Street, 10th Floor  
Salt Lake City, Utah 84111

Marti Allbright, Esq.,  
MPOWER COMMUNICATIONS CORPORATION  
5711 South Benton Circle  
Littleton, CO  80123

Penny Bewick  
NEW EDGE NETWORKS  
PO Box 5159  
3000 Columbia House Blvd.  
Vancouver, Washington  98668

Michael B. Hazzard  
KELLEY DRYE AND WARREN  
1200 19th Street, NW  
Washington, DC  20036

Janet Livengood  
Z-TEL COMMUNICATIONS, INC.  
601 South Harbour Island  
Suite 220  
Tampa, Florida  33602
Andrea Harris
ALLEGiANCE TELECOM
2101 Webster
Suite 1580
Oakland, CA 94612

Traci Grundon
DAVIS, WRIGHT TREMAINE, LLP
1300 S. W. Fifth Avenue
Portland, OR 97201

Joan Burke
OSBORN MALEDON
2929 N. Central Avenue
Phoenix, AZ 85012