INTRODUCTION AND SUMMARY

Qwest Corporation ("Qwest") submits these exceptions to the Recommended Opinion and Order ("ROO") dated September 16, 2003 that revisits the transport and switching rates ordered by the Commission in Phase II and Phase IIA. Qwest challenges the ROO for three reasons. First, Qwest takes exception to the recommended decision to revert to the old transport rates the Commission allowed to take effect in the first generic cost docket, more than four years ago. Those rates were never approved by the Commission as TELRIC-compliant and, were not developed using the HAI model that the Commission has held should be used to establish Arizona rates for unbundled network elements ("UNEs"). Second, the ROO seeks to apply the changed transport rates retroactively in violation of federal and state law. Third, even if retroactive application were lawful, there is no principled basis for applying the new transport rates retroactively, but refusing to apply the new switching rates retroactively.¹

¹ Qwest firmly believes that the ROO errs by refusing to consider the merits of Qwest's request that if the Commission orders retroactive application of the revised transport rates, it would do the same for the
The Commission should set the new transport rates based on "Option 2" of the two Staff options identified in the stipulation and Procedural Order. Only this option achieves each of the objectives essential to a fair and lawful resolution of this issue. Both Option 1 and Option 2 produce separate rates for direct trunk transport and entrance facilities. Under both options, therefore, competitive local exchange carriers ("CLECs") that do not want entrance facilities will not be required to pay for them. However, only Option 2 bases the new transport rates on the costs generated by the HAI model put forth in this case, and it is, therefore, the only option that complies with the Commission's ruling in its Phase II Order that "consistency requires adoption of the HAI model's results for both loop costs and transport." In contrast to Option 2, Option 1 would plainly violate this ruling, as it would result in transport rates not based on the HAI model used in this case.

Consistency in developing UNE rates is important for two reasons. First, there is a direct relationship between the costs the HAI model calculates for the unbundled loop and the costs the model develops for other UNEs, including transport. The model produces lower cost estimates for the unbundled loop than it otherwise would by assigning substantial percentages of overhead expenses to transport and switching. If the Commission uses HAI for the unbundled loop but not for transport, Qwest will not recover all of the overhead costs that the model has assigned to transport.

The Commission also should reject the ROO's application of the new transport rates revised switching rates, and that the Commission should correct that error in its ruling on these Exceptions. However, out of an abundance of caution, Qwest is filing a Conditional Petition of Qwest Corporation Concerning Retroactivity of Switching Rates. If the Commission agrees with the ROO that Qwest did not properly raise the issue, and does not address in its ruling on these Exceptions the merits of Qwest's request, they should be addressed in response to Qwest's separate petition. Should the Commission address the merits of Qwest's request in ruling on its Exceptions, Qwest will withdraw its separate Petition.

2 Phase II Opinion and Order, Investigation into Qwest Corporation's Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts, Docket No. T-00000A-00-0194, Decision No. 64922, at 79 (June 12, 2002) ("Phase II Order") (emphasis added).
retroactively to June 12, 2002, the date of the *Phase II Order*. As discussed below, federal and Arizona law prohibit the retroactive adjustment of rates prescribed or otherwise approved as lawful by the Commission. This rule applies notwithstanding any claim or subsequent finding by the Commission that the formerly prescribed or approved rates were unreasonable or even implemented by mistake (as was not the case here). As a matter of law, the new transport rates may apply from the effective date of the Order adopting them, and no earlier.

Even if the law permitted retroactive ratemaking based on "mistake" or "surprise", that exception would not apply here. In particular, there is no basis for the assertion in the ROO that all parties agreed that the HAI model produced "unanticipated" high rates by averaging entrance facilities with transport. This assertion, based on the representations of a party (MTI) that chose not to participate in the Phase II proceedings, is simply wrong. Briefs, as well as testimony from the Phase II hearing on this precise subject, all confirm that participants in that phase, unlike MTI, knew that the HAI model averaged transport and entrance facilities, and that such averaging would produce the very rates that the ROO now claims were an accident. Indeed, the Staff acknowledged during this phase that it knew exactly what rates the HAI model produced.3 The only party who was surprised by the rates was MTI, and it would not have been surprised had it appeared in the Phase II docket. During the Phase II hearing on the subject of setting transport rates, there was a vigorous and informed debate about including entrance facilities in direct trunked transport.4 If MTI had intervened in the case, it could have voiced its objection then, but it did not do so. The ROO rewards that conduct by not only revising the transport rates, but doing so retroactively to eliminate any consequence of MTI’s deliberate decision not to participate in

3 Tr. p. 56. Contrary to the ROO, no Qwest witness testified that it was surprised by the rates in the order. Qwest witness Million knew perfectly well what transport rates the HAI model set. She was surprised only by the belated complaint of MTI, because the rates were publicly available information no later than the conclusion of Phase II. Tr. pp. 84-85.

Phase II.

Finally, if the Commission believes that the law permits retroactive adjustment of rates it had previously approved as TELRIC-compliant, it should order that adjustments to the switching rates be made retroactive as well. There is no legitimate basis for disparate treatment of the transport rates on the one hand, and the switching rates, on the other. The theory underlying the request for revisions, i.e., that the rates established in the Phase II Order were in some material respect mistaken, applies no less to the switching rates than to the transport rates. The Administrative Law Judge nevertheless refused to consider the merits of the argument for retroactive application of the new switching rates because the issue had not been expressly identified in the stipulation. However, before retroactivity was briefed, Qwest asked the Administrative Law Judge to consider retroactivity for switching, and no party would have been prejudiced by consideration of the merits of Qwest's request. The net effect of the recommendations with regard to retroactivity for transport and switching, moreover, is to grant the former at the behest of a party that elected not to participate in Phase II, while denying as "untimely" the latter because Qwest did not make its request at the same time as MTI. Thus, far from supporting justifying a refusal to order retroactivity for the switching rates, the rationale of the ROO underscores the arbitrariness of that decision.

I. The Commission Should Continue to Use the HAI Model for Transport Rates and Should Not Retroactively Apply the Modified Transport Rates.

A. Consistency In UNE Pricing Requires The Use Of The HAI Model For Transport Rates.

In establishing new transport rates, the Commission should achieve each of the following objectives: (1) establish separate rates for entrance facilities and direct trunk transport so that CLECs do not pay for entrance facilities they do not need; (2) ensure that the transport rates are developed consistently with the other UNE rates established in this proceeding; and (3) ensure that the transport rates permit Qwest to recover the same costs and expenses the Commission
ordered in the *Phase II and IIA Orders*. Of the two pricing options set forth in the *April 11, 2003 Procedural Order*, only Option 2 meets these objectives. By producing separate rates for entrance facilities and direct trunk transport ("DTT") based on the HAI model, Option 2 eliminated MTI’s-belated objection to paying for entrance facilities it does not need, while also ensuring that the new rates are based on the same cost model the Commission used to set rates for the unbundled loop and switching. In addition, because the Option 2 transport rates would be based upon the same HAI-generated transport costs the Commission ordered in the *Phase II Order*, Qwest would receive the cost recovery that the Commission found appropriate in that Order.

Qwest initially argued in Phase II that the Commission should establish separate charges for entrance facilities and Direct Trunk Transport, and, indeed, Qwest’s own transport cost study presented in Phase II offered separate rates for these facilities because entrance facilities are more expensive than transport. The Commission, however, selected the HAI model, which averages together the costs of circuits with transport and entrance facilities and circuits with only transport. To address the objections of carriers which may not need entrance facilities, including MTI which chose not to participate in Phase II, Qwest is proposing a logical methodology for implementing Staff Option 2, which divides the total transport costs produced in the HAI model (and adopted in the *Phase II Order*) into distinct Direct Trunk Transport and entrance facility charges. Specifically, Qwest proposes to use the same ratio of entrance facility costs to direct trunk transport costs that the Commission established in the first generic cost docket.\(^5\) Under this approach, the direct trunk transport rate is calculated by multiplying (one) minus (the ratio of ICM entrance facility rates to transport rates) times (the total HAI transport cost). The entrance facility rate is determined by subtracting transport rates resulting from the above calculation from

\(^5\) Qwest Ex. 1 (Million Dir.) at 2-3.
the total HAI transport costs. Contrary to the claims of the ROO, application of Qwest’s proposal will produce completely distinct rates for direct trunk transport and entrance facilities; thus, the transport rate will not include any portion of charges for entrance facilities.

Option 2 allows the Commission to maintain a consistent approach in setting UNE rates. In its *Phase II Order*, the Commission ruled that the HAI model sponsored by the CLECs would determine the costs and rates for UNEs, stating that HAI “provides the most appropriate measure for determining TELRIC-compliant, forward-looking costs and prices for UNEs . . .” The Commission adopted HAI’s transport rates after careful consideration and specifically rejected AT&T’s and MCI’s contention that their model should not be used for transport. Stating that “any UNE pricing inquiry necessarily involves some cost averaging among different kinds of facilities[,]” the Commission ruled that it was necessary to establish transport charges using the same approach employed to establish loop and switching rates. Underscoring the need for consistency, the Commission stated: “We believe that consistency requires adoption of the HAI model’s result for both loop costs and transport.”

The need for consistency is more than just a matter of principle; it is essential to ensure that Qwest is compensated fully for providing transport. The undisputed testimony in this case and the stipulation between Qwest and AT&T/MCI establish that the HAI model allocates expenses among the different UNEs the model addresses and that there is, therefore, an

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6 Qwest Ex. 1 (Million Dir.) at 3.
7 Qwest Ex. 1 (Million Dir.) at 3; MTI Ex. 2 (Hazel Reb.) at 3.
8 *Phase II Order* at 10.
9 *Id.* at 79.
interrelationship among the model’s UNE cost estimates. Qwest’s cost witness, Teresa Million, explained this relationship:

One reason that HAI produces lower loop costs is that the model allocates various expense factors to the non-loop facility costs it produces in proportion to their estimated direct costs.... This method of allocation assumes that in order to recover the entire ... expense, Qwest must be able to charge rates produced by HAI for both loop and transport.

Accordingly, as the Commission previously recognized, selective adoption of the HAI model for only certain UNEs – loop and switching, but not transport – will prevent Qwest from recovering all the expenses HAI generates and that the Commission has determined Qwest is entitled to recover.

Finally, there is no merit to the ROO’s claims relating to the alleged ease of implementing Option 1 as compared to Option 2 or to the alleged lack of harm that would result from adopting the outdated transport rates proposed under Option 1. As Ms. Million testified, adoption of either Option 1 or Option 2 will produce separate rates for transport and entrance facilities, meaning Qwest will need to make similar changes to its billing systems regardless of the option the Commission adopts.

B. The Replacement Of The Phase II Transport Rates With New Transport Rates Should Be Prospective Only; Retroactive Application Of The New Transport Rates Would Plainly Be Unlawful.

The ROO made the revised transport rates effective as of June 12, 2002,” the date upon which the Commission adopted the transport rates currently in effect.” Under federal and state law, rates prescribed by the Commission or otherwise approved as lawful at the time of their

11 Qwest Ex. 4 (AT&T, MCI, and Qwest Stipulation).

12 Qwest Ex. 1 (Million Dir.) at 5.

13 See Phase II Order at 79.

14 Qwest Ex. 2 (Million Reb.) at 4.
adoption may not be changed except on a prospective basis. Accordingly, the new transport rates may apply from the effective date of the Order adopting them, and no earlier. The application of the new rates as of June 12, 2002, or any sooner than the date upon which they are adopted, is prohibited.

An order making the new rates effective prior to the date of their adoption would violate the rule against retroactivity, which has been described as “a cardinal principal of ratemaking.”\textsuperscript{15} The leading federal case on retroactive ratemaking, \textit{Arizona Grocery Co. v. Atchison, Topeka \& Santa Fe Railway, Co.}, 284 U.S. 370 (1932), was decided by the United States Supreme Court.

As the Court explained:

Where the Commission, has, upon complaint and after hearing, declared what is the maximum reasonable rate to be charged by a carrier, it may not at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, by declaring its own finding as to reasonableness erroneous, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate.”\textsuperscript{16}

In \textit{Arizona Grocery}, the Court invalidated a 1927 order by the Interstate Commerce Commission finding that the “maximum reasonable” rates prescribed by it after a hearing in 1922 were in fact “unreasonable,” and ordered the carrier to make “reparations” (\textit{i.e.}, “true-ups”) to its customers in an amount equal to the difference between the prescribed rate (or the rates actually collected by the carrier), and revised rates determined in a 1925 proceeding.\textsuperscript{17} The proposal here to make the revised transport rates effective as of June 12, 2002, is in substance identical to the order invalidated in \textit{Arizona Grocery}.

\textsuperscript{15} \textit{City of Piqua v. FERC}, 610 F.2d 950, 955 (D.C. Cir. 1979).

\textsuperscript{16} \textit{Arizona Grocery}, 284 U.S. at 390.

\textsuperscript{17} Id. at 382.
Indeed, the facts in Arizona Grocery are substantively indistinguishable from those here. Analogous to the rates at issue in Arizona Grocery, the current transport rates were prescribed by the Commission in the Phase II Order. In its decision, the Commission found that the rates it prescribed for UNEs, including the transport UNE rates, complied with the Telecommunications Act of 1996 ("the Act"). Specifically, the Commission found that "the prices for unbundled network elements are based on the cost (determined without reference to a rate of return or other rate-based proceeding) of providing the interconnection or network element... and are nondiscriminatory." Like the subsequent proceeding in Arizona Grocery, this proceeding was initiated following a complaint by MTI, a non-party to the initial proceeding during which the challenged rate was prescribed. In essence, MTI argued that the transport rates were unlawful on the day they were adopted by the Commission, June 12, 2002, and should therefore be replaced by different rates of that date. That is exactly what the law has always forbidden.

Neither the Act nor the FCC's orders and regulations, moreover, authorize the retroactive application of UNE rates found by the state commission at the time of their adoption to be fully compliant with TELRIC. The Act requires that transactions occur pursuant to Commission-approved interconnection agreements. Because the inclusion of rates is an express prerequisite for approval of interconnection agreements, it could not be clearer that Congress expected the parties to know the rates in advance of their transactions. The FCC's Local Competition Order confirms that rates may be changed during the term of an agreement, if at all, solely on a prospective basis. In particular, the FCC stated that where it is appropriate to replace rates with new ones, the replacement would "take effect at or about the time of the

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18 Phase II Order at 84.

19 47 U.S. § 252(c)(2).

"conclusion" of the state Commission's subsequent proceeding, and that the new rates would "apply from that time forward." There is no mention of "true-ups" or retroactivity. Other sections of the Communications Act also establish that to change a rate retroactively, the Commission must briefly suspend the rate and open an investigation— **when the rate is first placed into effect.** Here, the ACC established the transport rates as final when it placed the rates into effect.

Arizona law recognizes the rule against retroactive ratemaking. As explained by the Arizona Court of Appeals, "[w]hen an agency approves a rate, and the rate becomes final, the agency may not later on its own initiative or as a result of collateral attack, make a retroactive determination of a different rate and require reparations." Refunds or surcharges to correct the prior application of a commission-approved rate are permissible only upon a finding of unlawfulness made by a court on appeal of the agency order adopting the prior rate. That is why the Court of Appeals referenced the agency's "own initiative" and "collateral attacks" in

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21 Id. at ¶ 693 (emphasis added); see also id. at ¶¶ 769, 782.


23 Mountain States Tel. & Tel. Co. v. ACC, 124 Ariz. 433, 604 P.2d 1144, 1147 (App. 1979)("Mountain States"); see also El Paso & S.W.R. Co. v. Arizona Corporation Commission, 51. F.2d 573, 577 (D. Az 1931)("we are convinced that when the ACC has approved and authorized a rate to be collected, and the carrier has collected that rate and nothing in excess thereof while the rate was in force, the Commission has no authority to order a reparation, even though it should thereafter find, as it did in this case, that the rate so prescribed was excessive").

24 See Mountain States, 604 P.2d at 1147.

25 Id. Limiting the exception to the rule against retroactivity to cases where the rate previously approved by the Commission is invalidated on appeal to a court promotes not only certainty, but administrative efficiency. Had MTI participated during Phase II of the Commission's UNE rate proceeding, it could have then timely presented evidence and argument in an attempt to persuade the Commission to reach a different result, and if unsuccessful, pursued an appeal under 47 U.S.C. 252(e)(6) as "an aggrieved party." Ordering retroactivity in this case would not only reward MTI's failure to participate in Phase II, but would encourage parties to rest on the efforts of others in future Commission proceedings, and commence subsequent collateral attacks if they do not like the outcome.
describing the rule against retroactivity. Here, the retroactivity approved in the ROO is the result of a "collateral attack" by MTI, which is precisely what the law forbids. Retroactivity is not only unlawful, but bad policy. It rewards and encourages parties who fail to participate in or at least monitor proceedings, allowing them a second bite of the apple when the results of the proceeding are not to their liking. Notwithstanding this overwhelming body of authority, the ROO assumes that the law permits retroactive adjustments based on "mistake" or "surprise." The ROO cites not a single case to support that proposition nor does it attempt to distinguish the federal and Arizona cases cited by Qwest in opposing retroactivity.

Moreover, even if the ROO were correct that retroactivity may be ordered in the case of mistake or surprise, there was no surprise or mistake with regard to the HAI transport rates adopted by the Commission. Qwest originally proposed separate transport and entrance facility rates because these elements have different costs and different carriers order different elements. Joint Intervenors (AT&T, MCI, and XO) insisted that all entrance facilities are essentially the same as transport and filed HAI, which averages all the expenses of an entrance facility into a single transport element. Because the Qwest ICM produced lower rates for both transport and entrance facilities, AT&T then filed testimony urging adoption of the Qwest model (with certain reductions not relevant here) and rejection of the separate higher entrance facility rate in ICM. No CLEC objected to this proposal. MTI did not object because it did not bother to participate in Phase II.

After the Administrative Law Judge adopted the HAI model for DS-O loops in the first ROO dated November 8, 2001, Qwest then urged the Commission to use the HAI model for transport as well.26 The Administrative Law Judge held another hearing on January 25, 2002 where Qwest and AT&T debated the merits of using either model and discussed that the HAI model included all the costs of both entrance facilities and transport. Indeed AT&T claimed that

26 Qwest's Response to Other Parties Exceptions at pp.4-9.
there were no additional costs for entrance facilities and that HAI needed to be changed to make it
distance sensitive as opposed to a fixed rate.

Ms. Steele: Qwest has also tried to add in an entrance facility piece and
claimed that when you add in that piece that the costs are essentially the
same so it didn’t matter. You have to understand what an entrance facility
is when we’re talking about interconnection, and that’s where it applies, in
the interconnection, not with unbundled transport. Entrance facilities are
essentially just more transport. It’s not like we have more -- another
terminal, another piece of equipment, and the proposal that we had made in
this proceeding is an entrance facilities should just be treated as I’ve gotten
five miles of transport and two miles of entrance facility, add that and
charge me for seven miles, don’t charge me another fixed fee for entrance
facilities.

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Mr. Devaney: And if you look at the transport model that HAI presented,
it’s the only model in this proceeding that properly combines entrance
facilities and direct trunk transport, and they are different facilities. They
have different costs associated with those by counsel’s -- despite counsel’s
suggestion to the contrary. Entrance facilities have, by definition, a much
lower utilization rate than direct trunk transport, and as a result, costs
associated with entrance facilities are going to be distinct from and higher
than direct trunk transport facilities. The model combines, the HAI model
properly combines both of these into a combined rate, and the handout that
I presented demonstrates that if you look at what HAI proposes, what HAI
produces in this case, combined direct trunk transport and entrance facility,
you compare it to what’s been ordered in Qwest’s other states, and what’s
been ordered in states that have received 271 approval, the HAI estimates
fall right within the range that’s been set, and they’re comfortable within
that range. 27

The parties then filed briefs on February 1, 2002 and February 8, 2002 (pp. 5-7)
discussing this very issue and whether consistency required that the Commission use the HAI for
both loops and transport regardless of the effect on individual rates (i.e., HAI produced lower
loop rates and higher transport rates while ICM has higher loop rates and lower transport rates).

27 Tr. 1/25/2002 pp. 109, 112.
The Administrative Law Judges then issued another ROO which opted for the HAI model to maintain consistency and the Commission denied all exceptions on this issue. Qwest made a publicly available compliance filing on June 26, 2002, which contained the rates at issue and was concurred in by all parties to the case. Thus, the only CLEC “surprised” by the transport rates was MTI; and that surprise would not have occurred had MTI appeared in or at least monitored Phase II.

Contrary to the ROO, neither Qwest nor Staff agree they were surprised by the transport rates. Staff testified in this hearing that it knew what the HAI transport rates were. Staff concurred in the compliance filing that includes those rates. That Staff has now changed its position, provides no basis for retroactivity. Qwest witness Million similarly testified that she knew what the rates in the HAI model were and she was not at all surprised by the rates in the compliance filing.

C. If The Commission Orders That Revised Transport Rates Take Effect As Of June 12, 2002 Or Any Date Prior To Their Adoption, It Should Order That Revised Rates For Analog Ports Take Effect on December 12, 2002.

The ROO refused to make the new switching rates effective on the same date as the transport rates, claiming that Qwest did not raise the issue in the original stipulation setting the issues for the hearing. The ROO does not address the merits of Qwest’s request.

Qwest strongly believes that an order adopting the CLECs’ proposal to make the revised transport rates retroactive would be unlawful. However, shortly after the adoption of the

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28 Decision No. 64922 at 11.
29 See Qwest Notice of Compliance with Decision No. 64922.
30 Tr. p. 33, 55.
31 Tr. p. 84-85, 99-100.
32 ROO FN1.
stipulation, Qwest urged that if the Commission disagreed with Qwest and ordered retroactive adjustment of transport rates, then it should likewise order that the revised switching rates be made retroactive to the date of the adoption of the Phase IIA rates, December 12, 2002. There is no legitimate basis for disparate treatment of the transport rates on the one hand, and the switching rates, on the other. The theory underlying the request for revisions, i.e., that the rates established in the Phase II Order were mistaken, applies no less to the switching rates than to the transport rates. An order correcting an error through refunds of transport rates set by mistake, but refusing to permit surcharges to correct an admitted mistake resulting in understated rates for UNE switching, would epitomize arbitrary and capricious decision making.\textsuperscript{33}

Finally, addressing the potential retroactive application of the new switching rates will not prejudice any party to the proceeding. Qwest expressly identified this issue in the direct testimony of Ms. Million filed on April 28, 2003, thereby giving all the parties the opportunity to address the issue in their rebuttal testimony, at the hearing, and in their post-hearing briefs.\textsuperscript{34} Indeed, no party objected to Qwest’s submission of testimony addressing this issue.

\textsuperscript{33} See generally Arizona Corporation Commission v. Mountain States Tel. & Tel. Co., 71 Ariz 404, 228 P.2d 749, 751 (Az 1951)(Commission’s failure to effectuate a judgment and put into effect a schedule of rates that would not be confiscatory evidence[d] . . . a want of consideration and indurate attitude toward the company”).

\textsuperscript{34} Qwest Ex. 1 (Million Direct) at 7.
RESPECTFULLY SUBMITTED this 25th day of September, 2003.

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