OPEN MEETING ITEM

22

COMMISSIONERS
MARC SPITZER - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES

ORIGINAL

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ARIZONA CORPORATION COMMISSION

DATE:: 3/10/2004

DOCKET NOS.: T-00000A-97-0238; RT-00000F-02-0271; and T-01051B-02-0871

TO ALL PARTIES:

Enclosed please find a Hearing Division revised Recommended Opinion and Order in the above-captioned dockets. Also enclosed is a proposed amendment to the December 1, 2003, Recommended Opinion and Order. The proposed amendment sets forth the differences between the two orders. We hope to be able to provide a red-line version of the Recommended Opinion and Order on the Commission web site within a couple days.

You may file exceptions that are limited to the proposed amendments by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

MARCH 19, 2004

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. This matter will be considered by the Commission at an Open Meting on a date to be determined.

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Secretary's Office at (602) 542-3931.

Arizona Corporation Commission
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ADMINSITRATIVE LAW JUDGE

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF U S WEST COMMUNICATIONS, INC.'S COMPLIANCE WITH § 271 OF THE TELECOMMUNICATIONS ACT OF 1996.	DOCKET NO. T-00000A-97-0238
IN THE MATTER OF QWEST CORPORATION'S COMPLIANCE WITH SECTION 252(e) OF THE TELECOMMUNICATIONS ACT OF 1996.	DOCKET NO. RT-00000F-02-0271
ARIZONA CORPORATION COMMISSION Complainant. v. QWEST CORPORATION, Respondent.	DOCKET NO. T-01051B-02-0871 **OPINION AND ORDER**

DATE OF HEARINGS:	March 17, 18, 19 and 20, 2003 (Section 252(e) investigation); June 13, 2003 (OSC); and September 16 and 17, 2003 (Settlement Agreement)
PLACE OF HEARINGS:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGES	Jane L. Rodda Dwight D. Nodes
IN ATTENDENCE:	Chairman Marc Spitzer Commissioner Mike Gleason
APPEARANCES:	Mr. Timothy Berg, FENNEMORE CRAIG, PC, Mr. Peter Spivak and Mr. Douglas Nazarion, HOGAN & HARTSON, LLP, and Mr. Todd Lundy, Corporate Counsel for Qwest Corporation; Mr. Richard Wolters, for AT&T Communications of the Mountain States, Inc.;

Ms. Joan Burke, OSBORN MALEDON, PA, for Time Warner Telecom;

Mr. Martin A. Aronson, MORRILL & ARONSON, PLC, for Arizona Dialtone, Inc.;

Mr. Mitchell F. Brecher, GREENBERG TRAURIG, LLP, for Mountain Telecommunications, Inc.;

Mr. Daniel Pozefsky, Attorney for the Residential Utility Consumer Office;

Mr. Thomas Campbell, LEWIS & ROCA, LLP, and Mr. Dennis Ahlers, Corporate Counsel, for Eschelon Telecom;

Mr. Thomas F. Dixon for WorldCom; and

Ms. Maureen Scott and Mr. Gary Horton, Staff Attorneys on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

The following three dockets involving enforcement actions against Qwest Corporation ("Qwest") are before the Arizona Corporation Commission ("Commission") for consideration: the investigation into Qwest's compliance with Section 252(e) of the Telecommunications Act of 1996 ("1996 Act"); the Section 271 Sub-docket involving an investigation into whether Qwest interfered in the Section 271 regulatory process; and the Order to Show Cause for Delayed Implementation of Wholesale Rates. The Commission held hearings in the Section 252 investigation commencing on March 17, 2003 and in the OSC on June 13, 2003. On July 25, 2003, Commission Utility Division Staff ("Staff") and Qwest filed a proposed Settlement Agreement, which would, if adopted, resolve allegations that Qwest violated federal and state law and Commission regulations and Orders raised in the three dockets. The Commission convened a hearing on the Settlement Agreement commencing on September 16, 2003.

Background

The Section 252(e) Proceeding

Section 252(e) of the 1996 Act requires an Incumbent Local Exchange Carrier ("ILEC"), such

as Qwest, to file all interconnection agreements between it and a Competitive Local Exchange Carrier ("CLEC") with the Commission for approval. The issue of Qwest's compliance with Section 252(e) of the 1996 Act first came to light in Arizona when the Minnesota Department of Commerce filed a complaint against Qwest alleging that Qwest had not filed certain agreements with the Minnesota Public Utilities Commission for approval as required under Section 252(e). At then Chairman Mundell's request, Qwest was directed to submit any and all un-filed Arizona agreements to the Commission for review.[1] On March 8, 2002, AT&T Communications of the Mountain States, Inc. and TCG Phoenix ("TCG") (collectively "AT&T") filed a Motion with this Commission in the Section 271 docket asking the Commission to examine whether Qwest was complying with Section 252 in the context of the Section 271 investigation.

By Procedural Order dated April 8, 2002, the Commission determined to open a separate docket to investigate Qwest's Section 252 compliance. On June 7, 2002, based upon comments filed by interested parties and its own review of the facts and law, Staff filed a Report and Recommendation in the Section 252(e) docket. In its Report, Staff identified approximately 25 agreements that it believed should have been filed by Qwest under Section 252(e). Pursuant to A.R.S. § 40-425, Staff recommended penalties totaling $104,000 based on $3,000 for each un-filed agreement, and $5,000 for each agreement that contained a clause that prevented CLEC participation in the Section 271 investigation.

The Commission held a Procedural Conference on June 19, 2002, during which the Residential Utility Consumer Office ("RUCO") raised a new issue involving the existence of oral agreements between Qwest and McLeodUSA, Inc. ("McLeod"), and urged the Commission to broaden its examination to include the damage to competition and to other CLECs in the State resulting from Qwest not filing these agreements. The Commission directed Staff to conduct additional discovery of all CLECs operating in Arizona to determine the number of un-filed agreements and whether the un-filed agreements had tainted the record in the Section 271 proceeding.

On August 14, 2002, Staff issued a Supplemental Report and Recommendation concerning

[1] Qwest submitted approximately 90 agreements.

Qwest's Compliance with Section 252(e). In its Supplemental Report, based upon the additional discovery, Staff recommended that a hearing should be held to determine whether Qwest acted in contempt of Commission rules by not filing certain McLeod and Eschelon Telecom, Inc. ("Eschelon") agreements with the Commission for approval. Staff further recommended the Section 252(e) proceeding be separated into two phases, with Phase A addressing filing violations and Phase B addressing any opt-in disputes between Qwest and CLECs.

By Procedural Order dated November 7, 2002, the Commission set the Section 252(e) compliance issues for hearing. The hearing commenced on March 17, 2003, and continued through March 20, 2003. The parties filed Initial Briefs on May 1, 2003, and Reply Briefs on May 15, 2003.

In its investigation, Staff identified 42 agreements that it believed Qwest should have filed with the Commission for approval pursuant to Section 252(e). Qwest agreed that 14 of them contained terms that pertain to Section 251(b) or (c) services and were still in effect. Qwest filed these agreements in September 2002 and the Commission approved them in Decision No. 65475 (December 19, 2002).[2] Staff and Qwest disagreed about whether the remaining 28 agreements were required to be filed under Section 252(e). Qwest disputed that these agreements fell under the Section 252 requirement for a variety of reasons, including that some had been terminated or superceded, some contained only backward-looking provisions, others were form agreements, or they didn't involve Section 251(b) or (c) services. A list of the 28 interconnection agreements that Staff claims Qwest should have filed is attached as Exhibit B hereto.

Among the 28 agreements Staff believed Qwest should have filed were a series of agreements with Eschelon and McLeod. At the hearing, Staff and RUCO presented evidence that the agreements with Eschelon and McLeod were drafted specifically in an attempt to avoid the filing requirements of Section 252 in order to avoid having other CLECs opt into favorable provisions. In 2000, Eschelon and McLeod were two of Qwest's largest resellers. Both wanted to move away from reselling Centrex products and wanted to provide service over an unbundled network element platform ("UNE-P"). Under UNE-P, they believed they would earn higher margins and be able to collect their

[2] In approving the agreements, the Commission did not approve specific provisions that would have: prevented participation in other dockets; required confidentiality; required confidential private binding arbitration in lieu of bringing an action before this Commission; or required interpretation under Colorado law.

own access fees.

In the summer of 2000, McLeod and Qwest began negotiations that resulted in a Confidential Billing Settlement Agreement entered into on September 29, 2000, in which McLeod agreed to pay Qwest an amount for the conversion from resale to UNE-P. Qwest and McLeod finalized their agreement on October 26, 2000, when they executed a series of six agreements. The key component of these agreements was the creation of a product called UNE-Star (or UNE-M when purchased by McLeod). The UNE-M product is a flat-rated UNE platform that converted McLeod resold lines directly to UNE-P. With UNE-M, McLeod would avoid the provisioning issues associated with UNE-P, such as submitting individual Local Service Requests ("LSRs") for each line.

One of the agreements entered into on October 26, 2000 is the Fourth Amendment to the Qwest/McLeod Interconnection Agreement in Arizona, which McLeod filed with the Commission on December 26, 2000. This document sets out the publicly disclosed terms and conditions of the UNE-M product. In this agreement, McLeod agreed to pay Qwest $43.5 million to convert to the UNE-M platform. McLeod agreed *inter alia* to maintain a minimum number of local exchange lines, to remain on "bill and keep" for the exchange of Internet-related traffic, and to provide rolling 12-month forecasted line volumes. Qwest agreed *inter alia* to provide daily usage information to McLeod so that McLeod could bill interexchange companies and others for switched access.

In addition to the publicly disclosed Fourth Amendment to the Interconnection Agreement, on October 26, 2000, Qwest and McLeod also entered into several agreements that were not filed or otherwise made public. One was the Purchase Agreement in which McLeod agreed to purchase from Qwest Communications Corporation ("QCC", Qwest's affiliate), its subsidiaries or affiliates, a certain amount of services and products over a multi-year period. No. 15 on Exhibit B. At the same time, they entered into a Purchase Agreement in which QCC and its subsidiaries agreed to purchase products from McLeod over the same multi-year period. No. 16 on Exhibit B. McLeod and Qwest also entered into an Amendment to Confidential Billing Settlement Agreement which revised the Confidential Billing Settlement Agreement entered into on September 29, 2000. No. 13 on Exhibit B. This Amendment revised the earlier agreement to conform with the ultimately agreed upon payment amount from McLeod for the conversion and agrees with the amount set forth in the Fourth

Amendment to the Interconnection Agreement that was filed.

In addition to these written agreements, McLeod claims that it and Qwest entered into two oral agreements, one of which provided a 10 percent discount on McLeod's purchases from Qwest and the other precluded McLeod from participating in Qwest's Section 271 application. (No. 14 on Exhibit B) (RUCO's Section 252 Initial Brief p. 30) Blake Fisher, McLeod's vice president and chief planning and development officer, who was involved in the negotiations, testified in his deposition that in developing the UNE-Star product, McLeod was not satisfied that the pricing was sufficiently low to justify McLeod keeping its traffic on Qwest's network. Thus, Qwest and McLeod agreed to enter into the Purchase Agreements whereby McLeod would purchase goods and services from Qwest and Qwest agreed to provide McLeod with discounts ranging from 6.5 percent to 10 percent if McLeod's purchases exceeded its take-or-pay commitments. (RUCO's Section 252 Initial Brief at p. 28) Mr. Fisher stated that Qwest did not want to put the discount agreement into writing because Qwest was concerned that other CLECs might feel entitled to the same discount. In response to Mr. Fisher's concerns that the discount provision was not in writing, Qwest agreed to a take-or-pay agreement to purchase products from McLeod. According to Mr. Fisher, the amount of the Qwest take-or-pay commitment was calculated by applying the discount factor to a projected amount of purchases by McLeod from Qwest.

Qwest made payments to McLeod pursuant to the Purchase Agreements from October 2000 through September 2001. Qwest prepared spreadsheets that calculated the amount of the payment by applying the 10 percent discount factor to all purchases made by McLeod during the relevant time period. (RUCO's Section 252 Initial Brief at p. 31) After McLeod would confirm the accuracy of the spreadsheets, McLeod would send Qwest an invoice. Qwest paid invoices for the period October 2000 through March 2001, April 2001 through June 2001, and July 2001 through September 2001. Qwest did not make payments on the amount that would have been due for the fourth quarter of 2001 because this is when the Department of Commerce in Minnesota began investigating the discount agreement. Various Qwest emails and notes relating to the negotiations with McLeod and with the calculation of the discount due are consistent with Mr. Fisher's account of events. Although no written agreement refers to a 10 percent discount in McLeod's purchases, Qwest acted consistently

with the existence of such discount.

On November 15, 2000, Qwest and Eschelon entered into an Escalation Procedures and Business Solutions Letter, in which the parties agreed: to develop an implementation plan; that Eschelon agreed to not oppose Qwest efforts to obtain Section 271 approval or file any complaints with any regulatory body concerning interconnection agreements provided the plan was in place by April 30, 2001; that Qwest would send a vice president level or above executive to attend quarterly meetings with Eschelon to address, discuss and attempt to resolve business issues and disputes and issues related to the parties' interconnection agreements; that Qwest would adopt a six-level set of escalation procedures that gave Eschelon access to Qwest's senior management; and that Qwest would waive limitations on damages. (No. 5 on Exhibit B; Kalleberg Section 252 testimony at p.30)

Also, on November 15, 2000, Qwest and Escehlon entered into the Confidential Amendment to Confidential/Trade Secret Stipulation in which Eschelon agreed to purchase at least $15 million of telecommunication services between October 1, 2000 and September 30, 2001 and Qwest agreed to pay Eschelon $10 million to resolve issues related to the UNE platform and switched access. (No. 4 on Exhibit B; Kalleberg Section 252 testimony at p. 29) In addition, Eschelon agreed to provide consulting and network-related services and Qwest agreed to pay Eschelon 10 percent of the aggregate billed charges for all of Eschelon's purchases from Qwest from November 15, 2000 through December 31, 2005. Qwest also agreed to credit Eschelon $13.00 per UNE-platform line per month for each month during which Qwest failed to provide Eschelon with accurate daily usage information.

Qwest disputed that the purchase agreements it entered into with McLeod and Eschelon are subject to the filing requirements of the 1996 Act because an ILEC's contract to purchase services from CLEC vendors do not affect the terms of the CLEC's interconnection. Thus, Qwest argued the Purchase Agreement between QCC and McLeod entered into on October 26, 2000 in which QCC commits to purchase a minimum amount of services from McLeod, and agreements by the CLECs to purchase products and services from Qwest or QCC do not include any commitment by Qwest that is subject to the Section 251/252 regulatory framework. Furthermore, Qwest argued, even if the CLECs' purchase agreements were entered into as a means of conferring discounts to Eschelon and

McLeod, only the discount provisions of the agreements would fall within the filing requirement of Section 252.

With respect to the agreements related to the UNE-Star product, Qwest claims that the rates terms and conditions of the UNE-Star were negotiated and filed as amendments to Eschelon's and McLeod's existing interconnection agreements and were subsequently approved by the Arizona Commission. Qwest says these amendments reflect the significant development and implementation costs associated with the UNE-Star products and as a result, of those costs, Qwest required CLECs wishing to purchase the UNE-Star products to make total and annual minimum purchase commitments over a multi-year minimum term. Other requirements included imposing a significant penalty if the CLEC did not meet these minimum commitments; "bill and keep" for reciprocal compensation, including internet traffic; and a one-time, lump sum conversion charge, restricting the offering to business customers and providing end user volume and loop distribution forecasts. Qwest states as approved interconnection amendments, all of the UNE-Star rates, terms and conditions were available to any requesting CLEC in Arizona under Section 252(i). Qwest concedes that certain provisions in un-filed agreements that related to the UNE-Star platform fall within the FCC's recently articulated definition of interconnection agreement, but since no other CLEC purchased a variation of UNE-Star, no other CLEC would have been eligible to opt into the un-filed provision even if they had been filed and approved.

Qwest argued that it did not discriminate against Arizona CLECs, as its witnesses testified that all of Qwest's wholesale customers received the same level of service and their orders were processed under the same standards, and no party to the proceeding showed that Eschelon or McLeod received better service quality than any other CLEC.

Staff recommended that the Commission fine Qwest $15,047,000 pursuant to A.R.S. §§ 40-424 and 40-425. Staff's recommended penalties were broken down as follows: 1) $36,000 ($3,000 for the 12 agreements with carriers other than Eschelon and McLeod); 2) $11,000 ($1,000 for each of the 11 agreements with carriers other than Eschelon and McLeod that Qwest filed for approval in September 2002); and 3) $15,000,000 for the agreements related to Eschelon and McLeod and with other carriers if they contain the non-participation clauses.

Under A.R.S. § 40-425, the Commission may fine Qwest between $100 and $5,000 for each failure to file. Staff determined the range of penalties under A.R.S. § 40-425 to be between $4,200 and $210,000, and recommended penalties for the 23 non-Eschelon/McLeod agreements totalling $47,000. Staff believed that Qwest's failure to file the 23 agreements that were with carriers other than Eschelon and McLeod was inadvertent as a result of its misinterpretation of its obligations under Section 252.

Because Staff believed Qwest's failure to file the Eschelon and McLeod agreements was willful and intentional, Staff recommended penalties based on the number of days Qwest's violation continues. For every agreement between Qwest and Eschelon or McLeod or with another carrier if that agreement contains a non-participation clause, Staff calculated the number of days from the date the agreement should have been filed pursuant to A.A.C. R14-2-1506[3] and the dates the agreements were terminated, or if still in effect, through March 20, 2003 (the date Staff calculated the penalties in its April 1, 2003 Post-hearing exhibit). Staff argues that these penalties continue for each day Qwest fails to file these agreements. Through March 20, 2002, Staff calculated that Qwest was in contempt of Commission rules for a total of 8,848 days. Pursuant to A.R.S. § 40-424, Staff calculated the Commission could impose a penalty between $884,800 and $44,240,000. Staff recommended a penalty of $15,000,000.

Staff also recommended non-monetary penalties which included (1) requiring Qwest to file all of the previously un-filed agreements and that interested CLECs be permitted to opt into those agreements for two years from the date of Commission approval; (2) requiring Qwest to provide each CLEC (other than Eschelon and McLeod) with a cash payment totaling 10 percent of the CLEC's purchases of Section 251(b) or (c) services and 10 percent of its purchases of intrastate access from Qwest in Arizona for the period from January 1, 2001 through June 30, 2002, and requiring Qwest to provide each CLEC (except Eschelon and McLeod) with a credit totaling 10 percent of its purchases of Section 251(b) or (c) service and 10 percent of its purchases of intrastate access from Qwest in Arizona for 18 months following the date of the Commission's decision; (3)

[3] In addition to the filing requirements of section 252 of the 1996 Act, A.A.C. R14-2-1506 requires that an interconnection agreement be filed for approval within 30 days of its execution.

modifications to certain Performance Indicator Definitions ("PIDs") that measure wholesale service quality standards to ensure the provision of a minimum level of service to CLECs and foster competition; and (4) requiring Qwest to develop a Code of Conduct that will govern its relationship with CLECs and include prohibitions against the same (or similar) anti-competitive actions revealed in this investigation.

The Section 271 Sub-docket

During its investigation of Qwest's compliance with Section 252 filing requirements, Staff identified agreements with four carriers (Z-Tel, Eschelon, McLeod and XO) which prohibited these carriers from participating in Qwest's Section 271 proceeding. In its August 14, 2002 Supplemental Report, Staff recommended that the Commission open a sub-docket to the Section 271 investigation for the purpose of addressing allegations of interference with the regulatory process and determining appropriate penalties. In its November 7, 2003 Procedural Order, the Commission ordered parties to file comments on Staff's proposed sub-docket procedures, including the need for a hearing, no later than December 10, 2002. By Procedural Order dated December 20, 2002, all letters, comments and data responses identified in the Supplemental Report were made part of the Section 271 Sub-docket record. Parties were given until January 10, 2003, to submit additional evidence. Qwest, RUCO, Eschelon, AT&T and WorldCom filed comments.

Staff set forth the results of its investigation in its Report and Recommendation in the 271 Sub-docket which it filed on May 6, 2003. McLeod indicated in response to Staff inquiries that it had orally agreed to remain neutral on Qwest's Section 271 application as long as Qwest was in compliance with all of its agreements with McLeod and all applicable statutes and regulations. Z-Tel advised Staff that it had agreed not to participate in Section 271 proceedings for a period of 60 days while they were negotiating interconnection agreements with Qwest in eight states.[4] Eschelon provided substantial comment on the fact that it had a signed un-filed contract in which it agreed not to oppose Qwest in its Section 271 proceedings. XO stated that it did not participate in Arizona's 271

[4] Staff states that Z-Tel was an active participant in the Arizona PAP workshops, but entered into the two month stand-down agreement during the briefing stage of those workshops. Z-Tel filed an initial brief jointly with WorldCom on May 11, 2001. The Stand-down was executed May 18, 2001. Z-Tel did not participate in the Reply Brief stage of the proceeding, nor in the PAP open meeting.

proceeding because it did not have sufficient operations or experience with Qwest to warrant participation, but Staff found an agreement between Qwest and XO with provisions that required XO to stipulate that Qwest was in compliance with Section 271 requirements. Four CLECs (Eschelon, Covad, AT&T and WorldCom) responded to Staff that they were aware of Section 271 issues that they believed were not adequately addressed in the Arizona proceedings as a result of Qwest's un-filed agreements with CLECs.

Qwest stated that only two agreements (the December 31, 2001 Confidential Billing Settlement with XO and the November 15, 2000, Confidential Billing Agreement with Eschelon) contained provisions concerning CLEC participation in the Section 271 proceeding. Qwest claims the XO agreement resolved billing and reciprocal compensation disputes and provided that the resolutions would be filed as an amendment to the XO interconnection agreement and filed within 15 days of execution of the agreement. Qwest states the amendment was filed on April 3, 2002 and became available to other CLECs on July 2, 2002. Qwest states as part of the resolution of those issues, XO agreed to stipulate that Qwest complies with the Section 271 Checklist Items in Arizona and five other states. Qwest acknowledged that it entered into agreements with Eschelon and McLeod that contained provisions whereby those CLECs agreed not to oppose Qwest's Section 271 application. For a period of time, Eschelon or McLeod either did not participate or limited their involvement in that process. Qwest stated that suggestions that it prevented Eschelon from participating in the Section 271 process are baseless, as Eschelon determined of its own free will to work with Qwest to resolve business issues between them. Qwest stated that if Eschelon believed Qwest was not living up to its commitments in the agreement, Eschelon could have sought redress through regulatory or legal avenues. Qwest believed that the agreement with Eschelon served the interest of Section 271 because its purpose was to develop an implementation plan that would improve the provisioning process for all CLECs.

Staff held a Workshop on July 30-31, 2002, to address the concerns of parties who believed that they had been precluded from raising issues in the Section 271 proceeding as a result of their agreements with Qwest. Eschelon and McLeod raised issues during the workshop. Other parties were allowed to participate to the extent they had issues which arose from the new evidence

presented.

In its May 6, 2003 Report, Staff expressed the belief that there is substantial evidence in the record to conclude that Qwest interfered with the Section 271 regulatory process by requiring a nonparticipation clause in its agreements with certain CLECs. These clauses precluded participation by CLECs which otherwise would have participated and brought concerns regarding Qwest's provision of wholesale service. Staff stated the completeness of the Commission's Section 271 record was adversely affected and that Qwest's conduct was intentionally designed to prevent certain carriers from raising issues which would have reflected adversely on Qwest's Section 271 compliance. Staff believes that under A.R.S. § 40-424, the Commission can levy fines of up to $5,000 per calendar day, per occurrence. Based on the number of days between the dates the four agreements at question were entered into and the date they were either cancelled, superceded or filed with the Commission, Staff recommended penalties of $7,415,000. Staff found that Qwest's violation continued for 1,423 days. Staff recommended the maximum amount of penalties under A.R.S. § 40-424 because Staff believed that Qwest acted intentionally and willfully in violation of the Commission rules of process and Section 271 procedural orders when it failed to file with the Commission interconnection agreements which prevented certain CLECs from participating in the Section 271 investigation.

Staff further recommended four non-monetary penalties as follows: 1) Qwest must implement and abide by all assurances contained in its December 23, 2002 filing[5]; 2) Qwest must establish an independent, third party auditor to screen the work of the Agreement Review Commission regularly for two years or until the Commission authorizes termination; 3) on an annual basis, Qwest should attest to the fact that it has no agreements that preclude CLEC participation in Commission regulatory proceedings, or that would tend to discourage them from such participation; and 4) the Commission should conduct annual reviews of each December 23, 2002 filing commitment for two years, or until the Commission is fully assured that transgressions of the past will not recur.

[5] In its December 23, 2002 Supplemental Comments to its Motion to Reconsider Procedural Order, Qwest cited actions it was taking to assure Section 252 compliance, including an Independent Auditor to review the Agreement Screening Committee's work, to file all settlement agreements in any proceeding with generic application, on a going-forward basis, and creating a team of people to review all agreements with CLECs and apply FCC standard to ensure that all agreements are properly filed going forward.

On May 19, 2003, Qwest filed Exceptions to the May 6, 2003 Staff Report and Recommendation, and requested a hearing on the penalties proposed by Staff. Qwest argued that Staff's proposed penalties are not appropriate because: (1) there is no Commission Order, rule or requirement that prevents Qwest from entering into settlement agreements that contain non-participation clauses; (2) the Commission does not have statutory authority to impose penalties based on per-day violations; (3) no additional penalty is required on account of the nonparticipation agreements because Staff eliminated the impact of those agreements by holding a workshop at which CLECs could raise issues that they had not been able to raise on account of such provisions; and (4) Staff had already recommended penalties based on these clauses in the Section 252(e) docket.

By Procedural Order dated June 19, 2003, the Commission scheduled a Procedural Conference for June 30, 2003 to discuss the nature of further proceedings. On June 27, 2003, Qwest and Staff filed a Joint Motion to Extend the Time for Procedural Conference, stating they were in the process of negotiating a settlement agreement that involved the 271 Sub-docket. The Hearing Division granted a continuance.

Order to Show Cause for Delayed Implementation of Wholesale Rates

On December 12, 2002, in Decision No. 65450, the Commission issued a Complaint and Order to Show Cause ("OSC") against Qwest. The OSC alleged that Qwest failed to implement the wholesale rate change ordered in Decision No. 64922 (June 12, 2002) within a reasonable period of time, that Qwest failed to notify the Commission of the rate implementation delay, that Qwest failed to obtain Commission approval of the delay in implementation, and that Qwest's wholesale rate change system is unreasonably slow and inefficient. The OSC alleged three Counts of Contempt: (1) failure to implement rates approved in Decision No. 64922 within a reasonable amount of time; (2) deliberately delaying implementation of wholesale rate changes in Arizona until it had implemented the wholesale rate changes in other states in which Qwest had pending Section 271 applications with the FCC; and (3) attempting to discourage parties from notifying the Commission of its delay in complying with Decision No. 64922.

AT&T, Staff and Qwest submitted testimony and the OSC hearing convened on June 13, 2003. The parties filed briefs on July 15, 2003.

Decision No. 64922 authorized revised wholesale rates. The Decision required Qwest to file the price list agreed to by the parties within 30 days of the effective date of the Order. Qwest filed a Notice of Compliance on June 26, 2002, two weeks after the adoption of the Decision. Qwest stated it began implementing the new rates the next day. On October 7, 2002, AT&T sent a letter to the Commission expressing concerns about the length of time it was taking Qwest to implement the Arizona wholesale rates. Qwest completed the rate implementation for most companies on December 15, 2002 and completed implementation for all companies on December 23, 2002. The new rates were applied back to the effective date of the Decision, and CLECs were issued credits and paid interest at six percent on the difference between what they had previously been billed and the billable amounts using the new rates.

The ordering paragraphs of Decision No. 64922 provide in relevant part: "IT IS FURTHER ORDERED that the rates and charges approved herein shall be effective immediately. IT IS FURTHER ORDERED that this Decision shall become effective immediately." Staff argued that Decision No. 64922 requires that Qwest implement the rates immediately or within a reasonable period of time, which Staff believed would be between 30 and 60 days. Staff also argued that Qwest implemented wholesale rates in six states where it had Section 271 applications pending with the FCC prior to implementing the wholesale rates in Arizona even though the dates of the orders authorizing the rates in the other states were after the effective date of the Arizona Decision. Staff argued that even if Qwest is correct that the implementation of rates in the other states may have been less complex than in Arizona, it is still apparent that Qwest diverted resources from Arizona to the other states to support the Section 271 application and this prioritization and diversion of resources was unreasonable. Staff believes that Qwest acted unreasonably by not starting its review of CLEC agreements before its compliance filing and not having a process for easier and timelier mapping of rate elements into interconnection agreements. Staff argued that Qwest's actions and omissions, including not mechanizing its processes until too late to implement these rates, not notifying the Commission or affected CLECs of its inability to implement the rates within a reasonable time, and not seeking relief from the Commission for an extension to implement, indicate an intent to delay implementation, or that Qwest did not intend to implement the rates in a reasonable amount of time.

Qwest admits that the implementation of the wholesale rates and its failure to notify the Commission and CLECs about the implementation timeline was "inappropriate". (Qwest OSC Brief at 5) Qwest argued, however, that its conduct in this docket was not intentional. Qwest argued that the implementation process in Arizona was particularly complex due to a large number of rate elements and multiple billing systems and the fact that changes must be made on a carrier-by-carrier basis. Qwest states further that it implemented all comprehensive cost dockets sequentially in the order of the effective date of the decision establishing the rates and that only certain voluntary rate reductions were implemented prior to the implementation of Arizona wholesale rates. These rate changes were based on reference to benchmark rates adopted in Colorado and it was more efficient to implement them on an integrated basis.[6] According to Qwest, the complexity of the benchmark rate changes was significantly less than required in the Arizona's order—they involved an average of 35 changes versus 547 in Arizona and did not require CLEC-by-CLEC true ups, a determination of how the rate changes applied to a given CLEC, or any restructuring of the rate elements and the necessary resultant system changes. Qwest argued there was no evidence indicating the benchmark rate change slowed implementation in Arizona, or that Qwest intentionally pushed Arizona to the end of the line in implementing wholesale rates. Qwest stated that Arizona took an average of five months, while implementation in Wyoming and Washington took more business days, Colorado took the same number of business days, although two less calendar days, and Montana took two less business days than Arizona.

Qwest stated it had already started to examine how to improve its rate implementation processes including: 1) engaging an outside consultant to provide recommendations for automation; 2) implementing in the first quarter of 2003 a mechanized solution to shorten the time it takes to map individual CLEC contracts; 3) designating a Program Management Office to oversee the implementation process; 4) establishing a Cost Docket Governance Team to provide an oversight role and an escalation point for issues and obstacles that may arise during the process; and 5) modifying

[6] Benchmarking is an approach the FCC uses to evaluate UNE prices by comparing rates among states. Qwest used the benchmark approach proactively in its 271 applications and compared eight states' rates to the Colorado rates (which it believed were TELRIC-complaint) , and where certain rates were higher than the Colorado benchmark, Qwest lowered the rate to be equivalent to the Colorado rate.

its communications process to require increased correspondence with Commission Staff.

Pursuant to A.R.S. § 40-424, Staff recommended fines of $750.00 per day for its failure to notify the Commission of its rate implementation delay and failure to obtain approval of the delay; and $750 per day for its unreasonable prioritization of states ahead of Arizona. Staff's recommended fines totaled $189,000, based on a total of 126 days, the difference between the date Qwest completed implementation of the wholesale rates and the date that Staff believed Qwest should have implemented the rates (i.e. 60 days after the Effective Date of Decision No. 64992). In making its recommendations, Staff took into account that Qwest made retroactive efforts to remedy the situation including crediting the CLECs with interest on the overcharges and its intent to improve its rate implementation process. In addition, Staff recommended that Qwest implement billing and systems process changes that will allow it to implement wholesale rates within 30 days, and that such changes should be implemented within four months of a Decision in this docket, and that Qwest should be required to employ an independent auditor to evaluate and verify that the changes made by Qwest are effective in allowing Qwest to implement wholesale rates changes within 30 days.

The Combined Cases

On July 25, 2003, Qwest and Staff filed a Notice of Filing Settlement Agreement and Request for an Expedited Procedural Conference. The Settlement Agreement between Qwest and Staff purports to resolve all the issues raised in the three enforcement dockets involving Qwest. A copy of the Settlement Agreement between Staff and Qwest is attached hereto as Exhibit A, and incorporated herein by reference.

On July 29, 2003, Qwest and Staff filed a Joint Proposed Procedural Schedule. A Procedural Order dated August 7, 2003 consolidated the three cases and reopened their records to consider the Proposed Settlement, established a schedule for testimony concerning the Settlement Agreement, and set the matter for hearing. Pursuant to the Procedural Order, Staff and Qwest filed testimony on August 14, 2003; AT&T, RUCO, Arizona Dialtone, Inc., ("ADI") and Mountain Telecommunications, Inc. ("MTI") filed testimony on August 29, 2003; and Qwest filed rebuttal testimony on September 8, 2003. Pursuant to the terms of the August 7, 2003 Procedural Order, Time Warner Telecom ("Time Warner") and WorldCom filed comments to the Settlement

Agreement. The hearing was held on September 16 and 17, 2003. The parties filed initial briefs on October 15, 2003 and reply briefs on October 29, 2003.

The Settlement Agreement

The proposed Settlement Agreement contains the following substantive provisions:

Recitals This section summarizes the underlying allegations and states Qwest's commitment to (1) conduct its Arizona operations in compliance with state law and Commission regulations and orders; (2) not to engage in any fraudulent, deceptive or unlawful behavior in any matter pending before the Commission; and (3) to act in a manner evidencing respect for the Commission's regulatory process. Qwest acknowledges that a breach of the Settlement Agreement may be punished by contempt after notice and a hearing as provided by A.R.S. § 40-424. Qwest further acknowledges the existence of concerns about the effect of the alleged wrong-doing, but explicitly states that it is not admitting wrong-doing in the Settlement Agreement.

Section 1 Cash Payment This Section provides for Qwest to pay $5,197,000 to the State's General Fund within 30 days of the Effective Date of Commission approval. The aggregate cash payment consists of three components: $5,000,000 for the allegations concerning Qwest's willful noncompliance with Section 252(e) and for Qwest's alleged interference with the Section 271 regulatory process; $47,000 for un-filed interconnection agreements which Staff believes should have been filed pursuant to Section 252(e) but for which Staff could not find that Qwest's actions were intentional and willful; and $150,000 for delayed implementation of the wholesale rates ordered by the Commission in Decision No. 64922.

Section 2 Voluntary Contributions In this Section, Qwest agrees to make Voluntary Contributions of at least $6,000,000 for (1) economic development, (2) educational programs, and (3) infrastructure investments, including those permitting the provision of service in un-served and underserved territories. Qwest agrees that all investments shall be in addition to any investments, construction or work already planned by Qwest. Qwest and Staff will submit a joint list of projects for Commission consideration for allocating the Voluntary Contributions among the three categories. The Settlement Agreement calls for either the Commission or Staff to provide guidance by determining the percentage allocation of the Voluntary Contributions for each of the investment

categories prior to the submission of the proposed project list. The Commission will determine the final allocation of how the funds will be allocated among specific projects.

Section 3 Discount Credits This Section provides that Eligible CLECs[7] are entitled to a credit equal to ten percent of their purchases of services covered by Sections 251(b) and (c) of the 1996 Act made during the time period January 1, 2001 through June 30, 2002. Qwest will issue the credits to Eligible CLECs within 180 days of the Commission's Decision approving the Settlement. The credit is based upon provisions contained in agreements entered into between Qwest and McLeod and Qwest and Eschelon which were the subject of the Section 252(e) proceeding. Wholesale services covered by Section 251(b) and (c) include Unbundled Network Elements ("UNEs"), resale services and charges for collocation. Intrastate access, interstate access, switched access, special access, and private line services are not covered by Section 251(b) and (c) of the 1996 Act, and not subject to the discount credit provisions of Section 3. The amount of the aggregate Discount Credits will not exceed $8,910,000 nor be less than $8,100,000. If the aggregate Discount Credits are less than $8.1 million, Qwest will contribute the difference as an additional Voluntary Contribution under Section 2. If the aggregate claims for Discount Credits are greater than $8,910,000, Qwest will pro-rate the amount among Eligible CLECs.

Section 4 Access Line Credits This Section provides that an Eligible CLEC can obtain credits in the amount of $2.00 per the average number of UNE-P lines or unbundled loops purchased each month from July 1, 2001 through February 28, 2002, less the amount that the CLEC actually billed Qwest for terminating intraLATA toll during the same period. The minimum amount of the Access Line Credits is $600,000 and will not exceed $660,000. If the aggregate amount of Access Line Credits is less than $600,000, Qwest will make additional Voluntary Contributions equal to the difference between the amount paid and the minimum.

Section 5 UNE-P Credits This Section provides that Eligible CLECs can obtain UNE-P Credits in the amount of $13 per UNE-P line purchased each month from November 1, 2000 to June 30, 2001, and $16 per UNE-P line purchased each month from July 1, 2001 to February 1, 2002, less

[7] Eligible CLECs include all CLECs certified and operating in the State of Arizona between January 1, 2001 through June 30, 2002, with the exception of Eschelon and McLeod and their affiliates.

amounts that the CLEC billed interexchange carriers for switched access during those respective periods. To be eligible for the UNE-P Credits, CLECs must submit four pieces of information (i) information regarding the months that the CLEC did not receive accurate daily usage information; (ii) the reasons it believes the information was inaccurate; (iii) the average number of UNE-P lines leased by the CLEC for each relevant month; and (iv) the total amount the CLEC actually billed interexchange carriers for switched access in each relevant month. The minimum amount of UNE-P Credits is $500,000 and will not exceed $550,000. Qwest will make additional Voluntary Contributions in the amount of the difference between amounts actually paid for UNE-credits and the minimum.

Section 6 Additional Voluntary Contributions Under this Section, to the extent the credits paid by Qwest under Sections 3, 4 and 5 do not equal the set required minimum amounts, Qwest will pay the difference (the minimum amount less the actual amount paid) as additional Voluntary Contributions under Section 2. Qwest may deduct amounts attributable to Eligible CLECs that do not execute a release of all claims against Qwest for a period of one year from the Effective Date. Qwest can also deduct amounts due under Sections 3, 4 and 5 for any individual CLEC which brings a claim against Qwest within one year from the Effective Date.

Section 7 Reports on Credits This Section provides that within 240 days from the Effective Date, Qwest shall submit a written report to Staff demonstrating payment of the credits under sections 3 through 5.

Section 8 Retention of Independent Monitor Qwest agrees to pay for an independent, third party monitor selected by Staff to conduct an annual review of Qwest's Wholesale Agreement Review Committee for a period of three years. The Wholesale Agreement Review Committee determines which agreements are to be filed with the Commission to comply with the 1996 Act and the FCC standards.

Section 9 Compliance Training Qwest agrees to continue for three years its internal web-based Compliance Training Program which addresses compliance with Section 252(e).

Section 10 Opt-in For Eligible CLECs This Section provides that CLECs can opt into the non-monetary terms of certain un-filed agreements designated by Staff. In exercising this opt-in

right, the CLEC must satisfy the criteria under Section 252(i), including but not limited to, assuming any and all related terms in the agreement.

Section 11 Withdrawal of Federal Appeal Qwest agrees to dismiss its pending United States District Court appeal of the Commission's final Order, Decision No. 64922, in the Wholesale Pricing Proceeding, Docket No. T-00000A-00-0194, now pending in the US District Court for the District of Arizona (Case No. CIV 02-1626).

Section 12 Retention of Consultant For Implementation of Wholesale Rates This Section requires Qwest to pay for an independent consultant to provide independent assessments to the Commission of improvements made to automate Qwest's wholesale rate implementation process. The consultant will be hired within 90 days of the Effective Date of Commission approval and will be retained for three years. Staff, with input from Qwest and other parties, will determine the scope of the consultant's work.

Section 13 Cost Docket Governance Team This Section provides that the Qwest Docket Governance Team will continue for a period of three years from the Effective Date. This team is comprised of executive level personnel from organizations within Qwest with primary involvement and responsibility for wholesale cost docket implementation in Arizona. The purpose of the team is to provide both an oversight role and to serve as an escalation point for issues or obstacles that may arise during the implementation process.

Section 14 Notification of Wholesale Rate Changes To Commission and CLECs In this Section, Qwest agrees to provide prompt written notice of the status and time frames of wholesale rate implementation to the Commission and the CLECs.

Section 15 Wholesale Rate Implementation This Section requires Qwest to implement new rates within 60 days of the issuance of a Commission Decision that includes the final price list. Qwest shall file its initial compliance filing including a numeric price list within 14 days of a Recommended Opinion and Order.

Section 16 Filing of Settlement Agreements In this Section, Qwest agrees to file with the Commission any settlement agreements entered into in Commission dockets of general application within 10 days of execution.

Arguments For and Against the Settlement Agreement

Staff and Qwest believe that the Settlement Agreement reaches a reasonable and balanced resolution of the issues raised in each of the three Enforcement Dockets and is in the public interest. They believe it benefits ratepayers, the State and CLECs and prevents a recurrence of the problems giving rise to the litigation. Staff argues that absent the Settlement Agreement, any benefits to the public or CLECs would not be seen until after years of litigation. Qwest argues that requiring a larger penalty or finding of wrongdoing is a poor substitute for the practical measures that would be achieved through the immediate adoption of the Settlement.

Staff notes that the Settlement provides for substantial monetary payments of over $20 million by Qwest split between payments to the State Treasury, investments in projects to benefit consumers and various credits to Eligible CLECs. No other settlement presented to the Commission has involved this large a sum of money. CLECs will receive the credits without going through a lengthy and litigious process that might occur under Section 252(i)'s opt-in provisions or by bringing their claims in other forums. The Settlement specifies 28 interconnection agreements that are available for opt-in, 23 of which are terminated. In addition, Qwest is offering the 10 percent Discount Credit based on Section 251 services without also requiring CLECs to satisfy the volume and term commitments agreed to by Eschelon and McLeod. Qwest argues that offering CLECs credits without requiring them to assume all related terms and conditions in the underlying contracts is a significant concession. Likewise, the Section 5 UNE-P Credit is offered without requiring that CLECs be similarly situated to Eschelon.[8]

Staff believes that the non-monetary provisions of the Agreement are as important as the monetary payments. Staff asserts that the retention of an independent monitor and consultant will give the Commission a way to ensure that Qwest's newly established processes are adequate to prevent future violations. Staff also claims that provisions designed to improve Qwest's wholesale billing implementation processes will also benefit CLECs. Finally, the Agreement resolves the

[8] The agreement to pay Eschelon a per-line credit was expressly based on issues that resulted from Eschelon's receiving daily usage files through a manual (rather than mechanized) process as part of the UNE-Star platform. Under the Settlement, Section 5 credits are available to CLECs that received daily usage records through a mechanized process as part of the UNE-P platform.

appeal by Qwest of the Commission's final Decision in the Wholesale Cost Docket.

RUCO, AT&T, ADI, MTI and Time Warner participated in the hearing on the Settlement Agreement. They each opposed the Settlement, raising arguments that certain provisions are anti-competitive, unfair, unlawful, overly complicated and not a sufficient deterrent of future wrong-doing.

Issue: The Negotiating Process

The CLECs and RUCO criticized the negotiation process between Staff and Qwest that lead to the Settlement Agreement because it excluded all other parties from the talks until after Staff and Qwest had agreed to the principles of the agreement. After Staff and Qwest sought input from other parties, RUCO and the CLECs claim Staff and Qwest did not meaningfully modify the agreement based on criticisms. Both Time Warner and AT&T claim that Staff did not comply with Commission policy to file notice of settlement discussions three days prior to engaging in settlement talks.

In addition, the CLECs in particular, take issue with Staff's view that the underlying dockets are not about CLECs or CLEC assertions of economic harm, but rather about Qwest and its inappropriate behavior. They do not believe Staff adequately considered the CLEC position in negotiating the Settlement. The CLECs believe that Qwest's illegal behavior harmed competitors and competition, and the Agreement should either compensate CLECs more or make it easier for CLECs to obtain the benefits of the credits.

Staff defends the process that resulted in the Settlement. Staff claims critics give no weight to the fact the underlying dockets are all enforcement dockets initiated by Staff or the Commission against Qwest, and thus, it was not unusual for Qwest to approach Staff, and for these two parties to have initial discussions to determine if settlement were possible. Staff denies that CLECs were denied an opportunity to meaningfully participate in crafting the Settlement. Staff states that if it was presented with a compelling argument regarding the need to change a Settlement principle, Staff would have pursued the issue with Qwest.

Staff states that if these cases had been about actual CLEC compensatory damages claims, then the CLECs would have had to establish their damages with certainty. Staff recognizes that CLECs were disadvantaged or discriminated against as a result of Qwest's conduct, thus Staff

included penalties to benefit CLECs in the 252(e) and Wholesale Billing OSC dockets, but Staff claims in settling these dockets with Qwest it is not required to adopt a penalty designed to redress any and all alleged CLEC harm.

Staff states that the Commission's current policy regarding providing notice of settlement discussions, adopted at its February 8, 2001 Open Meeting, does not apply to enforcement dockets, but only to large rate cases and merger dockets. Staff argues there are valid reasons to distinguish rate cases from enforcement dockets. In rate cases, intervenors often have a direct economic stake in the outcome, but that direct interest often is not present in enforcement dockets. A requirement that Staff may not talk to any respondent without notifying and involving all intervenors may not be productive or desirable in every enforcement action as it may chill settlement discussions and serve no legitimate purpose. Staff believes that even in large rate cases and mergers, some discretion must be left with Staff to determine how best to effectuate the policy.

Issue: Aggregate Value of Settlement and Overall Amount of Penalties

AT&T believes that the penalties provided for in the Settlement Agreement are inadequate. Staff originally recommended aggregate penalties for the three underlying dockets totaling $22,651,000. ($15,047,000 in the 252(e), $7,415,000 in the 271 sub-docket and $189,000 in the Show Cause proceeding). AT&T argues that the total cash payment to the General Fund as contemplated under the Settlement Agreement, only one quarter of Staff's original recommended penalties, is inadequate. Moreover, AT&T believes that based on the evidence of the intentional and egregious nature of Qwest's conduct, Staff's recommendations were too low in the underlying dockets.

Staff believes that a Settlement with a value of over $20 million is more than adequate. Staff also believes that the non-monetary provisions of the Settlement provide significant benefits to consumers, CLECs and the public. According to Staff, the fact that consumers and CLECs will receive the benefits of the Settlement immediately, rather than after years of litigation, weigh in favor of approval.

Staff argues that the focus of the underlying Enforcement Dockets has been on Qwest's conduct and not upon the identification and remedy of individual CLEC harm or economic damages.

Staff argues that identifying individual CLEC harm, or damages or competitive harm is not within the scope of the underlying proceedings and would not be possible with any precision.

Staff believes that the Settlement Agreement is a critical component in restoring the integrity of the Commission's processes and should be considered in conjunction with important measures already taken by the Commission, including the Commission's holding Qwest's Section 271 application in abeyance pending its investigation into the un-filed agreements, and conducting a Supplemental Workshop in July, 2002 that allowed CLECs who believed they had been precluded from participating in the Section 271 process to put their issues into the record for Commission resolution.

Qwest argues that the Commission's ability to impose criminal contempt penalties in the underlying dockets is in doubt, and moreover, that the Commission does not have the ability to impose fines on a daily basis in any event under A.R.S. § 40-424.

Issue: Voluntary Contributions

Time Warner questions the legality of the "Voluntary Contributions" under Section 2 of the Settlement because it is unclear whether the Commission has the constitutional or statutory authority to assess a penalty and use the proceeds to fund yet-to-be-identified projects. The Arizona Constitution specifies that civil penalties are to be paid into the state's general fund, unless otherwise provided by statute. If the $6 million to be set aside for "Voluntary Contributions" is in reality a redirected penalty, Time Warner asserts, the Commission is exceeding its authority as it has no constitutional authority to divert penalty payments from the general fund. In addition, because the Commission has no authority to appropriate money directly, the Settlement arguably contemplates a direct appropriation by the Commission of public funds.

AT&T criticizes the Voluntary Contributions as artificially inflating the value of the settlement and giving Qwest credit for legal obligations it already has, or forces new obligations on Qwest that are unrelated to the issues raised in these proceedings. AT&T argues that if the Commission believes that education, economic development or infrastructure investment is necessary, and it has the constitutional and statutory authority to address these issues, it should do so on the record, with an explanation as to why doing so is just, reasonable and in the public interest. If

Qwest has legal obligations to serve unserved or underserved areas, the Commission should initiate a show cause proceeding to determine why Qwest is not serving such areas. AT&T argues Staff should not be using these proceedings to force Qwest to serve areas it has no legal obligation to serve.

Several parties note that as a result of the Voluntary Contributions, Qwest will own and operate and earn a return on any investment in facilities in unserved areas, and that Qwest would receive goodwill and tax deductions from any charitable contributions. AT&T argues that these are not penalties. RUCO, too, argues that the proposed penalty is not representative of the actual amount that Qwest will be penalized if it is allowed to earn a return on investments made from the voluntary contributions. RUCO recommends that Qwest not be able to earn a return on its "Voluntary Contributions."

AT&T argues that because Qwest testified it will not have a construction budget for 2004 until December 2003 or January 2004, and Qwest can easily manipulate the budget on the expectation that the Voluntary Contributions in the Settlement Agreement will be approved. Thus, there will be no way for Staff to prove that Qwest omitted a planned investment it later submits for consideration as a Voluntary Contribution.

AT&T further argues the Voluntary Contributions do not promote the benefits of competition of consumer choice and lower rates. AT&T argues the investment contemplated under the Settlement will serve only a limited number of consumers, not the service territory as a whole. Furthermore, to the extent future investments are contemplated to involve broadband, current federal rules do not require Qwest to provide CLECs access to that portion of its network.

RUCO believes that Qwest has made promises in the past that it would make additional investment in underserved areas, and that Qwest is not promising anything new under the Settlement. Because of past promises, RUCO recommends that Qwest be required to commit to an acceptable timetable when broadband services will be available in the underserved areas.

Staff argues that the Voluntary Contributions required under the Settlement Agreement are lawful and in the public interest. The $6 million associated with Section 2 is not in the form of monetary payments being made to the Commission or CLECs. Staff asserts that the funds to be paid under Section 2 for infrastructure and educational programs, unlike Sections 1, 3, 4 and 5 do not

involve any monetary payments or credits. Staff believes another important distinction is that Qwest is making these contributions and investments voluntarily to benefit consumers. Staff asserts the Voluntary Contributions are not a direct appropriation of public funds by the Commission, as the Commission receives no funds under the Settlement, and if it receives nothing under the Settlement Agreement, it has nothing to appropriate.

Qwest notes that Time Warner's identification of potential problems with the legality of the Voluntary Contributions is "tentative." Qwest argues that neither Time Warner nor case law suggests that there is any basis for concluding that the Voluntary Contributions in this case could be considered an "appropriation" from the treasury. Qwest argues that the Voluntary Contributions cannot reasonably be considered penalty payments when no penalty has been assessed and no findings of fact nor conclusions of law have been made upon which the penalty could be based. Qwest says that the Settlement includes the maximum cash payment on which the parties could reach agreement, and there is no basis to conclude the Voluntary Contributions are redirected penalty payments. Qwest states its willingness to fund the projects contemplated under Section 2 is no more a redirected penalty than Qwest's willingness to fund the independent monitor provided for in Section 8 or the consultant provided for in Section 12.

Staff argues that the Voluntary Contributions provide direct benefit, through infrastructure investments and educational projects, to consumers who were adversely affected by Qwest's conduct. According to Staff, criticism of the Voluntary Contributions on the grounds that Qwest would benefit from certain contributions or investments is not well-founded because the Settlement is silent on rate base treatment. Staff emphasizes that it is up to the Commission to determine how the investments will be dealt with for rate base and rate case purposes. Qwest argues that in allocating the Voluntary Contributions, the Commission is able to weigh the benefits to ratepayers with any potential public relations or tax benefits to Qwest, and that Staff is capable of monitoring Qwest's compliance. Furthermore, to the extent Qwest's revenue is likely to be determined by its rate base, the allowable return is largely within the Commission's discretion.

Issue: Finding of wrong-doing

RUCO argues that monetary penalties are not sufficient to deter Qwest from future wrong-

doing. Based on past experience, RUCO believes that the Company considers regulatory fines as a cost of doing business. In this case, RUCO believes that a large fine would only have a minimal impact and not deter Qwest from engaging in similar behavior. RUCO advocates that the Commission hold Qwest accountable for its conduct by making findings that Qwest acted illegally.

RUCO argues that findings of wrong-doing are necessary to restore the integrity of the Commission's process. RUCO argues that the Settlement leaves the public with the impression that the Commission is more interested in the money than in defending its process and deterring future conduct. RUCO believes that without findings of wrongdoing and an Order proscribing such conduct, it will be difficult for the Commission to enforce future unlawful conduct. RUCO argues that an Order that adopts the Settlement would only allow the Commission to invoke its contempt powers for failing to comply with the Settlement's explicit requirements, but findings that Qwest acted illegally and interfered with and obstructed its process would be the basis for the Commission to order Qwest to cease such conduct. Specifically, RUCO recommends that any Order approving the Settlement include Conclusions of Law finding that Qwest's failure to file interconnection agreements between Qwest and McLeod and Qwest and Eschelon violated 47 U.S.C. § 252(e) and A.A.C. R-14-2-1112, and that Qwest engaged in a practice of discriminatory conduct in violation of A.R.S. §§ 13-1210, 13-1211 and 40-203. RUCO also recommends that the Commission make findings that Eschelon and McLeod engaged in a scheme with Qwest to defraud this Commission, the public and other CLECs.

In addition, RUCO recommends that the Commission specifically order Qwest to cease engaging in discriminatory conduct and cease scheming to defraud the Commission. Such a finding would also prevent Qwest from arguing in future proceedings before this Commission that there was never a finding of wrong-doing. It also would send the message that wrong-doers can not buy their way out of difficulties.

Staff argues that the Settlement Agreement, without a finding of wrongdoing, does not adversely affect the Commission's ability to invoke its contempt powers for any violation under A.R.S. § 40-424. Staff points to the fourth clause of the Settlement which contains an acknowledgement by Qwest that violations of the Commission's Order approving the Settlement may

be punished by contempt after notice and hearing.

Qwest argues that RUCO fails to explain how a finding of wrongdoing would enhance the Commission's civil contempt power and fails to cite any legal authority that would provide clarification. Qwest asserts that RUCO fundamentally misconceives the nature of the contempt power. Qwest argues that in order to be enforceable by contempt an order must be directed at specific and definite conduct. Qwest asserts the language of the Settlement Agreement sufficiently specifies and defines such conduct. Qwest argues the Commission's civil contempt authority is significantly narrower than the Commission's general enforcement power, and the findings RUCO seeks would do nothing to change that.

Issue: CLEC Credits

The CLECS and RUCO argue that the provision of the Settlement Agreement offering credits to CLECs do not adequately resolve CLEC claims of harm and, contrary to their intent, would lead to additional litigation.

Uncertainty Resulting from Credits

AT&T asserts that although Staff and Qwest may have obtained some certainty as a result of the Settlement, the CLECs have not, and are faced with having to file complaints with the Commission to settle their claims.

ADI argues that the proposed Settlement, with all its qualifying circumstances and other issues of proof, leaves the CLECs unsure of what compensation or eligibility may be disputed by Qwest, and that such uncertainty would lead to more disputes and hearings. Moreover, ADI states that the smaller CLECs were the most directly hurt by Qwest's anti-competitive conduct and are the least likely to be able to afford litigation post-settlement.

ADI advocates the elimination of the caps on the CLEC credits. ADI notes that the CLECs do not have access to any data confirming the total amount of claims, as only Qwest has this information, but CLECs are taking all the risk that Qwest underestimated the amounts. If the maximums are eliminated, ADI argues, CLECs can evaluate the amount of the settlement based on their knowledge of their own claims, without having to weigh the unknown risk that other CLECs claims may cause their own claims to be discounted. ADI asserts that Qwest should bear the risk that

it has underestimated the credits, not CLECs.

Scope of Services Included in Discount Credits

CLECs believe that fairly recompensing CLECs for harm caused by Qwest has been, and should be, a central concern of the Commission in these dockets.

Time Warner and AT&T complain that the 10 percent discount proposed on Section 251(b) and (c) services does not include all the services on which Eschelon and McLeod received discounts. They along with RUCO believe the Discount Credit should be expanded to include, at a minimum, intrastate services. (RUCO advocates including purchases of both intrastate and interstate services.) Eschelon and McLeod received discounts on Section 251(b) and (c) services, intrastate and interstate switched access, special access and private line, and all other services Eschelon and McLeod purchased from Qwest. The CLECs claim there is no reason to limit the remedy and scope of the discount that the other CLECs would receive. Since not all CLECs purchase the same services or have the same product mix, eliminating certain services will treat all CLECs differently. Thus, as AT&T argues, the remedy as structured is inherently discriminatory. To remedy past discrimination and harm, all services must be included.

Time Warner agrees that the effect of limiting the remedy to certain services is enormous for carriers like it. Time Warner competes with Eschelon and McLeod for similar customers. While Eschelon and McLeod were "favored" CLECs, Time Warner claims it lost ground as a competitor. Because Time Warner did not buy a significant volume of Section 251(b) and (c) services during the discount period, Time Warner would receive only $26,877 under the Settlement, however if Time Warner were given a ten percent discount on all service for the same period, the amount paid by Qwest would be twelve times this much. Time Warner is particularly troubled by the fact that Staff did not analyze how the proposed discounts would affect individual CLECs. Time Warner notes the harm affected all CLECs who purchased services from Qwest, but the remedy benefits only those CLECs who purchased 251(b) and (c) services from Qwest.

MTI notes that the minimum amount of $8,100,000 to be paid in Discount Credits to CLECs may sound like a substantial amount, but that based on the record, it does not appear that Qwest's compensation to Eligible CLECs will be anywhere close to that amount. Although MTI

acknowledges that the difference between the amount actually paid to CLECs and the $8,100,000 would be added to the amounts paid as "Voluntary Contributions," amounts Qwest would pay as Voluntary Contributions yield tax benefits and/or revenue-producing infrastructure.

Staff argued that the Commission has the authority to include intrastate services, including special and switched access charges and private line services in the 10 percent discount even though they are not 251(b) or (c) services. Staff cautions, however, that the Commission should consider that no party pursued a tariff discrimination claim during the course of this proceeding and Staff is still considering bringing a separate action against Qwest based on illegal discounts on a tariffed rate.

Qwest argues that the Settlement Agreement is not discriminatory as all CLECs are treated the same under the credits. The fact that the amount of the credit will vary from CLEC to CLEC is a function of the CLECs' different business models and not an indication that the credit discriminates among carriers.

Furthermore, Qwest argues the scope of the discount credits mirrors the litigation which addressed Qwest's compliance with Section 252. The discount credits were crafted to address the alleged harm to CLECs from a Section 251 and 252 perspective. As a result, Qwest states, CLECs will receive differing amounts because the remedy parallels the alleged harm suffered by each specific CLEC. Qwest asserts that if a CLEC did not typically purchase Section 251(b) or (c) services from Qwest, then it was not injured by the conduct at issue in the litigation.

According to Qwest, because Section 252(e) does not create a filing obligation for non-252(b) and (c) services, basing the credits on purchases of Section 251 (b) and (c) services alone is appropriate. Qwest argues that whether Eschelon or McLeod may have received a discount for intrastate wholesale purchases from Qwest does not expand the scope of the CLECs' opt-in rights under Section 252. Qwest argues that the Commission does not have jurisdiction to order Qwest to provide discounts on interstate services. Qwest also argues that the Commission cannot order a refund based on non-Section 251(b) and (c) services without violating the filed rate doctrine, which prevents the Commission from retroactively changing a tariffed service, such as switched access rates. Qwest argues that the proper remedy under the filed rate doctrine is to require the carriers receiving the different rates to refund the amounts of the alleged discounts.

Similarly, Qwest argues that A.R.S. §40-334 which requires a public service corporation to provide impartial service and rates to all its customers similarly situated does not apply in this case as no CLEC demonstrated in the Section 252(e) hearing that they were similarly situated to Eschelon or McLeod, and thus could not have suffered discrimination under A.R.S. § 40-334 to justify the inclusion of intrastate access in the Discount Credits. Moreover, Qwest argues, the likely remedy for a violation of A.R.S. § 40-334 is not to reproduce the alleged benefit to every customer in the market, but more likely to require Eschelon and McLoud to disgorge any benefits they received that were not available to similarly situated CLECs.

AT&T responds that CLECs were not similarly situated as Eschelon and McLeod because Qwest purposely structured the Eschelon and McLeod agreement so other CLECs were not similarly situated. AT&T states the structure was a sham and should be disregarded. AT&T is bothered greatly by Qwest's apparent argument that it can willfully violate federal and state law, prevent CLECs from participating in Commission proceedings and when it gets caught, the Commission cannot structure a remedy to address the harm to other CLECs but must force McLeod and Eschelon to give back the discounts. AT&T notes that courts have the latitude to make exceptions and distinctions to general rules based on unique facts. AT&T argues that assuming for the sake of argument that the filed rate doctrine applies, the facts of this case cry out for a unique remedy.

Retrospective Discount vs Prospective Discount

AT&T argues that the discount should be based both on retrospective and prospective CLEC purchases of services. AT&T argues that although the Commission may not have jurisdiction to include interstate claims in the Discount Credits, it can order retroactive and prospective discount to approximate the harm done to CLECs.

Staff and Qwest argue that a prospective discount that does not include Eschelon and McLeod would be discriminatory. If Eschelon and McLeod were included in a prospective discount, the discount would fail to address the alleged harm or level the playing field for other CLECs.

AT&T's witness recognized the problem with a prospective discount, but recommended that the benefit of having the discount apply to future purchases was important enough to allow Eschelon and McLeod to participate.

Length of Credits

AT&T argues that the credits should be extended for a period of 23 months, the length that the McLeod agreement was in effect. RUCO recommends that the credits apply for a three year period. ADI argues the credits should be extended to the full five-year term of the Eschelon agreement, to allow CLECs to participate in the full economic benefit of Qwest's secret agreements, including early termination payments.

Qwest asserts that the Discount Credits are consistent with the scope of the Section 252(e) Docket. Staff argues too that terms for the discounts longer than 18 months (the time that Eschelon and McLeod received the discount) also raises discrimination issues.

Simplicity of Credits

AT&T is concerned about the documentation required from CLECs to make a claim for the Access Line and UNE-P Credits. Because the period subject to recovery is so long ago, retrieval and production of documentation could be difficult. AT&T recommends that the greatest possible flexibility be afforded to CLECs in substantiating the basis for the credits.

ADI asserts that there is no practical purpose served by making the CLECs prove to Qwest they had trouble with Daily Usage Files ("DUFs") when Qwest is already aware of and does not deny that it has had trouble providing accurate DUFs to CLECs. ADI argues it is unfair to require CLECs to prove the existence of calls which were not properly recorded at the time by Qwest. ADI believes that the procedures for payments to the CLECs under Sections 3, 4 and 5 of the Settlement should be streamlined and initially based on the numbers Qwest has already generated. ADI recommended that instead of going through CLEC by CLEC and addressing document production, proof and accounting issues one by one, the average payment per line per month made by Qwest to Eschelon should be used as a proxy for the amount of credit owing to each CLEC.

ADI also argues that CLEC credits should not be limited to "credits" but should be made as cash payments if the CLEC has insufficient ongoing business to justify the "credit" method of payment. In addition, ADI asserts Qwest should not be allowed to apply the "credits" to an outstanding bill that is the subject of a good faith billing dispute by the CLEC. Furthermore, ADI argues that Qwest should be required to pay pre-and post- judgment interest on the amounts being

paid back to CLECs. Finally, ADI advocates that the Settlement contain a dispute resolution clause and consent to jurisdiction provision to minimize future potential litigation with Qwest over whether a claim should be in state court, federal court, the Arizona Corporation Commission or the FCC. ADI believes that the Commission is the proper forum for resolution of any disputes related to the Settlement.

Qwest is amenable to amending the Agreement consistent with ADI's suggestion to credit CLECs for Access Line and UNE-P Credits based on proxy amounts. Qwest clarifies, however, that this change would apply to all CLECs requesting credits under Sections 4 and 5, and Qwest would not agree to offer CLECs a choice between the proxy amounts or the current calculation. Furthermore, to be eligible for the Section 5 Credit, even using the proxy numbers, CLECs must have leased UNE-P lines from Qwest for each relevant month and have actually billed interexchange carriers for switched access during the relevant time period. Qwest does not believe that the remainder of ADI's proposed modifications are necessary.

Issue: ADI's claim

ADI advocates that the Commission include in its Order a finding that sets the amount of ADI's claim. ADI states that throughout the process Qwest has been unwilling to commit that ADI is an "Eligible CLEC" or to the amount of ADI's claim under Section 3. To remove that uncertainty, ADI wants the Commission to make a specific finding that ADI, and other CLECs participating in the hearing are "Eligible CLECs" under the terms of the Settlement. In addition, Qwest has informed ADI that it is eligible for a Section 3 Discount credit of $319,004. ADI states it does not dispute this amount and thus, it should be included as a specific finding.

ADI also desires to opt in to the non-monetary provisions of the Global Crossing agreement (one of the agreements that Staff identified that Qwest should have filed pursuant to Section 252(e)). ADI wants to opt into the portion of the Global Crossing agreement that rolled back the date of Global Crossing's UNE-P conversion to April 15, 2000. ADI wants to use the earlier UNE-P conversion date for the purpose of calculating the amount of Section 4 and 5 CLEC Credits in the Settlement Agreement.

Qwest argues that ADI's attempt to backdoor eligibility for the UNE-P Credits must fail.

First, ADI was reselling PAL lines and, as such, was not entitled to convert to UNE-P PAL until the FCC ordered that UNE be used for payphone lines. Second, Section 10 of the Settlement would allow Eligible CLECs to opt into only non-monetary provisions related to Section 251(b) and (c) services, and if opting into a provision would result in any exchange of money, as in the case of ADI's request, such provision would not qualify as "non-monetary" and would not be available for opt-in under Section 10. Third, even if the conversion date and retroactive wholesale pricing were non-monetary, ADI would be eligible to opt-in to that provision only if they satisfied the criteria under Section 252(i) that they must be similarly situated and willing to accept all related terms and conditions. Qwest states that the Global Crossing agreement makes it clear that Global Crossing had submitted to Qwest requests for conversion of its lines to UNE-P and was in dispute with Qwest regarding the proper charges for the lines. Qwest states it does not appear that ADI was in a similar situation at that time. Finally, Qwest argues that even if ADI were to opt into the conversion date in the Global Crossing agreement, it would not be eligible for the UNE-P Credits if it were not actually billing interexchange carriers for switched access during the relevant time period.

ADI argues that Qwest's interpretation of Section 10 of the Settlement Agreement is illusory. Moreover, at the hearing, Qwest's witness, Mr. Ziegler, testified that from a business perspective, this term was non-monetary and subject to opt-in under Section 10 of the Settlement. ADI argues that since all parties operate for economic reasons and motives, it would be very difficult to imagine a term that a CLEC might want to opt-in to that wouldn't have a positive economic benefit to the CLEC. Thus, under Qwest's interpretation there would be virtually no terms available for opt-in. ADI disputes, too, Qwest's claims that it did not repeatedly request Qwest to convert its wholesale discount payphone lines to UNE-P provision and that Qwest repeatedly refused and failed to do so.

Issue: The Release

CLECs criticized the Release of Claims that Qwest had initially circulated among the parties as being overly broad. AT&T complained that Qwest and Staff limited the Discount Credit to Section 251(b) and (c) services, but Qwest's Release of All Claims required the CLECs to release Qwest from all intrastate discriminatory and unlawful conduct.

ADI argues that the release should be narrowly defined for each of the three credit sections to

include only the claims that are the basis of the particular credit and limited to the time periods applicable for each credit section, and the CLEC should only be required to sign-on to a release for the particular credit basket for which that CLEC is participating in.

Qwest attached a revised draft release to its Opening Brief, which it claims comports with the actual language of the Agreement, and that CLEC criticism of the earlier version does not apply to the revised version. Qwest asserts that the release does not require the CLECs to release any claims they may have relating to the purchase of interstate services.

Qwest rejects ADI's suggestion that CLECs should be able to select only part of the credits and execute a more limited release based only on the credits it opts to receive. Qwest argues such suggestion is not reasonable and that CLECs may choose to participate fully in the Settlement or to not participate in the Settlement at all and pursue any claims against Qwest independently. Qwest argues they should not be able to pick and choose among the terms of the Settlement Agreement. Qwest states the revised release is a reasonable quid pro quo in exchange for the credits CLECs are entitled to under the Agreement.

AT&T, Time Warner and ADI continue to have concerns about the revised release. AT&T recommends that the release should specifically state the CLECs are not releasing any interstate claims for discrimination they may have because of Qwest's agreements with McLeod and Eschelon. In addition, AT&T and Time Warner note the revised release specifically states the CLEC releases all claims for Section 251(b) and (c) services purchased in Arizona and all other intrastate services purchased by the CLEC. The CLECs argue that CLECs should not have to release all intrastate claims to receive payment on their Section 251(b) and (c) claims. ADI argues the claims released should only be those that form the basis of the Sections 3, 4 and 5 credits. Time Warner notes too, that it appears that Staff and Qwest have not reached agreement on a revised release, thus, it is difficult for CLECs to comment on the reasonableness of the release when it is not apparent that the settling parties have agreed upon its terms.

ADI is concerned too that if a CLEC does not dispute Qwest's numbers for a Section 3 Credit, but disputes the Section 4 and 5 credit calculations, Qwest should not be able to hold the Section 3 credit hostage to the disputes over the other credits. Yet, ADI argues, having a single release for all

credits will hold up payment on all credits until all disputes are resolved. Thus, ADI argues, the integration clause that Qwest has proposed which purports to divorce the release document from the context of this global settlement is inappropriate, and is not in the public interest.

Analysis and Resolution

The Process

Generally, this Commission encourages parties to resolve disputes consensually. This policy promotes the public interest as it conserves resources, saves time and can lead to creative solutions that often can maximize the benefits to the public. In the past, where there are multiple parties participating in a docket, the Commission has urged Staff to ensure that any settlement process is as open as possible. Such openness promotes confidence in the process, protects due process and can improve efficiency by considering differing points of view that are best advanced by individual parties. In large rate cases and mergers, the Commission has expressed a policy that Staff should file a notice in the docket at least three days prior to engaging in settlement talks.

In this case, Staff and Qwest first engaged in bi-lateral settlement discussions before inviting other parties to participate. Other parties were not excluded, but were invited to the table later. While this approach did not violate any law or Commission rule or policy, it led to much criticism by those parties who were initially excluded from discussions. The negotiating process in this case did not violate any party's rights nor should it invalidate the Agreement, however, allowing intervenor participation at an earlier date would have eliminated the need to address criticisms of the process, and allowed us to focus solely on the merits of the Settlement. Inviting all parties to participate in the settlement discussions from the beginning, may have resulted in a settlement that more than two parties could agree to, and would not necessarily have precluded the Agreement that was eventually reached.

We urge Staff and any party to a multi-party proceeding to carefully consider the appearances of propriety when engaging in any settlement discussions. Our policy in large rate cases and mergers is designed to dispel any notions that settlements are the result of closed door secret negotiations. We believe that Staff should consider whether the policy is well-served in other docket types as well.

Staff states it did not have an obligation to consider CLEC harm because these were

enforcement dockets brought by Staff and not complaints. However, it was AT&T in March 2002 that filed a Motion in the Section 271 Docket asking the Commission to investigate Section 252 compliance and who in October 2002 wrote to the Commission about Qwest's delay in implementing the new wholesale rates. The record in the Section 252(e) docket shows that throughout that proceeding Staff had advocated remedies that produced benefits to CLECs. Those benefits were the equivalent of a direct economic interest, even if not considered to be monetary penalties, and in this case, it seems reasonable for CLECs to have relied on Staff's recommendations in lieu of bringing their own discrimination cases. In addition to considering the appearance of propriety, Staff should consider the interests of any intervenors in exercising its discretion whether notice of settlement discussions is warranted in a particular case. We do not mean to prevent Staff from one-on-one discussions in any enforcement docket, but merely encourage Staff to consider the appearances of propriety and the interests of any intervenors.

The Settlement Agreement

We find that the proposed Settlement Agreement is not a fair and reasonable resolution of the issues raised in the three dockets and is not in the public interest. The reasonableness of the Settlement should be measured against all of the evidence in the record. The Commission has completed hearings and post-hearing briefing in two of the three underlying dockets. The third (the Section 271 Sub-docket) involves the same facts as the Section 252 investigation, however, the Commission has not held hearings on the allegations contained in the Staff Report because Staff and Qwest reached their agreement before a hearing had been set, and Qwest withdrew its request for a hearing pending the outcome of the Commission's consideration of the Settlement Agreement.

The record in the Section 252(e) docket supports a finding that Qwest violated Section 252(e) of the 1996 Act, R14-2-1307, R14-2-1506 and R14-2-1508 when it failed to file the 28 agreements listed on Exhibit B and the 14 agreements it filed in September 2002 and which were approved in Decision 65745. These agreements contain on-going obligations related to Section 251 (b) and (c) services. We are not persuaded by Qwest's arguments that the agreements did not have to be filed because they have been terminated, are form contracts, or did not involve Section 251(b) or (c) services. We agree with Staff that "form" contracts that contain terms and conditions not contained

in the interconnection agreement do not fall under the FCC's exemption of form contracts from the filing requirements. (Staff's Initial Brief in Section 252 proceeding at p.10-11) We also find that provisions related to reciprocal compensation arrangements, operator services, directory services and ICNAM services are Section 251(b) and (c) services. (Id. at 12-13) In addition, we concur with Staff's position that agreements relating to Section 251 (b) and (c) services, that are later formalized or superceded by other agreements should be filed if they are not superceded within the filing deadline. Id. at p.14.

Furthermore, the evidence shows that Qwest intentionally and willfully violated Section 252(e) of the 1996 Act, A.R.S. § 40-203, 40-334 and 40-374, and A.A.C. R14-2-1112, R14-2-1307, R14-2-1506 and R14-2-1508 when it entered into, and failed to file, agreements with Eschelon and McLeod that gave these CLECs discounts off all their purchases from Qwest, including Section 251(b) and (c) services, as well providing these CLECs with escalation procedures not granted to other carriers.

The evidence shows that the agreements with Eschelon for consulting services and with McLeod for purchases which Qwest claims were not subject to Section 252 requirements, were shams designed to hide the true nature of the agreements. Qwest argues that its accounting treatment of the payments to McLeod and Eschelon are consistent with purchase contracts rather than discounts. We find that Qwest's accounting treatment is not conclusive as to the true nature of the agreement and that the preponderance of the evidence indicates that indeed the agreements under which Qwest purchased services or products from McLeod or Eschelon were calculated attempts to provide favorable pricing on the UNE-Star product. (RUCO Initial Section 252 Brief at pp 27-39)

The evidence indicates that Qwest did not want the McLeod "discount" to appear in an agreement that would have to be filed with a state commission and become public. By filing the Fourth Amendment to the McLeod Interconnection Agreement which indicated a price for the UNE-M conversion, but not including all of the terms of the conversion to UNE-M, Qwest made the UNE-Star product appear more expensive than it had actually been for McLeod. The public version of the UNE-Star agreement states that McLeod had to pay $40 million to Qwest to convert to UNE-Star, while un-filed agreements show that Qwest gave back much of that amount to McLeod.

Likewise, the consulting agreement with Eschelon was a sham arrangement designed to hide the true purpose of the discount. The 10 percent discount was not tied to the amount of consulting services that Eschelon was to provide, but rather was based on the amount of Eschelon purchases. Eschelon could provide no consulting services and still receive a 10 percent discount on Section 251 services. Moreover, if Eschelon did not meet its minimum take-or-pay commitment, then all of the discount would return to Qwest regardless of how much consulting Eschelon performed for Qwest. Furthermore, there is no evidence of documents supporting the assertion that Eschelon provided consulting services under the agreement. In a letter dated May 15, 2002 to the Minneapolis Office of Administrative Hearings, Eschelon states that Qwest treated the consulting agreement as a "sham almost immediately." Richard Smith, Eschelon's president, stated that the idea that Eschelon could provide consulting services was an afterthought, as a mechanism to bring down the cost of the UNE-Star product and that Qwest did not take offered consulting services. Mr. Smith stated that Qwest was concerned that other CLECs would attempt to opt into the lower (i.e. discounted) UNE-Star prices. (RUCO Initial Section 252 Brief at p 41-48)

The preponderance of evidence in the OSC proceeding supports a finding that Decision No. 64299 required Qwest to implement the wholesale rates approved in that Decision within a reasonable amount of time, and that by not implementing the rates until December 15, 2002, and not notifying the Commission or CLECs of the delay in implementation, Qwest violated the Commission's Decision.

Because Qwest withdrew its request for a hearing in the Section 271 sub-docket only on the condition that the Commission accept the Settlement Agreement, the record in that docket is not fully developed, and we do not make an ultimate finding concerning the allegations of interference with the regulatory process raised in that docket. This does not prevent us from evaluating the Settlement Agreement.

Given the extensive record in the three dockets and our conclusions concerning Qwest's culpability in the Section 252 and OSC dockets where we have a complete record, the question becomes does the Settlement Agreement provide a fair and reasonable resolution that is in the public interest. We believe that it does not and do not approve the Settlement Agreement as proposed.

One of our primary concerns with the Settlement Agreement is that Voluntary Contributions which provide a substantial portion of the value of the Settlement, are not good public policy and are potentially unlawful under Arizona law. Qwest and Staff tout this Settlement as having a value of over $20 million. The cost to Qwest, however, will not approach that amount, as a significant portion of the Settlement's value stems from the Voluntary Contributions which yield significant benefits to Qwest. Although we recognize that the Voluntary Contributions may provide benefits to Arizona consumers, Qwest, itself, will derive a significant benefit, either through goodwill and charitable tax deductions or through increased revenue producing assets. Given the nature of Qwest's conduct with respect to the Eschelon and McLeod agreements, such result is perverse. Under the terms of the Settlement Agreement, at least half, and probably more, of the cost to Qwest under this Settlement would be in the form of Voluntary Contributions. We do not believe that it is appropriate that Qwest should be rewarded with community goodwill, tax benefits and revenue producing investment as a result of its conduct in these cases.

Moreover, given our findings of culpability in the Section 252 and OSC dockets, it appears disingenuous to claim that the Voluntary Contributions are not re-directed penalties. Qwest would not be making these contributions or investments absent the allegations raised in these dockets. The Settlement calls for the Commission to approve the contributions and investments which is further indication that they are not truly voluntary. It is not good public policy to allow Qwest to buy its way out of a finding that it violated state and federal statutes, regulations and orders by making self-serving investments and contributions.

We appreciate Staff's creative approach to devising a way to meet concerns that telecommunication investment in parts of the state are lacking and to promote consumer awareness of competition in the telecommunications market, however, after careful consideration of all the issues in these matters, we do not believe this is the appropriate docket to address Qwest's infrastructure investments. We have concerns that our approval of infrastructure investment may have anti-competitive results. Approving Qwest investments in unserved and underserved areas or for unregulated services, increases Qwest's position in these markets to the potential ultimate detriment of competition. We acknowledge that it is possible there are investments that the Commission could

approve that would not favor Qwest over its competitors, but the record does not provide sufficient information to determine what investments or contributions would be fair and appropriate in advance of knowing what projects may be proposed. In addition, we are concerned that it will be difficult to determine if the investments would not have been made in any case, and we can envision disputes arising involving interested parties over which projects or contributions are appropriate.

Even though we are not approving the Settlement Agreement, because the record in the Section 252(e) and OSC dockets are complete, we are able to finally resolve these two dockets at this time. We will order the Hearing Division to schedule a hearing, as Qwest has requested, in the Section 271 sub-docket.

Monetary Penalties

Prior to the Settlement Agreement, Staff advocated penalties of over $15 million[9] in the Section 252 docket and $189,000 in the OSC. In each of these dockets Staff believed it was important to assess substantial penalties against Qwest because of the egregious nature of Qwest's conduct and to ensure that Qwest would comply in the future.

We believe that based on the records in the underlying dockets, administrative penalties in the amount of $11,000,000 for Qwest's intentional willful violation of Section 252(e) and Arizona law is appropriate. Qwest's conduct of failing to provide the Commission complete information when requesting approval of Interconnection Agreements shows contempt on Qwest's part.[10] Our finding is well within the range of penalties Staff recommended in the Section 252(e) docket.[11]

In addition to the penalties for its intentional and willful violation of Section 252, Arizona law and Commission rules related to the Eschelon and McLeod agreements, Staff recommended penalties totaling $47,000 based on A.R.S. §40-425 for Qwest's failure to file 23 agreements with carriers

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[9] The penalties in the Section 252(e) docket were in addition to Staff's recommended non-monetary penalties that Qwest provide discounts to CLECs.

[10] After October 26, 2000, Qwest submitted Interconnection Agreements or amendments for McLeod, which the Commission approved in Decision Nos. 63248 (December 14, 2000) and 63335 (February 2, 2001). Qwest did not disclose the existence or terms of the un-filed agreements with McLeod. Qwest's deliberate failure to file or notify the Commission of the terms of the "secret agreements" when it sought approval of its interconnection agreements and amendments calls into question the Commission's ability to rely on information provided by Qwest.

[11] In the Section 252 docket pursuant to A.R.S. § 40-424, Staff calculated the Commission could impose a penalty between $884,800 and $44,240,000. Staff recommended a penalty of $15,000,000.

other than Eschelon and McLeod. We concur with Staff that Qwest should have filed these agreements, that this obligation arises directly from the language of Section 252 and that Qwest should have known it was obligated to file them. Because unlike the case with the Eschelon and McLeod agreements, the failure to file appears to be a result of a misunderstanding of the requirements of Section 252 rather than a willful attempt to avoid the filing requirements, Staff's recommended penalties of $47,000 are reasonable and should be adopted.

In the OSC docket, pursuant to A.R.S. § 40-424, Staff recommended fines of $750.00 per day for Qwest's failure to notify the Commission of its rate implementation delay and failure to obtain approval of the delay; and $750 per day for its unreasonable prioritization of states ahead of Arizona. Staff's recommended fines totaled $189,000, based on a total of 126 days. We find that Staff's recommended penalties in that docket are reasonable and should be adopted.

We recognize that in the OSC docket, Qwest challenged the ability of the Commission to impose fines on a "per-day" basis under A.R.S. § 40-424.[12] Qwest argues that because A.R.S. § 40-424 does not explicitly provide for per-day penalties, such power cannot be inferred. Qwest also argues the Arizona Constitution does not grant the Commission the authority to impose per-day penalties. Finally, Qwest relies on the legislative history of A.R.S. § 40-425, in which the legislature revised the statute to specifically eliminate the reference to allowing violations that continue from day to day to be deemed separate and distinct offenses. Qwest argues the history of A.R.S. § 40-425 shows that the Arizona legislature deliberately omitted the authority to assess day-to-day penalties when it adopted A.R.S. § 40-424 because it included that ability in A.R.S. §40-425.

Article 15, Section 16 of the Arizona Constitution provides that:

> If any public service corporation shall violate any of the rules, regulations, orders, or decisions of the Corporation Commission such corporation shall forfeit and pay to the State not less than one hundred nor more than five thousand dollars *for each such violation*, to be recovered before any court of competent jurisdiction. (emphasis added)

Qwest would have us read the italicized words of Section 16 as precluding a finding that each day a violation is outstanding constitutes a separate violation. The language of Article 15, Section 16 is

[12] Qwest did not raise this argument in the Section 252 proceeding.

not as restrictive as Qwest argues. It does not preclude finding that a separate violation can occur for each day the corporation is not in compliance with a rule, regulation or order of the Commission. Neither do we believe that the legislative history of A.R.S. § 40-425 necessarily allows any conclusion to be made about the legislative intent behind A.R.S. § 40-424, the statute at issue here. In any case, our interpretation of A.R.S. § 40-424 has never been overruled. As a practical matter, interpreting the statute as Qwest argues means that once a public service corporation fails to comply with a Commission order or violates a statute, there is no incentive to comply because the greatest a penalty would be is $5,000 whether the violation lasted one day or one thousand days.

By failing to file the Eschelon and McLeod agreements, Qwest denied each of the telecommunication carriers certificated in Arizona at the time an opportunity to opt-into those agreements. As an alternative to imposing penalties for Qwest's violations on a per-day basis under A.R.S. § 40-424, we believe that the Commission has authority to impose penalties based on a finding that Qwest incurred a separate violation for each of the 804 telecommunications carriers certificated in Arizona at the end of 2000 who were denied an opportunity to opt-in. A.R.S. § 40-425 allows the imposition of fines between $100 and $5,000 for each violation, consequently the Commission could impose a penalty between $80,400 and $4,020,000, for each of the agreements that it should have filed but didn't. Similarly, when Qwest failed to implement the wholesale rates approved in Decision No. 64922 in a timely fashion, it failed to implement 500 separate UNE rates. Each one of the rates not implemented timely is a separate violation of Qwest's obligation under Decision No. 64922. Thus, pursuant to either A.R.S. §§ 40-425 or 40-424, the Commission could impose penalties between $50,000 and $2,500,000 for violating Decision No. 64922. Our imposition of penalties for Qwest's contempt of Commission Orders and rules totaling $11,236,000 is supported both by imposing a per-day penalty and by imposing a per-violation penalty.

Non-monetary Penalties

We understand and laud Staff's desire to level the competitive playing field and structure a remedy for the damage to competition that resulted from Qwest's secret agreements with Eschelon and McLeod. In the Section 252 proceeding, Staff recommended that Qwest be required to file all terminated agreements and make the terms of those agreements available to CLECs to opt-in to for

the same period of time the agreement was in effect with the initial contracting CLEC. CLECs would still be required to accept all legitimately related terms to receive the benefit of the selected terms. We believe Staff's recommendation in the Section 252 proceeding to be a reasonable attempt to remedy the harm caused by Qwest not filing these interconnection agreements.

In addition, to rectify the harm to competition caused by Qwest providing discounts to Eschelon and McLeod, Qwest should be required to provide each CLEC certificated in Arizona during the period October 1, 2000 to September 30, 2002, with a credit totaling 10 percent of its purchases of Section 251(b) and (c) services and all intrastate services including intrastate access from Qwest in Arizona from October 1, 2000 through September 30, 2002.

The underlying agreements with Eschelon and McLeod from which these discounts are derived, included all services purchased from Qwest, including Section 251(b) and (c) services, intrastate and interstate switched access, special access and private line services. This Commission does not have jurisdiction to order discounts on interstate services, however, we believe equity warrants applying these discounts to all purchases of Section 251(b) and (c) services, and intrastate services such as, but not limited to, switched access, special access and private line services. The Eschelon agreement was in effect from November 15, 2000 to March 2, 2002, a period of 17 months. (Kalleberg Direct, EX ,ST-2, p 20) The McLeod agreement was in effect from October 2, 2000 to September 19, 2002, a period of 23 months. (Kalleberg Direct, St-2, p. 37) The discounts we order herein are intended to reflect the time period that the Eschelon and McLeod agreements were in effect.

Although we are sympathetic to AT&T's argument that prospective credits provide a greater benefit to CLECs, to require Qwest to provide prospective credits to all CLECs except Eschelon and McLeod violates federal and state prohibitions on discriminatory rates. The alternative of requiring prospective rates, but allowing Eschelon and McLeod to participate, is not good public policy as it would allow Eschelon and McLeod to benefit as a result of involvement in illegal activity.

Qwest may provide the discounts to the CLECs in the form of credits, however, if an eligible CLEC is no longer doing business in Arizona, or does not do sufficient business in Arizona to utilize the credits within six months, Qwest should provide the discount as a cash payment.

The Discount Credits we order herein are intended to rectify the harm to competition in this state that resulted from Qwest's conduct. In addition to the Discount Credits, we find that other non-monetary remedies are appropriate to prevent future violations. Consequently, we find that it is reasonable to require the following: 1) Qwest to pay for an independent, third party monitor selected by Staff to conduct an annual review of Qwest's Wholesale Agreement Review Committee for a period of three years; 2) Qwest to continue for three years its internal web-based Compliance Training Program which addresses compliance with Section 252(e); 3) CLECs to be able to opt into the non-monetary terms of the 28 agreements listed in Exhibit B even if these agreements have terminated; 4) Qwest to retain an independent consultant for three years to provide independent assessments to the Commission of improvements made to automate Qwest's wholesale rate implementation process, with input from Staff and other parties to determine the scope of the consultant's work; 5) Qwest to continue its Docket Governance Team for a period of three years; 6) Qwest to provide prompt written notice of the status and time frames of wholesale rate implementation to the Commission and the CLECs; 7) Qwest to implement new rates within 60 days of the issuance of a Commission Decision that includes the final price list; and 8) Qwest to file with the Commission any settlement agreements entered into in Commission dockets of general application within 10 days of execution. [13]

ADI's Claims

Because we are not adopting the Settlement Agreement, we do not make a specific finding of whether ADI qualifies as an Eligible CLEC under the Settlement Agreement. If a CLEC such as ADI was certificated in Arizona at any time during the period October 1, 2000 to September 30, 2002, it would be eligible to receive the discount credits ordered herein. Pursuant to our November 7, 2002 Procedural Order, issues related to ADI's ability to opt into the Global Crossing agreement is an issue that is more appropriately addressed in Phase B of the Section 252(e) proceeding. There remain

[13] A.R.S. §40-423 provides that if a public service corporation acts in a manner declared to be unlawful or forbidden, by the constitution or laws of the state of orders of the Commission, that corporation is liable to the persons affected for all loss, damages or injury. And furthermore, recovery of damages shall not affect a recovery by the state of the penalties provided pursuant to chapter 40 of the Arizona Revised Statutes or the Commission's exercise of its power to punish for contempt.

issues of fact associated with ADI's ability to opt-into that particular agreement.

We do not believe that RUCO's suggestion that the Commission order Qwest to commit to a timetable for making broadband investment is appropriately made in this docket. If Staff believes that Qwest is failing to live up to an agreement to make certain investments, or that Qwest does not have adequate plant and facilities to provide adequate service, it is best addressed in a separate enforcement proceeding. The purpose of these dockets involves Qwest behavior concerning its filing obligations, its discriminatory actions, and with a Commission Order concerning the implementation of wholesale rates, including the consideration of the resultant harm, it is not about Qwest's investment in its network.

* * * * * * * * * * * *

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

FINDINGS OF FACT

1. In Decision No. 60218 (May 27, 1997) the Commission opened the Section 271 docket and established a process by which Qwest would submit information to the Commission for review and a recommendation to the FCC whether Qwest meets the requirements of Section 271 of the 1996 Act. Section 271 specifies the conditions that must be met in order for the FCC to allow a Bell Operating Company ("BOC"), such as Qwest, to provide in-region interLATA services. Section 271(d)(2)(B) requires the FCC to consult with state commissions with respect to the BOC's compliance with the competitive checklist.

2. By Procedural Order dated October 1, 1999, the Commission bifurcated its investigation into Qwest's compliance with Section 271 into Operational Support System ("OSS") related elements and non-OSS related elements. In a December 8, 1999 Procedural Order, the Commission instituted a collaborative workshop process to evaluate the non-OSS Checklist Items. Under the procedures of the December 8, 1999 Procedural Order, Staff submitted its report of findings and conclusions concerning issues raised in the workshops. If there were no disputed issues, Staff submitted its report directly to the Commission, but if disputes remained after the workshop process, the issues were submitted to the Hearing Division for resolution.

3. On March 8, 2002, after the Minnesota Department of Commerce raised allegations that Qwest was not complying with its obligation to file interconnection agreements for commission approval pursuant to Section 252(e) of the 1996 Act, AT&T filed a Motion with this Commission in the Section 271 docket asking the Commission to examine Qwest's compliance with Section 252 in the context of the Section 271 investigation.

4. By Procedural Order dated April 8, 2002, the Commission opened a separate docket to investigate Qwest's compliance with Section 252 of the 1996 Act.

5. On June 7, 2002, Staff filed a Report and Recommendation in the Section 252(e) docket, setting forth the results of its investigation and identifying agreements that it believed should have been filed by Qwest under Section 252(e).

6. At a June 19, 2002 Procedural Conference, after hearing additional allegations concerning possible oral agreements, the Commission broadened its investigation into Qwest's Section 252 compliance, and directed Staff to investigate whether the un-filed agreements had tainted the record in the then-on-going investigation into Qwest's compliance with Section 271 of the 1996 Act.

7. On August 14, 2002, Staff issued a Supplemental Report and Recommendation concerning Qwest's Compliance with Section 252(e). Staff recommended that a hearing should be held to determine whether Qwest acted in contempt of Commission rules by not filing certain agreements with McLeod and Eschelon with the Commission for approval. Staff recommended that issues related to whether the agreements had an adverse affect on the Section 271 investigation be conducted in a Sub-docket of the Section 271 proceeding, and further, that the Section 252(e) proceeding be separated into two phases, with Phase A addressing filing violations and Phase B addressing any opt-in disputes between Qwest and CLECs.

8. By Procedural Order dated November 7, 2002, the Commission set the Section 252(e) compliance issues for hearing. In addition, the Commission ordered parties to file comments on Staff's proposed Sub-docket procedures, including the need for a hearing, no later than December 10, 2002.

9. On December 12, 2002, in Decision No. 65450, the Commission issued an OSC

against Qwest. The OSC alleged that Qwest failed to implement the wholesale rate changes ordered in Decision No. 64922 (June 12, 2002) within a reasonable period of time, that Qwest failed to notify the Commission of the rate implementation delay, that Qwest failed to obtain Commission approval of the delay in implementation, and that Qwest's wholesale rate change system is unreasonably slow and inefficient.

10. By Procedural Order dated December 20, 2002, all letters, comments and data responses identified in Staff's August 14, 2002 Supplemental Report were made part of the Section 271 sub-docket record. Parties were given until January 10, 2003 to submit additional evidence.

11. By Procedural Orders dated November 7, 2002, January 3, 2003 and February 11, 2003, a schedule for filing testimony was set in the Section 252 proceeding. Qwest, RUCO and Staff filed testimony.

12. The hearing on Qwest's compliance with Section 252 commenced on March 17, 2003, and continued through March 20, 2003. Staff, Qwest and RUCO filed testimony in the Section 252 hearing. The parties filed Initial Briefs on May 1, 2003, and Reply Briefs on May 15, 2003.

13. On May 6, 2003, Staff filed its Report and Recommendation in the Section 271 Sub-docket. Staff identified agreements with four carriers (Z-Tel, Eschelon, McLeod and XO) which prohibited these carriers from participating in Qwest's Section 271 proceeding. Staff recommended penalties of $7,450,000 as a result of Qwest's intent to interfere with the regulatory process.

14. On May 19, 2003, Qwest filed Exceptions to the May 6, 2003 Staff Report and Recommendation and requested a hearing on the penalties proposed by Staff.

15. By Procedural Order dated June 19, 2003, the Commission scheduled a Procedural Conference for June 30, 2003 to discuss the nature of further proceedings in the Section 271 sub-docket.

16. Pursuant to a March 4, 2003 Procedural Order, the OSC hearing convened on June 13, 2003. AT&T, Staff and Qwest submitted testimony pursuant to the schedule set in the March 4, 2003 Procedural Order.

17. On June 27, 2003, Qwest and Staff filed a Joint Motion to Extend the Time for Procedural Conference, stating they were in the process of negotiating a settlement agreement that

involved the 271 Sub-docket. The Hearing Division vacated the procedural conference.

18. The parties filed post-hearing briefs in the OSC proceeding on July 15, 2003.

19. On July 25, 2003, Qwest and Staff filed a Notice of Filing Settlement Agreement and Request for an Expedited Procedural Conference. The Settlement Agreement purports to resolve all the issues raised in the three above-captioned enforcement dockets involving Qwest. A copy of the Settlement Agreement is attached hereto as Exhibit A, and incorporated herein by reference.

20. On July 29, 2003, Qwest and Staff filed a Joint Proposed Procedural Schedule.

21. A Procedural Order dated August 7, 2003 consolidated the three cases and reopened their records to consider the Proposed Settlement, established a schedule for testimony concerning the Settlement Agreement, and set the matter for hearing.

22. Pursuant to the Procedural Order, Staff and Qwest filed testimony on August 14, 2003; AT&T, RUCO, ADI and MTI filed testimony on August 29, 2003; and Qwest filed rebuttal testimony on September 8, 2003. Pursuant to the terms of the August 7, 2003 Procedural Order, Time Warner and WorldCom filed comments to the Settlement Agreement.

23. The hearing on the Settlement Agreement was held on September 16 and 17, 2003.

24. The parties filed initial post-hearing briefs on the Settlement on October 15, 2003 and reply briefs on October 29, 2003.

25. Section 252(e) of the 1996 Act requires Qwest to file all interconnection agreements with the Commission for approval.

26. Section 252(i) of the 1996 Act requires a local exchange carrier to make available any interconnection, service or network element provided under an agreement approved under Section 252 to any other telecommunications carrier upon the same terms and conditions as those provided in the agreement.

27. A.A.C. R14-2-1112 requires local exchange carriers such as Qwest to provide non-discriminatory interconnection agreements, and which agreements must be filed with the Commission for approval.

28. A.A.C. R14-2-1307 provides that local exchange carriers shall make essential facilities or services available under negotiated agreements or an approved statement of terms and conditions

which shall be filed with the Commission.

29. A.A.C. R14-2-1506 provides that interconnection agreements shall be submitted to the Commission for approval under Section 252(e) of the 1996 Act within 30 calendar days of execution.

30. A.A.C R-14-2-1508 provides that any amendments to interconnection agreements shall be filed with the Commission.

31. A.R.S. § 40-203 provides that the Commission shall determine and prescribe any rates, charges, classifications, practices or contracts of public service corporations that are unjust, discriminatory, preferential, illegal or insufficient.

32. A.R.S. §40-374 requires a public service corporation to charge the rates on file and shall not refund or remit in any manner any part of the rates, nor extend any form of contract or agreement except as offered to all persons and except upon order of the Commission.

33. A.R.S. §40-334 prohibits a public service corporation from granting preferences or advantage with respect to rates, charges, service facilities or in any other respect.

34. The 28 agreements listed in Exhibit B contain provisions related to on-going obligations concerning resale, UNEs, reciprocal compensation, interconnection and wholesale services in general under Section 251(b) and (c) of the 1996 Act and should have been filed pursuant to Section 252(e) for the reasons set forth in the testimony of Marta Kalleberg in the Section 252(e) proceeding. See Kalleberg testimony in section 252(e) proceeding at pp 25-64.

35. Qwest has not filed for Commission approval under Section 252(e) any of the agreements listed on Exhibit B.

36. As described herein, Qwest granted Eschelon and McLeod significant concessions to induce them to remain on Qwest's system, including: (1) a 10 percent discount[14] on all the carriers' purchases of Qwest services including, not limited to, Section 251(b) and (c) services, for 5 years in Eschelon's case and 3 years in McLeod's case; (2) the creation of the UNE-E and UNE-M product through which Eschelon and McLeod were able to avoid provisioning issues associated with UNE-P; and 3) more favorable escalation procedures, providing for a six-tier escalation process up to and

[14] The McLeod agreement provided for a discount of up to 10 percent.

including Qwest's CEO, than available to other carriers.

37. Qwest purposely structured the agreements with Eschelon and McLeod to avoid its filing obligations under Section 252(e).

38. By intentionally failing to file its agreements with Eschelon and McLeod that gave those two CLECs discounts on all of their purchases, including services specified under Section 251 (b) and (c), and which granted escalation procedures and favorable provisioning procedures not given to other carriers, Qwest willfully and intentionally violated the requirements of Section 252 of the 1996 Act, A.R.S. §§ 40-203, 40-374, 40-334 and A.A.C R14-2-1112, R14-2-1307, R14-2-1506 and R14-2-1508.

39. By providing discounts and escalation procedures to Eschelon and McLeod, Qwest impermissibly discriminated against other CLECs and harmed competition in Arizona.

40. In addition to the agreements with Eschelon and McLeod, Qwest entered into and failed to file 11 interconnection agreements with eight other CLECs, as identified in Exhibit B hereto, and 14 other agreements the Commission approved in Decision No. 65475 (December 19, 2002).

41. On or around October 26, 2000, McLeod and Qwest orally agreed that McLeod would remain neutral on Qwest's Section 271 application as long as Qwest was in compliance with all their agreements with McLeod and all applicable statutes and regulations. On November 15, 2000, Qwest and Eschelon entered into an agreement that provided during the development of their implementation plan, Eschelon agreed not to oppose Qwest's efforts regarding Section 271 approval or to file complaints before any regulatory body concerning issues arising out of the parties' interconnection agreements. On December 31, 2001, Qwest and XO entered into a Confidential Billing Settlement Agreement in which XO agreed to stipulate that Qwest was in compliance with Section 271 of the 1996 Act. On May 18, 2001, Qwest and Z-Tel entered into a stand-down agreement in which Z-Tel agreed to not participate in Section 271 proceedings for a period of 60 days while Z-Tel and Qwest negotiated interconnection agreements in eight states.

42. Decision No. 64299, with an effective date of June 12, 2002, required Qwest to implement the wholesale rates approved in that Decision immediately.

43. On October 7, 2002, AT&T sent a letter to the Commission expressing concerns about

the length of time to implement the lower rates approved in Decision No. 64299.

44. Qwest did not implement the rates approved in Decision No. 64299 until December 15, 2002, six months after the effective date of Decision No. 64299.

45. By not implementing the rates approved in Decision No. 64299 until December 15, 2002, and not notifying the Commission or CLECs of the delay in implementation, or requesting an extension of time, Qwest violated the Commission's Decision.

46. Qwest's wholesale rate change system in effect at the time of Decision No. 64922 was unreasonably slow and inefficient.

47. To prevent future violations it is reasonable to require:

a. Qwest to pay for an independent, third party monitor selected by Staff to conduct an annual review of Qwest's Wholesale Agreement Review Committee for a period of three years;

b. Qwest to continue for three years its internal web-based Compliance Training Program which addresses compliance with Section 252(e);

c. CLECs to be able to opt into the non-monetary terms of the 28 un-filed interconnection agreements identified in Exhibit B even if these agreements have been terminated;

d. Qwest to retain an independent consultant for three years to provide independent assessments to the Commission of improvements made to automate Qwest's wholesale rate implementation process, with input from Staff and other parties to determine the scope of the consultant's work;

e. Qwest to continue its Docket Governance Team for a period of three years;

f. Qwest to provide prompt written notice of the status and time frames of wholesale rate implementation to the Commission and the CLECs;

g. Qwest to implement new rates within 60 days of the issuance of a Commission Decision that includes the final price list; and

h. Qwest to file with the Commission any settlement agreements entered into in Commission dockets of general application within 10 days of execution.

48. A.A.C. 14-2-1109 and 14-2-1110 establish the procedures for changing rates of competitive telecommunications services, and provide that the rates must be above the total service long-run incremental cost of providing the service and that the carrier must provide the Commission with notice of the price change.

49. The evidence shows that with respect to the McLeod and Eschelon agreements, Qwest charged rates other than the tariffed rates approved by the Commission. Staff has indicated it is considering bringing a separate action against Qwest based on illegal discounts on tariffed rates.

CONCLUSIONS OF LAW

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

2. The Commission has jurisdiction over Qwest and of the subject matter of Qwest's compliance with Sections 252 and 271 of the 1996 Act, the OSC, and the Settlement Agreement attached hereto as Exhibit A.

3. Notice of the proceedings was given in accordance with the law.

4. The preponderance of evidence indicates that Qwest violated the provisions of Section 252 of the 1996 Act by entering into the 28 interconnection agreements identified in Exhibit B and the 14 interconnection agreements approved in Decision No. 65745 and not filing these agreements with the Commission for review.

5. Qwest's failure to file the agreements discussed herein with Eschelon and McLeod, more specifically identified as agreements nos. 3-10, and nos. 12-16 on Exhibit B, was a willful and intentional violation of Section 252 of the 1996 Act, A.R.S. §§ 40-203, 40-334, 40-374, and A.A.C R14-2-1112, R14-2-1307, R14-2-1506 and R14-2-1508.

6. By failing to implement the rates approved in Decision No. 64922 until December 15, 2002, and not informing the Commission or CLECs that implementation of the rates would be delayed or requesting an extension time to implement the rates, Qwest violated Decision No. 64922.

7. In light of the record in these matters, the Settlement Agreement is not a fair and

reasonable resolution of the issues raised and is not in the public interest.

8. The monetary and non-monetary penalties adopted herein are reasonably calculated to penalize Qwest for its violations of federal and state law and Commission rules, regulations and Orders and to deter and prevent such conduct from occurring in the future.

ORDER

IT IS THEREFORE ORDERED that approval of the Settlement Agreement between Qwest and Commission Staff attached hereto as Exhibit A is denied.

IT IS FURTHER ORDERED that Qwest Corporation shall cease and desist from violating Section 252 of the 1996 Act, A.R.S. §§ 40-203, 40-374, 40-334 and A.A.C. R14-2-1112, R14-2-1307, R14-2-1506 and R14-2-1508.

IT IS FURTHER ORDERED that pursuant to Article 15, Section 16 of the Arizona Constitution, A.R.S. §§ 40-424 and 40-425, Qwest Corporation shall pay as and for an administrative penalty the sum of $11,000,000 on account of its intentional and willful violation of Section 252 of the 1996 Act, A.R.S. §§ 40-203, 40-374, 40-334 and A.A.C R14-2-1112, R14-2-1307, R14-2-1506 and R14-2-1508 within 30 days of the effective date of this Decision.

IT IS FURTHER ORDERED that in addition to the penalties prescribed above, pursuant to Article 15, Section 16 of the Arizona Constitution, and A.R.S. §§ 40-425, Qwest Corporation shall pay as and for an administrative penalty the sum of $47,000 for its failure to file for Commission approval the 28 agreements identified in Exhibit B and the 14 agreements approved in Decision No. 65745, other than the agreements with Eschelon and McLeod.

IT IS FURTHER ORDERED that pursuant to Article 15, Section 16 of the Arizona Constitution, A.R.S. §§ 40-424 and 40-425, in addition to the penalties prescribed hereinabove, Qwest Corporation shall pay as and for an administrative penalty the sum of $189,000 for its violation of Decision No. 64922.

IT IS FURTHER ODERED that the administrative penalties shall be made payable to the State Treasurer for deposit in the General Fund for the State of Arizona.

IT IS FURTHER ORDERED that Qwest shall file with the Commission for its approval the interconnection agreements identified in Exhibit B hereto.

IT IS FURTHER ORDERED that the terms of the interconnection agreements ordered to be filed herein as well as those filed for approval in September 2002 and approved in Decision No. 65475, shall be available for opt-in upon Commission approval, and that the terms shall be available for the same period of time as they were available to the originally contracting party regardless of whether such agreements are currently in effect.

IT IS FURTHER ORDERED that Qwest Corporation shall provide each CLEC, certificated in Arizona at any time during the period October 1, 2000 to September 30, 2002, with a credit totaling 10 percent of its purchases of Section 251(b) and (c) services and all intrastate services from Qwest Communications Corporation or Qwest Corporation, and their affiliates, in Arizona from October 1, 2000 through September 30, 2002, and that if such CLEC does not currently do sufficient business in Arizona to utilize its full credit within six months, Qwest shall make a cash payment to such CLEC for the balance of the credit to which it is entitled.

IT IS FURTHER ORDERED that Qwest Corporation shall pay for an independent, third party monitor to be approved by Staff to conduct an annual review of Qwest's Wholesale Agreement Review Committee for a period of three years.

IT IS FURTHER ORDERED that Qwest Corporation shall continue for three years its internal web-based Compliance Training Program which addresses compliance with Section 252(e); CLECs to be able to opt into the non-monetary terms of the un-filed interconnection agreements even if these agreements have been terminated.

IT IS FURTHER ORDERED that Qwest Corporation shall retain an independent consultant for three years to provide independent assessments to the Commission of improvements made to automate Qwest's wholesale rate implementation process, and that Staff and other interested parties shall have input to determine the scope of the consultant's work.

IT IS FURTHER ORDERED that Qwest Corporation shall continue its Docket Governance Team for a period of three years.

IT IS FURTHER ORDERED that Qwest Corporation shall provide prompt written notice of the status and time frames of wholesale rate implementation to the Commission and the CLECs.

IT IS FURTHER ORDERED that Qwest Corporation shall implement new wholesale rates

within 60 days of the issuance of a Commission Decision that includes the final price list.

IT IS FURTHER ORDERED that Qwest Corporation shall file with the Commission any settlement agreements entered into in Commission dockets of general application within 10 days of execution.

IT IS FURTHER ORDERED that the Hearing Division shall schedule a hearing in the Section 271 Sub-docket.

IT IS FURTHER ORDERED that Staff shall refer the issue of illegal discounts on interstate rates to the proper federal authority.

IT IS FURTHER ORDERED that Staff shall bring a separate action in Phase Two of this proceeding for the purpose of addressing Qwest's discriminatory rates.

IT IS FURTHER ORDERED that Staff shall consider bringing an appropriate action against McLeod and Eschelon and shall consider any other appropriate referrals.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN MCNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this day of _____, 2003.

_____
BRIAN MCNEIL
INTERIM EXECUTIVE SECRETARY

DISSENT _____

DISSENT _____

JR:mlj

SERVICE LIST FOR: QWEST CORPORATION

DOCKET NO.: T-00000A-97-0238
RT-00000F-02-0271
T-01051B-02-0871

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