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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

DOCKETED

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IN THE MATTER OF QWEST  
CORPORATION'S FILING AMENDED  
RENEWED PRICE REGULATION PLAN

DOCKET NO. T-01051B-03-0454

MOTION TO CLARIFY, OR IN THE  
ALTERNATIVE, TO TERMINATE  
PRICE CAP PLAN

Qwest Corporation ("Qwest") moves the Arizona Corporation Commission (the "Commission") for an order clarifying Decision No. 63487 in the above-captioned matter ("Decision") and the Settlement Agreement and Price Cap Plan approved therein.<sup>1</sup> Qwest requests that the Commission clarify that after the expiration of the initial term of the Price Cap Plan (on March 30, 2004), the following conditions apply until the Commission enters an order approving a revised plan or setting new rates for Qwest:

1. No further adjustment of the Price Cap Index for Basket 1 Services will be made pursuant to 2(b) of the Price Cap Plan after March 30, 2004;
2. No further annual reduction in the level of access charges under the Settlement Agreement and the Price Cap Plan will be made after April 1, 2003; and
3. The procedures for changes in Qwest's rates and charges, including the hard caps imposed on specific Basket 1 Services, continue to apply until superceded by a revised plan approved by the Commission or a Commission order setting new rates and charges for Qwest.

<sup>1</sup> The Settlement Agreement and the Price Cap Plan approved in the Decision will be referred to herein as the "Settlement Agreement" and the "Price Cap Plan" or "Plan," respectively.



1 Plan required revision. To date, Qwest has not proposed any specific amount of  
2 adjustments in these caps.

3 Also in support of its July filing, Qwest filed financial and other information as  
4 required by the Settlement Agreement. The financial information filed by Qwest was based  
5 on its unrestated results for 2002. On October 16, 2003, Qwest Communications  
6 International Inc. ("QCI"), Qwest's parent company, filed with the SEC its updated  
7 financial statements. Qwest is preparing updated financial statements for its Arizona  
8 regulated operations and will file them when they are available.

### 9 ARGUMENT

10 The initial term of the Price Cap Plan expires on March 30, 2004. The parties to the  
11 Settlement Agreement and Price Cap Plan contemplated that a revised plan would be  
12 approved and in place by the end of the Plan's initial term. For numerous reasons Qwest  
13 has concerns whether a new plan will be ready for adoption by the Commission prior to the  
14 expiration of the initial term of the Price Cap Plan. The purpose of this motion is to clarify  
15 the regulatory framework that will govern Qwest between the end of the initial term of the  
16 Price Cap Plan and the adoption of a revised plan or new rates. Qwest will also indicate  
17 how it believes this matter should proceed from this point forward.

18 Qwest has operated under the Settlement Agreement and Price Cap Plan since their  
19 approval. The Price Cap Plan divided Qwest's services into 3 baskets: (1) Basic/Essential  
20 Noncompetitive Services, (2) Wholesale Services and (3) Flexibly Priced Competitive  
21 Services. Particularly relevant for purposes of this motion are three provisions of the  
22 Settlement Agreement and Price Cap Plan. First, under the Price Cap Plan, on April 1 of  
23 each year of the initial term of the Plan, Qwest was required to calculate a revised Price Cap  
24 Index for Basket 1 and adjust the revenue cap (and rates) in Basket 1 to reflect the  
25 operations of the agreed-upon productivity minus inflation factor on the Price Cap Index.  
26 Second, the Settlement Agreement and Price Cap Plan provided for a three-year \$15 million

1 reduction in Qwest's intrastate access rates with a corresponding increase in the revenue cap  
2 on Basket 3. Third, the Price Cap Plan contains a provision that provides that the Plan  
3 continues in effect until the Commission approves a revised plan, an extension of the Plan,  
4 or an order declaring the Plan to be terminated.

5 **I. Market Conditions Have Changed Dramatically Since Adoption of the Plan**

6 The Settlement Agreement, and in particular, the Price Cap Plan, represented an  
7 experiment in moving from rate-of-return regulation to price regulation. Both Qwest and  
8 Staff agreed, with the approval of the Commission, to undertake a form of regulation that  
9 had not previously been used in Arizona. The Price Cap Plan was not, and could not have  
10 been, imposed on Qwest. Indeed, the purpose of the Settlement Agreement and Plan was to  
11 attempt a new regulatory paradigm. The parties contemplated that the Plan would be  
12 revisited in three years in light of changes in the marketplace that would occur during that  
13 time and the experience of the parties under the Plan.

14 Qwest has informed the Commission of its intention to seek modifications of the  
15 Price Cap Plan because conditions in the marketplace have changed dramatically since  
16 2000, when the record was developed that led to the Plan's creation. It is both necessary  
17 and appropriate that the Plan be modified to reflect the reality of today's intensely  
18 competitive local telecommunications markets.

19 In many cases, it should be noted, the changes sought by Qwest are consistent with  
20 terms of the *original* proposed Settlement Agreement that were modified by the  
21 Administrative Law Judge and/or by the Commission itself. In the end, Qwest was  
22 willing to accept something less than that original proposed Settlement Agreement in the  
23 interest of making the transition to price regulation, but with the expectation that if  
24 changes needed to be made following the initial three-year term, they would be. Qwest  
25 would not, and could not, have accepted the Price Cap Plan (or any plan) that would, in  
26 effect, continue in perpetuity; nor would such a plan be consistent with Qwest's

1 constitutional right to earn a fair return.

2 For example, in substantially reducing the flexibility for Basket 3 Services to  
3 which Qwest and Staff had agreed, the Commission held that “[g]iven the current early  
4 stage of competition, we believe that it is critical that whenever Qwest desires to combine  
5 a Basket 1 service with a Basket 3 service, that request should be subject to all of the  
6 provisions of a filing under R14-2-1108.” Decision at 15 (emphasis added). Whether or  
7 not Qwest agreed with the Commission’s view that competition was at an “early stage” in  
8 2000, it cannot be said that competition is at an early stage today.

9 The competitive reality is that Qwest’s competitors are well established in  
10 Arizona. This reality is evident in the *fact* that:

- 11 • There are currently 64 CLECs certificated in Arizona;
- 12 • CLECs are collocated in 48% of Qwest’s central offices;
- 13 • CLECs currently purchase 111,759 UNE-P lines and 39,874 unbundled loops from  
14 Qwest; and
- 15 • CLECs provide resold services to 6,169 access lines in Arizona.

16 Intermodal competition is thriving as well. For example:

- 17 • Cox Communications has widely deployed its digital telephone services  
18 throughout Phoenix and Tucson and offers a package of fifteen features and a  
19 residence line (the Cox Solution Package) for a rate of \$26.70 per month. This  
20 deployment has taken place largely over the past three years in Phoenix and over  
21 the last ten months in Tucson. Given the relatively short duration of Cox’s  
22 deployment in Tucson, competition in Arizona will only increase in the coming  
23 months.
- 24 • There are 20 wireless companies competing directly with Qwest for both business  
25 and residential customers and those companies have over 2.8 million lines in the  
26 State (as compared to 2.4 million for Qwest). In addition, wireless prices have  
fallen and wireless usage has increased significantly since 2000.
- New platforms are also being deployed in Arizona. For example, Vonage is now  
offering its Voice over Internet Protocol (“VoIP”) service in Phoenix where it  
advertises:



1 new environment.

2 Qwest has also proposed that the Price Cap Plan including the Basket 1 revenue  
3 cap be adjusted to permit Qwest to adjust rates in a manner that will permit it to earn a  
4 reasonable return on the fair value of its property devoted to providing public service in  
5 Arizona. Qwest has not yet proposed a specific revenue cap adjustment or any specific  
6 price increases, but intends to work with Staff and other parties on these issues.

7 As a revised price cap plan is developed and discussed, a key issue becomes what  
8 are the ground rules governing Qwest from the end of the initial term of the existing Plan  
9 to the adoption of a revised one or the setting of new rates for Qwest. The next sections  
10 of this motion address how the Plan applies after March 30, 2004, and the procedure  
11 proposed by Qwest for further proceedings in this docket.

12 **II. The Parties To The Settlement Agreement And The Price Cap Plan Intended It**  
13 **To Be In Effect For 3 Years and Not to Continue Automatically And**  
14 **Indefinitely.**

15 Both the Plan and Settlement Agreement repeatedly reference a three-year term for  
16 the Plan. Initially, the Settlement Agreement Recitals provide, in part, that “by adopting the  
17 Price Cap Plan, the Parties intend to avoid the need for any general rate proceeding for the  
18 next three years . . .” Settlement Agreement Recitals at 1.

19 Paragraph 4 of Settlement Agreement mentions the three-year term and the  
20 procedure for renewal or amendment of the Plan on multiple occasions. For example,  
21 Paragraph 4 states, “The term of the Price Cap Plan shall be three years from the effective  
22 date as specified in the Commission’s Order approving this Agreement and Price Cap Plan.  
23 Settlement Agreement ¶ 4 at 4. It further provides that “Nine months prior to the expiration  
24 of the Price Cap Plan, Qwest will submit an application with its recommendation for  
25 extension, or revision of the Price Cap Plan for review by Staff, [RUCO], and the  
26 Commission.” Settlement Agreement ¶ 4 at 5. “Renewal or modification of the Price Cap  
Plan at the end of the initial term is subject to approval by the Commission.” Settlement

1 Agreement ¶ 4 at 6.

2 Paragraph 7 of the Settlement Agreement imposes a rate moratorium on any  
3 adjustment to Qwest's general rates and charges "during the initial term of the Price Cap  
4 Plan." Settlement Agreement ¶ 7 at 8. The Settlement Agreement requires that the  
5 Commission extend this "Rate Proceeding Moratorium Period" "for any "additional period  
6 of extension or revision of the Price Cap Plan" that it approves. *Id.*

7 Paragraph 6 of Price Cap Plan affirms its "initial term of three years at the end of  
8 which Qwest may propose to either: (i) Renew the Price Cap Plan under the current terms  
9 and conditions; or (ii) Renew the Price Cap Plan with proposed revisions." Price Cap Plan  
10 ¶ 6 at 6. Notably, under Paragraph 6 continuation of the current terms and conditions does  
11 not occur absent Qwest's proposal and the Commission's approval. *Id.* ("Nothing herein  
12 shall affect the Commission's jurisdiction or authority to determine the most appropriate  
13 from of regulation for Qwest at the end of the three year term . . ."). In addition, Paragraph  
14 6 provides that "Whether and under what terms and conditions to renew the Price Cap Plan  
15 will be determined by negotiations among Staff, Qwest, and other parties subject to the  
16 Commission's approval." *Id.*

17 The Decision itself recognizes that the Price Cap Plan has a limited term of 3 years.  
18 Decision at 4. It further acknowledges the requirement that Qwest submit an application for  
19 the continuation or modification of the Price Cap Plan 9 months prior to its expiration.  
20 Decision at 6. Notably, the Decision provides that "Continuation or modification of the  
21 Plan is subject to Commission approval and the Plan remains in effect pending a  
22 Commission decision renewing, modifying or terminating it." *Id.* The Decision, however,  
23 recognizes that certain terms contained in the Price Cap Plan were not intended to continue,  
24 inadvertently creating a "Catch-22" scenario for the benefit or detriment of any party,  
25 during this interim period (after the expiration of the three-year term when the Plan is under  
26 review and reconsideration). For example, in discussing the Productivity Factor contained

1 in the Settlement Agreement, the Decision states “The Price Cap Plan is for only three  
2 years, and if the Commission finds Qwest has, or is expected to, enjoy greater productivity  
3 gains than it has in the past, this factor, as well as other terms of the Agreement, can be  
4 adjusted.” Decision at 10-11. Likewise, the Decision recognizes that “Although the  
5 Settlement Agreement professes a goal of reaching parity between Qwest’s intrastate and  
6 interstate switched access charges, it does not, at least in its initial three year term reach that  
7 goal.” Decision at 12. The Decision goes on to recognize that the goal of achieving parity  
8 between intrastate and interstate switched access rates must ultimately be addressed by the  
9 Commission in other proceedings. *Id.*

10 At the Commission’s open meeting in which the Settlement Agreement and Price  
11 Cap Plan were adopted, the parties reiterated this understanding. The Administrative Law  
12 Judge (“ALJ”) who recommended such adoption confirmed this interpretation by stating  
13 that the Settlement Agreement required Qwest to submit an application for its continuation  
14 or modification nine months prior to its expiration, for review by Staff and RUCO. Open  
15 Meeting Transcript, Vol. 1 at 9 (March 7, 2001). She noted that continuation or  
16 modification of the Price Cap Plan was subject to Commission approval, and that the Plan  
17 remained in effect pending a Commission decision renewing, modifying or terminating it.  
18 *Id.* Counsel for RUCO stated “At the end of three years it’s very unclear to me whether this  
19 Commission would be evaluating the fair value of the company and determining the price  
20 cap plan at the end of the three years.” Open Meeting Transcript, Vol. I at 212 (March 7,  
21 2001). Qwest itself expressly noted the necessity of a review of the end of the Plan’s term.  
22 Open Meeting Transcript, Vol. I at 214 (March 7, 2001).

23 The testimony provided in support of the Settlement Agreement and the Price Cap  
24 Plan supported such statements. Qwest witness, Maureen Arnold, testified that the Plan’s  
25 reporting requirements were designed to “permit the Commission to monitor the Price Plan  
26 while it is in effect and to determine at the end of the Price Plan’s initial term whether it

1 should be renewed.” Direct Testimony of Maureen Arnold (October 20, 2000) at 6. *See*  
2 *also*, Rebuttal Testimony of Maureen Arnold (November 20, 2000) at 4-5. At hearing, Ms.  
3 Arnold again asserted that at the end of three years, the locked-in rates established by the  
4 Price Cap Plan could potentially be renewed or modified by the Commission for an  
5 additional three years. Hearing Transcript (November 29, 2000) at 81.

6 Staff’s witness also noted that although the Plan placed limits directly on the prices  
7 Qwest would charge for service, it would run for only three years, after which extension by  
8 the Commission was necessary. Direct Testimony of Harry M. Shooshan III (October 27,  
9 2000) at 6. At hearing, Staff’s own counsel, elaborated:

10 There are important safeguards also built into the price cap  
11 plan. The price cap plan will expire after three years, at  
12 which time it will be subject to full review by the  
13 Commission, and any of its provisions can be adjusted at that  
14 time. Nothing in the agreement will affect the Commission’s  
15 jurisdiction or authority. If, at the end of the plan, it should  
decide to terminate price cap regulation and go back to  
traditional rate of return regulation, the Commission has that  
authority, of course.

16 Hearing Transcript (November 29, 2000) at 60. Diane Bacon of the CWA characterized the  
17 Price Cap Plan as “a three-year trial to create pricing flexibility that should encourage  
18 competition and open the Arizona telephone industry.” Hearing Transcript (November 29,  
19 2000) at 43. She further noted that the nine months prior to the expiration of the Plan were  
20 intended to arrive at a recommendation concerning its extension, revision or termination.

21 *Id.*

22 The Price Cap Plan contains a provision that requires an annual resetting of the Price  
23 Cap Index for Basket 1. Price Cap Plan ¶ 2(b). This provision, however, does not apply  
24 after the expiration of the initial three-year term of the Settlement Agreement and the Price  
25 Cap Plan.

26 In discussions between Qwest and Staff, Staff has indicated that it believes that the

1 all provisions of the Price Cap Plan, including the annual productivity/inflation adjustment  
2 to the Price Cap Index in Basket 1, continue in effect indefinitely until the Commission  
3 enters an order renewing, revising or terminating the Plan.<sup>2</sup> Staff relies on the following  
4 language from Paragraph 4 of the Settlement Agreement:

5 Renewal or modification of the Price Cap Plan at the end of the  
6 initial term is subject to approval by the Commission. Until the  
7 Commission approves a renewal or modified Price Cap Plan, or  
8 orders termination of the Plan after its term, the Plan including  
the hard cap on Basket One Services set forth in paragraph  
2(c) (i) shall continue in effect.

9 This language, however, was intended to serve a limited purpose. The language  
10 permits a grace period after the initial term of the Plan expires and before the Commission  
11 approval of a new price cap plan is put into place. The language does not and was not  
12 intended to permit the Plan to be extended indefinitely simply by the Commission taking no  
13 action on a proposed revised price cap plan or rate application. As is clear from the record  
14 in the previous docket discussed above, the parties to the Settlement Agreement intended  
15 the Price Cap Plan to be an experiment. It was always understood that after the initial term  
16 of the Price Cap Plan expired, there would be no automatic renewal of the Plan but a  
17 process by which the Plan would be renewed, modified or terminated. An interpretation of  
18 the Settlement Agreement that permits the Price Cap Plan to continue indefinitely is simply  
19 inconsistent with the intent of the parties to the Agreement.

20 Although Qwest' rates under the Settlement Agreement and Price Cap Plan,  
21 including the hard caps on specified services, may certainly remain in place to preserve the  
22 status quo pending the adoption of a new price cap plan or the setting of new rates, any  
23 continuation of the Plan in its entirety, by inaction of the Commission or without Qwest's  
24

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25 <sup>2</sup> Staff has also indicated that it believes that the Settlement Agreement and Plan call for further  
26 annual reductions in access charges until the Plan is revised or terminated. Staff's position is  
addressed in the next section of this motion.

1 consent, including further automatic reductions in the revenue cap for Basket 1 would  
2 potentially pose a constitutional problem.<sup>3</sup> It is clear from the language of the Settlement  
3 Agreement and the testimony in the docket that the parties contemplated that Qwest could  
4 be kept under price cap regulation past the expiration of the Plan's initial term only if Qwest  
5 and the Commission both agreed.

6 The Price Cap Index Adjustment provision, by its express language, was limited to  
7 the three-year term. The Index was designed as an experiment that would necessarily  
8 require review and adjustment at the end of three years. Its application beyond the three-  
9 year term was clearly not contemplated. Decision at 10. The Commission should clarify  
10 that the provision of the Price Cap Plan providing for further adjustments in the Basket 1  
11 revenue cap based on the productivity/inflation mechanism terminates on March 30, 2004.

12  
13 **III. The Decrease In Access Charges Under the Settlement Agreement And Price**  
14 **Cap Plan Is Limited To Three Years.**

15 Neither does the Settlement Agreement contemplate any further reductions in  
16 Qwest's access charges upon the expiration of the three-year term. The Settlement  
17 Agreement provides for only a \$15 million reduction in Qwest's intrastate access rates, a  
18 reduction of \$5 million at the time of entry of the Order approving the Settlement  
19 Agreement and reduction of an additional \$5 million in each of the two years thereafter,  
20 with a corresponding increases in the revenue cap on Basket 3. Settlement Agreement ¶ 3 at  
21 3; Price Cap Plan ¶ 3 at 2-3. The parties' testimony uniformly confirms that they  
22 anticipated three reductions and nothing further. See Hearing Transcript (November 29,  
23 2000) at 57 (Staff); See Hearing Transcript (November 30, 2000) at 182, 196, and 210

24  
25 <sup>3</sup> The refusal of the Commission to process a rate application or renewed price cap plan in the  
26 face of a confiscatory level of earnings by Qwest is contrary to the provisions of the Arizona  
Constitution. See *Mountain States Telephone & Telegraph Co. v. Arizona Corporation*  
*Commission*, 71 Ariz. 404, 228 P.2d 749 (1951). See also, *infra*. at X.

1 (Qwest); *See* Hearing Transcript (December 1, 2000) at 529 575 and 596 (Staff). *See also*,  
2 Open Meeting Transcript, Vol. I at 7 (ALJ), 140 (Staff), and 169 (Staff) (March 7, 2001);  
3 Open Meeting Transcript, Vol. II at 360 (Joe Gosiger) (March 7, 2001). For example,  
4 Staff's witness, Harry M. Shooshan III, testified that the Settlement Agreement lowered  
5 "charges made by Qwest to long-distance carriers by \$15 million over the three years of the  
6 period," with a goal of eventually "reducing those rates, switched access rates, to the  
7 interstate level." Hearing Transcript (December 1, 2000) at 604. The Commission  
8 expressly rejected argument by IXCs calling for additional reductions in access charges,  
9 indicating that any further adjustments would be addressed on an industry-wide basis in the  
10 Commission generic access docket. Decision at 12. To the extent that the Commission or  
11 other parties seek further reductions in Qwest's access rates, the parties are free to negotiate  
12 such terms as proposed amendments or revisions to the Price Cap Plan. However, nothing  
13 in the Plan requires any further access reductions beyond the third reduction, which was  
14 made on April 1, 2003. The Commission should clarify that no further reductions in access  
15 charges are required by the Plan.

16 **IV. Alternatively, The Commission Should Terminate The Price Cap Plan.**

17 Notwithstanding the foregoing, if the Commission does not clarify the application of  
18 the Price Cap Plan as suggested by Qwest, the Plan should be terminated. Both the  
19 Settlement Agreement and the Price Cap Plan expressly contemplate their termination at the  
20 end of the three-year term. Additionally, Paragraph 7 of the Settlement Agreement, which  
21 imposes a rate moratorium on Qwest's rates during the initial term of the Price Cap Plan,  
22 contemplates a possible rate proceeding after the expiration of that term. Settlement  
23 Agreement ¶ 7 at 8.

24 Qwest has a constitutional right to earn a reasonable return on its rate base and  
25 renewal of the Price Cap Plan by default does not change this. The continuation of a Price  
26 Cap Plan that results in inadequate or negative earnings would amount to confiscation in

1 violation of the Plan itself as well as the Arizona constitution. Along with its July 1, 2003  
2 filing, Qwest submitted financial information as required by the Settlement Agreement.  
3 Using the Commission's prescribed jurisdictional accounting (JR records), Qwest reported  
4 in Attachment D to its filing that Qwest's 2002 intrastate net income was a negative \$ 8.4  
5 million. Qwest anticipates that its 2003 financial results will be similar to those for 2002.  
6 Qwest's 2002 earnings in Arizona were negative and its 2003 earnings are anticipated to be  
7 inadequate by any reasonable measure.<sup>4</sup> Under these circumstances, continuation of the  
8 Price Cap Plan in its present form, without Qwest's consent, would most certainly prevent  
9 Qwest from earning a reasonable return on its investment in violation of Article 15, § 3 and  
10 § 14. In contrast, termination of the Plan would return parties to the status quo and permit  
11 either Qwest or the Commission to initiate a proceeding to adjust Qwest's rates to permit  
12 the Company to earn a fair rate of return.

13 **V. Qwest's Proposals For Further Proceedings.**

14 Qwest requests that the Commission enter an order clarifying the Price Cap Plan in a  
15 manner consistent with the interpretation set forth in this motion. If clarification of the Price  
16 Cap Plan consistent with Qwest's interpretations is granted, Qwest believes this docket  
17 should be continued. Qwest will then provide its restated financial information as soon as  
18 possible. Both before and after that filing, the parties should continue to discuss and  
19 negotiate appropriate revisions to the Plan. Ultimately, a revised price cap plan could be  
20 presented to the Commission for its approval.

21 If the Commission denies Qwest's motion or its clarification of the Price Cap Plan is  
22

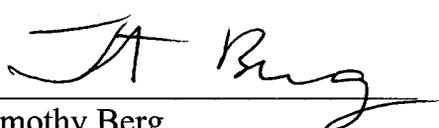
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23 <sup>4</sup> Various provisions of the Price Cap Plan contributed to this negative earnings situation. Prior  
24 to reaching the Settlement Agreement with Staff, Qwest had requested a revenue increase of  
25 \$201 million. The Settlement Agreement permitted Qwest an increase of only \$23.3 million.  
26 Over the time the Plan has been in effect, the application of the Price Cap Index in Basket 1 has  
reduced the caps for that Basket \$14.4 million in 2002 and \$28.9 million in 2003. Thus, Qwest's  
revenue levels under the Plan have been decreased by \$20 million.

1 inconsistent with the interpretations set forth in this request, Qwest requests that the  
2 Commission terminate the Price Cap Plan effective with the expiration of its three-year  
3 term, as the parties are no longer in agreement as to its terms and conditions. Upon  
4 termination of the Price Cap Plan, Qwest's rates should be continued at their current levels,  
5 under rate of return regulation. Qwest's rates would be subject to the same rules governing  
6 competitive and noncompetitive services provided by any telecommunications company in  
7 Arizona. In such case, if these rates require further revision, both Qwest and Staff remain  
8 free to initiate a rate case if appropriate.

9 RESPECTFULLY SUBMITTED this 7<sup>th</sup> day of November, 2003.

10  
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12  
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7 COPY of the foregoing delivered  
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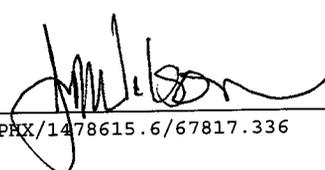
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