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CARL J. KUNASEK  
Chairman  
JIM IRVIN  
Commissioner  
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Commissioner

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

DOCKET NO. T-00000A-00-0194

U S WEST COMMUNICATIONS, INC.'S  
POST-HEARING BRIEF

INTRODUCTION

Four years after the Telecommunications Act of 1996 (the "Act") was passed, it is clear that the Act has effected a shift in the telecommunications market. Increased competition has meant increased choices for some consumers, along with the potential for increased confusion. Competition has emerged in a spotty fashion with new entrants focusing primarily upon the lucrative business accounts clustered in the most densely populated urban areas of the state.

This is perhaps natural, since under the current rate structure low-cost, urban business customers have been subsidizing high-cost customers by paying rates that are higher than the actual costs to serve them. Thus, new entrants realize substantial margins by serving low cost customers in urban areas and pricing below the tariffed rates of the incumbent carrier. This leads to rate arbitrage. The way to avoid rate arbitrage is by recognizing, as this Commission did in Docket No. U-3021-96-448 ET AL. that unbundled network element prices should be deaveraged in concert with deaveraging of retail prices. (Decision No. 60635, pp. 21-22)

Although U S WEST recognizes that its retail rates should be deaveraged in phases over time to avoid consumer "rate shock", U S WEST still believes that the Commission should do its utmost to limit consumer confusion and arbitrage. Thus, in ordering UNE deaveraging, the

1 Commission should recognize that deaveraging of wholesale rates drives the deaveraging of  
2 retail rates. In other words, where cheaper wholesale rates prevail, cheaper retail rates prevail.  
3 Conversely, where higher wholesale rates prevail, ultimately, higher retail rates will follow.  
4 Therefore, an elaborate or complex scheme for UNE deaveraging will ultimately result in a  
5 similar scheme for retail deaveraging.

6         Accordingly, U S WEST has submitted a deaveraging proposal which relies heavily upon  
7 the way retail basic exchange prices are structured in Arizona,<sup>1</sup> and which deaverages prices  
8 based upon the FCC requirements of cost-related loop rates in three geographic zones. Under  
9 U S WEST's proposal, loop prices are deaveraged based upon relative costs while preserving, to  
10 the greatest extent possible, the base rate area and zone increments which makes a rate design  
11 intelligible to a customer, and in Arizona results in cost-based rate differences among the various  
12 geographic zones. U S WEST's approach is simple: service areas are differentiated according to  
13 the retail base rate area and incremental zones, the relative costs to serve each zone is  
14 determined, and prices are deaveraged according to the relative costs incurred to serve each zone.

15         AT&T's proposal, on the other hand, fails to minimize either customer confusion, or rate  
16 arbitrage, and produces multiple zones within each geographic area (e.g., 5 zones in metropolitan  
17 Phoenix). When the FCC required the deaveraging of UNE rates it was with the understanding  
18 that, ultimately, implicit subsidies would be eliminated and retail prices would more closely  
19 reflect cost to provide service. AT&T's proposal ignores the existing retail structure in Arizona  
20 which means that until the retail structure can be adjusted there will be no connection between  
21 retail rates and the underlying wholesale costs. When retail does move toward the underlying  
22 wholesale structure, under AT&T's proposal, Arizona will end up with a retail structure similar  
23 to the one the Commission abandoned in 1991. (Million, U S WEST Ex. 1, p. 9)

24 \_\_\_\_\_  
25 <sup>1</sup> U S WEST assumes the base rate areas with the expanded boundaries as recommended by  
26 David Teitzel in Docket No. T-1051B-99-105, see Teitzel testimony, filed January 8, 1999, p.  
42.

1 When all of the relevant factors are considered, U S WEST's proposal for UNE  
2 deaveraging is plainly better and is the one that this Commission should adopt.

3 **STATEMENT OF THE CASE**

4 In August 1996, the Federal Communications Commission (FCC) issued its Local  
5 Competition Order which implemented section 251 of the Telecommunications Act of 1996.  
6 Section 51.507(f) required each state public utilities commission to establish different rates for  
7 interconnection and unbundled network elements (UNEs) in at least three geographic areas  
8 within the state to reflect geographic cost differences. The Court of Appeals for the Eighth  
9 Circuit, however, subsequently stayed and then vacated this deaveraging rule. Based on those  
10 decisions, this Commission did not establish different rates for different geographic areas.  
11 However, in January 1999, the United States Supreme Court reversed, in part, the Eighth  
12 Circuit's decision. Thereafter, on May 7, 1999, the FCC stayed the effectiveness of the rule in  
13 order to allow it more time to address universal service concerns.

14 In November 1999, the FCC lifted the stay effective May 1, 2000. In the Matter of the  
15 Federal-State Joint Board on Universal Service, CC Docket 96-45, Ninth Report and Order and  
16 Eighteenth Order on Reconsideration, FCC 99-306, ¶ 120 (released November 2, 1999). The  
17 FCC order provides that by May 1, 2000, "states are required to establish different rates for  
18 interconnection and UNEs in at least three geographic areas pursuant to section 51.507 (f) of the  
19 Commission's rules." Id.

20 Accordingly, on March 30, 2000, this Commission issued an order establishing this  
21 docket and set a procedural schedule. The parties filing testimony were U S WEST, NEXTLINK  
22 and AT&T, and they filed simultaneous direct testimony on April 24, 2000. These same parties  
23 filed simultaneous responsive testimony on May 1, 2000, and, in addition, the Staff for the  
24 Arizona Corporation Commission filed rebuttal testimony, as well.

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1 **STATEMENT OF FACTS**

2 **A. Deaveraging of UNE (wholesale) rates is inextricably linked to the deaveraging of**  
3 **retail rates**

4 At the outset, as U S WEST noted in the testimony of Teresa K. Million (Million,  
5 U S WEST Ex. 1, pp. 3, 6-8; 5/11/00 Tr. pp. 11-15), it is a matter of public policy and economic  
6 reality that the deaveraging of UNE (wholesale) rates is inextricably linked with the deaveraging  
7 of retail rates. Discrepancies between the retail and wholesale price structures undermine  
8 competition and competitive neutrality. In addition, as U S WEST showed, deaveraging of  
9 wholesale rates without the deaveraging of retail rates does not promote competition, is not fair,  
10 and is not consistent with Congress' intent when it drafted the Telecommunications Act. (Id.) Of  
11 course, U S WEST recognizes that it will take time for implicit subsidies to be replaced by  
12 explicit subsidies, and therefore for retail rates to become entirely consistent with wholesale  
13 costs.

14 The intent of the Telecommunications Act is to provide competitive choices to all  
15 consumers, regardless of where they live in the state. If UNE rates are deaveraged, UNE rates  
16 will be reduced in lower-cost urban areas, and increased in higher-cost areas. Competitors will  
17 flock to the urban business markets, like downtown Phoenix and Tucson, where UNE rates are  
18 low and retail rates are higher, while completely ignoring higher-cost rural areas. This scenario  
19 is not deaveraging; it is simply a UNE price decrease in low-cost densely populated urban areas.  
20 When retail and wholesale prices are synchronized, there is the possibility of UNE based  
21 competition because competitors will see opportunity in both densely populated and outlying  
22 areas. (Million, U S WEST Ex. 1, p. 8.) In fact, this Commission has previously recognized that  
23 UNE rates and retail prices should be deaveraged in concert. Specifically, in Docket No. U-  
24 3021-96-448 ET AL., the Commission concluded "we share U S WEST's concerns that  
25 geographic deaveraging would need to occur for U S WEST retail customers at the same time it  
26 occurs at the wholesale level." (Decision No. 60635, pp. 21-22)

1 **B. U S WEST's deaveraging method**

2 Based on its belief that wholesale and retail rates are inextricably linked, U S WEST  
3 proposed a deaveraged wholesale rate structure consistent with the retail rate structure in  
4 Arizona. Such a structure results in three distance-based cost-related zones, i.e., base rate area  
5 and two zone increments. Costs in each of the three zones were grouped together and the relative  
6 loop investments were calculated for each zone. The investment for each zone was then  
7 compared to the statewide average investment and a percentage was determined by dividing the  
8 zone investments by the statewide investment. These percentages were multiplied by the  
9 statewide average unbundled loop rate of \$21.98 to determine the deaveraged price for each  
10 zone. U S WEST used this approach, in part, because it is logical and easily understood by  
11 consumers. The results of U S WEST's method are rates of \$20.12 for the base rate area, \$40.65  
12 for Zone 1 and \$63.70 for Zone 2.<sup>2</sup> (Million, U S WEST Ex. 1, p. 14.) This methodology is  
13 cost-related, and is consistent with the FCC's rules under CFR 51.507(f). (Million, U S WEST  
14 Ex. 1, pp. 12-13)

15 As the evidence showed, there are numerous advantages to this Commission using U S  
16 WEST's base rate area and zone increment deaveraging approach. For example, because retail  
17 rates in a competitive environment will necessarily be drawn toward the level of wholesale rate  
18 deaveraging, retail customer perspectives are essential in the selection of a deaveraging method.  
19 This method of deaveraging is relatively easy to administer in Arizona because the zone  
20 increment structure already exists for retail purposes. Further, this deaveraging method is  
21 generally compatible with the systems U S WEST uses to provision service, bill customers, and  
22 manage the network, thus minimizing costs to implement billing and other changes. (Million,  
23 U S WEST Ex. 1, p. 11; 5/11/00 Tr. pp. 45-49) Finally, given that the deaveraging is intended to

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25 <sup>2</sup> At Commission Staff's request, U S WEST also submitted a late filed exhibit with rates based  
26 on the current retail zone structure. The resulting rates are as follows: \$18.96 for the base rate  
area, \$34.94 for Zone 1 and \$56.53 for Zone 2.

1 occur by May 1, 2000, or in Arizona's case by June 29, 2000, this methodology would be  
2 relatively simple to implement. (Million, U S WEST Ex. 1, pp. 3, 11.)

3 **C. AT&T's UNE deaveraging proposals**

4 AT&T, on the other hand, did not consider the existing retail structure in its proposal.  
5 The AT&T proposal estimates average loop costs by wire center generated using the HAI model.  
6 AT&T then applies a factor so that the average cost, utilizing the HAI model equals the statewide  
7 average loop cost (i. e., \$21.98) as determined by the Commission. (Denny AT&T Ex. 1, pp. 11-  
8 12.) The resulting average loop costs are then sorted by wire center and assigned to zones. An  
9 average loop rate is then developed for each zone. In his direct testimony AT&T's witness,  
10 Douglas Denney, submitted four possible sets of rates.

11 The reason there are so many cost and rate calculations for the Commission to consider  
12 under AT&T's proposals is that, as Mr. Denney admits, there are any number of ways under this  
13 method to group wire center costs into zones. (Denny, AT&T Ex. 1, pp. 15-16; 5/11/00 Tr. pp.  
14 98-99) As U S WEST points out, unlike its own objective approach, the AT&T method is  
15 subjective and susceptible to manipulation.

16 AT&T's method results in 5 different rates in the Phoenix metropolitan area, alone. This  
17 proposal could eventually result in a retail rate structure similar to a structure the Commission  
18 abandoned in Arizona in 1991. Mr. Denney suggests that because AT&T's method is wire center  
19 based, it will be easy to identify customers by zone and that CLECs will be burdened if they have  
20 to pay a "look-up" charge to determine a customer's zone. (Denny, AT&T Ex. 1, p. 8.) This  
21 argument is unfounded since U S WEST currently does not charge CLECs for making inquiries  
22 or facilities checks. Thus, the retail zone information needed under U S WEST's proposed zone  
23 increment method is readily available to the CLECs. In addition, Mr. Denney evidently assumes  
24 that there will necessarily continue to be a link between telephone numbers and wire centers, and  
25 that CLECs will only be serving existing customers in Arizona.

26

1 **D. Staff's UNE deaveraging proposal**

2 Staff proposes to deaverage the unbundled loop UNE on a wire center basis using three  
3 zones. Staff's method for determining cost is based on the FCC's universal service model, also  
4 known as the Synthesis Model, on grounds that it is a neutral model that has been subject to  
5 review, although not by the Arizona Commission. Using the Synthesis Model, Staff determined  
6 average loop costs by wire center. These average loop costs are the result of averaging the costs  
7 of varying loop lengths and densities across a wire center. Loop length and density are the  
8 factors that drive geographic cost differences in loops. Staff then selected three zones based on  
9 wire center cost and averaged those costs to determine the average UNE loop rate per zone.  
10 These loop rates were adjusted by a factor to put them on an equivalent basis with the statewide  
11 average loop rate.

12 Based on the testimony and attendant schedule originally filed on May 1, 2000, by Staff  
13 witness Matthew Rowell, it is evident that Mr. Rowell made more than one grouping of wire  
14 centers in determining what zones to establish. Mr. Rowell subsequently corrected Schedule 1  
15 on May 8, 2000 to reflect the zones described in his testimony. According to Mr. Rowell, the  
16 grouping of wire centers under Staff's method (and presumably AT&T's method) is a "matter of  
17 judgment." (Rowell, Staff Ex. 1, p. 4.)

18 Staff questioned U S WEST about the loop model ("LoopMod") it used to develop the  
19 relative investments by zone. Staff appeared concerned that LoopMod had not been filed  
20 previously in Arizona and so had not been subject to review. LoopMod is the replacement model  
21 for U S WEST's previously filed RLCAP model. LoopMod has been updated to address concerns  
22 raised by other parties in their review of RLCAP. Although, Staff did not ask similar questions  
23 of AT&T, the HAI model submitted by AT&T has also not been filed previously or subject to  
24 review in Arizona. HAI 5.0a is a later version of the Hatfield model 2.2.2 that AT&T submitted

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1 previously in Arizona. AT&T has also made changes to HAI in an effort to update the way it  
2 calculates loop costs. (Denny, AT&T Ex. 1, p. 11, footnote 10.)

3 ARGUMENT

4 III. AT&T's HAI PROPOSALS ARE ARBITRARY, AND OPEN TO  
5 MANIPULATION

6 As was plainly evident from both U S WEST's cross-examination and from a review of  
7 AT&T's exhibit, the HAI model proposals are arbitrary, and open to manipulation, and thus  
8 produce average prices that are no more accurate than other methods. The evidence showed that  
9 there was nothing precise, objective, or even scientific about AT&T's wire center groupings. In  
10 fact, AT&T's proposal of four different sets of costs merely supports U S WEST's contention that  
11 there is no single "true" cost upon which to base deaveraged rates, and therefore, it is appropriate  
12 to consider other factors in determining geographic zones. Nevertheless, AT&T conveniently  
13 grouped only the five wire centers in downtown Phoenix in Zone 1. AT&T arbitrarily assigned  
14 zones based on wire center costs on grounds that \$5 increments most closely reflected cost  
15 differences in Zones 1 through 4, then lumped all wire center costs from \$30.70 to \$336.34 into  
16 Zone 5. AT&T could have just as easily grouped the wire centers into \$10 increments and made  
17 Zone 5 reflect all wire centers above \$50. The obvious net result of AT&T's arbitrary groupings  
18 was a low \$12.75 loop rate in Zone 1. (Denny, AT&T Ex. 1, Attachment A.)

19 By choosing only a few of the lowest cost wire centers, AT&T was able to manipulate the  
20 results to produce a very low loop rate for Zone 1. Downtown Phoenix is very likely to be the  
21 only place that AT&T will compete in Arizona. The result of this type of rate manipulation is  
22 merely an opportunity for rate arbitrage. Under AT&T's proposals, CLECs would enjoy the  
23 benefit of a more than 40 percent UNE price decrease in downtown Phoenix (\$21.98 to \$12.75),  
24 but would not pursue UNE-based competition in the high-cost areas of Arizona, leaving U S  
25 WEST to serve those customers at basic exchange retail rates that do not recover the cost of the  
26 loop.

1 Not surprisingly, of the seven states in U S WEST's region that have deaveraged UNEs,  
2 three (New Mexico, South Dakota and Utah) adopted U S WEST's MSA approach, and two  
3 (Colorado and Wyoming) have chosen U S WEST's zone increment approach, similar to the  
4 proposal for Arizona. In North Dakota the deaveraged rates have been stipulated in an agreement  
5 between the parties. To date only one state, Washington, has adopted a five zone method based  
6 on groupings of wire-center costs. (Million, 5/11/00 Tr. p. 50) However, Washington's retail  
7 structure, unlike Arizona's, is not based on base rate areas and zone increments. It should also be  
8 noted that the method proposed by AT&T and the CLECs was adopted in principle only;  
9 Washington's commission did not adopt AT&T proposed rates.

10 In addition, Mr. Denney essentially acknowledged his assignment of wire centers to  
11 various zones was arbitrary, and that the Commission could choose different break points than  
12 the break points he used. (Denny, 5/11/00 Tr. pp. 98-99.) It appears as though Mr. Denney  
13 applied his break points to ensure that the unbundled loop price in Zone 1 (downtown Phoenix)  
14 remains low, that the majority of unbundled loops in Arizona (Zones 1 and 2) are priced below  
15 \$20, and that loops in the outlying areas where AT&T is not likely to compete (the 71 wire  
16 centers in Zone 5) are priced in excess of \$50.

17 Finally, the arbitrariness of the AT&T proposal is made manifest when one considers that  
18 it results in the city of Phoenix being divided among Zones 1 through 5. The problem will be  
19 exacerbated when retail deaveraging follows wholesale deaveraging, as it must. For example,  
20 consumers in Phoenix – living within a six-mile radius of the Phoenix South wire center – will  
21 pay retail rates based upon UNE prices, ranging from \$12 to in excess of \$50, that have no  
22 connection to the retail structure. Accordingly, AT&T's proposals are neither consumer-friendly,  
23 nor transparent.

24 **II. THE WIRE CENTER METHODS PROPOSED BY STAFF AND AT&T ARE**  
25 **NOT MORE ACCURATE**

26 Both AT&T and Arizona Staff challenged U S WEST for proposing a deaveraging plan

1 that is highly averaged because almost 95% of customers are in the base rate area. This should  
2 not be a surprising result in Arizona, since nearly 85% of customers are concentrated in the two  
3 metropolitan areas of Phoenix and Tucson. Nevertheless, the FCC must have contemplated that  
4 any deaveraging plan would contain an element of averaging, otherwise states would have been  
5 required to create more than three deaveraged zones. (Million, U S WEST Ex. 1, p. 12.) Just  
6 because AT&T and Staff have produced loop costs by wire center does not mean that those costs  
7 are not also highly averaged.

8         The two principal drivers of geographic cost differences in the loop UNE are loop length  
9 and density. By grouping costs and averaging them across wire centers, Staff and AT&T have  
10 chosen to ignore the differences in loop cost between customers that are close to a central office  
11 in densely populated areas, and those that are far away from a central office in more sparsely  
12 populated areas, within any given wire center. Their methods take loop costs by wire center that  
13 range from \$11 to \$336 according to AT&T's model (\$12 to \$334 according to Staff's  
14 calculations) and average them across three or five zones.

15         At best, picking the wire centers to group into zones of similar cost is a matter of  
16 judgment, at worst it is pure rate manipulation. Ultimately, the result is highly averaged rates,  
17 and zones that contain anywhere from 10% of customers to 60% of customers. Nowhere in the  
18 FCC's rules does it say that deaveraging should be based on the average relative cost of wire  
19 centers. Nor does the FCC give any guidance in its rules about the appropriate percentage of  
20 customers that should fall into each zone. What the FCC does say is that there should be at least  
21 three zones and those zones must be cost-related. (Million, U S WEST Ex. 1, p. 12.)

22         U S WEST's method establishes three zones. It bases its deaveraging on Arizona's retail  
23 structure, and uses distance of the customer from the central office and the density of the area in  
24 which the customer resides to calculate average loop rates for the three zones. While this method  
25 averages the loop investments for all customers within the base rate areas and each of the zone  
26

1 increments, it differentiates between the zones based on loop length and density.

2 **III. U S WEST'S ZONE INCREMENT APPROACH MAKES SENSE FOR ARIZONA**

3 As stated, U S WEST's UNE deaveraging proposal makes sense for Arizona, and  
4 accomplishes the FCC's goal to have cost-related loop rates and three zones. The base rate area  
5 and zone increments proposed by U S WEST result in three cost-related zones. U S WEST's  
6 loop rates represent geographic deaveraging in the sense that they are developed using loop  
7 length and density information, the two drivers of loop cost differences.

8 AT&T and Staff expressed concerns that customers be easily identified with zones and  
9 that U S WEST's zone increment would place a burden on CLECs in making such an  
10 identification. The "burden" that they are concerned about is a look-up charge that is non-  
11 existent in U S WEST's current pre-order process. They contend that establishing zones by wire  
12 centers provides an easy and publicly available method for identifying customers within zones.  
13 A CLEC need only know the customer's existing NNX (assuming it has a list of wire centers by  
14 NNX and zone) to locate the customer within a zone. This argument does not take into effect  
15 that not all customers will have existing telephone numbers. Presumably, CLECs will be  
16 competing for new customers in Arizona, as well as U S WEST's existing customers. Nor does  
17 this argument recognize that in the future, local number portability removes the link between  
18 telephone number and wire center. Therefore, as a practical matter, since CLECs use U S WEST  
19 systems in the pre-order process to identify existing customers, and facilities and locations for  
20 new customers and new locations, identifying zones by wire centers is not any easier in the long  
21 run. U S WEST's proposal is based on the existing retail rate structure and, thus, all of the  
22 information necessary to identify customers within the base rate area and zone increments is  
23 easily available to CLECs through the pre-order process.

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1 U S WEST's zone increment approach is understandable to consumers, is relatively easier  
2 to administer, is generally compatible with existing computer systems, and is relatively simple to  
3 implement in a timely manner. (Million, U S WEST Ex. 1, p. 11, 5/11/00 Tr. pp. 45-49)

4 **CONCLUSION**

5 For all of these reasons, U S WEST respectfully submits that the Commission should  
6 adopt U S WEST's reasonable, compliant and competition-friendly UNE deaveraging proposal.

7 RESPECTFULLY SUBMITTED this 26<sup>th</sup> day of May, 2000.

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