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

DOCKET NO. T-00000A-00-0194
PHASE II-A

QWEST CORPORATION'S POST-HEARING BRIEF RELATING TO WHOLESALE RATES FOR SWITCHING AND TRANSPORT

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

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

Attorneys for Qwest Corporation

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Introduction and Summary

Qwest Corporation ("Qwest") submits this post-hearing brief in this phase of the cost docket in which the Commission, pursuant to the Procedural Order issued April 11, 2003, is revisiting the transport and switching rates it ordered in Phase II and Phase IIA. Per the terms of the April 8, 2003 stipulation among the parties and the Procedural Order, in this phase of the docket, the Commission will adopt new transport rates that will remain in effect until the Commission sets new, permanent rates in Phase III of the docket. In addition, the Commission will determine the appropriate permanent rates for unbundled switching based on use of the HAI model, including the extent to which switching costs should be divided between the fixed rate for the analog switch port and the per minute of use switching rate.

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

Consistency in developing unbundled network element ("UNE") rates is important for two reasons. First, there is a direct relationship between the costs the HAI model calculates for

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[1] Phase II Opinion and Order, *Investigation into Qwest Corporation's Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-00000A-00-0194, Decision No. 64922, at 79 (June 12, 2002) ("*Phase II Order*") (emphasis added).

the unbundled loop and the costs the model develops for other UNEs, including transport. The model produces lower cost estimates for the unbundled loop than it otherwise would by assigning substantial percentages of overhead expenses to transport and switching. If the Commission uses HAI for the unbundled loop but not for transport, Qwest will not recover all of the overhead costs that the model has assigned to transport. Second, as the Commission implicitly recognized in its Phase II decision to use HAI for transport, there is no legitimate or fair basis for using the model when it produces rates favorable to the CLECs but not using it when CLECs deem the rates it generates as unfavorable.

In addition to violating the *Phase II Order*, resurrecting the old transport rates from the first generic cost docket would directly conflict with the Procedural Order issued in this docket on February 15, 2001, and with the basic purpose of Phase II. In that Procedural Order, the Administrative Law Judge ("ALJ") ruled that the Commission had never determined that the UNE rates from the first generic cost docket, including the transport rate, complied with the FCC's pricing rules and, therefore, she ordered that those rates had to be revisited in Phase II:

> When the Commission approved Qwest's current UNE rates in Decision No. 60635, the FCC's pricing rules were not effect. This Commission has not to date found that Qwest's UNE rates comply with the FCC's pricing rules . . . . The record indicates that the Commission has always contemplated that it would review the statewide UNE rates.[2]

In support of her ruling that these UNE rates had to be revisited, the ALJ expressed concern about whether the rates were still viable, stating that "since the Commission originally approved the UNE rates there have been factual and legal changes that support a review at this time."[3]

While the Commission never found that the transport rates from the first cost docket complied with the FCC's pricing rules, in contrast, it has specifically ruled that the UNE rates from Phase II produced by the HAI model, including the transport rates, provide an appropriate

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[2] Procedural Order, *Investigation into Qwest Corporation's Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-00000A-00-0194 (February 15, 2001) at 2 ("*Feb. 15, 2001 Procedural Order*").

[3] *Id.* at 3.

measure of "TELRIC-compliant, forward-looking costs and prices for UNEs . . . ."[4] Thus, the choice presented by Options 1 and 2 is between transport costs that have not been found to comply with TELRIC (Option 1) and transport costs that the Commission has affirmatively ruled do comply with TELRIC (Option 2). This fact, coupled with the Commission's Phase II "consistency" ruling, establish that only Option 2 complies with the Commission's and the ALJs' prior, directly applicable rulings in this docket.

Significantly, no party objects to Option 2, and there is, therefore, no reason for the Commission to take the legally suspect step of adopting rates that would contradict its prior order. While Staff and Mountain Telecommunications, Inc. ("MTI"), have stated their preference for Option 1, they have expressly stated that Option 2 also is acceptable.[5]

The Commission also should reject the request of the CLECs and Staff to apply the new transport rates retroactively to June 12, 2002, the date of the *Phase II Order*. As discussed below, under settled principles of controlling federal law, in addition to Arizona law, rates that are either prescribed by the Commission, or otherwise approved as lawful may not be changed except on a prospective basis. This rule applies notwithstanding any claim or subsequent finding by the Commission that the formerly prescribed or approved rates were unreasonable or otherwise unlawful. As a matter of law, the new transport rates may apply from the effective date of the Order adopting them, and no earlier.[6]

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[4] *Id.* at 10.

[5] *See* MTI Ex. 2 (Hazel Reb.) at 3; Staff Ex. 1 (Dunkel Dir.) at 3 (". . . since I also presented option 2 as an acceptable interim solution, I do not have a strong objection to Option 2 being the interim solution."); Tr. at 224-25 (Hazel Cross).

[6] While it would be unlawful for the Commission to apply any of the rates it adopts in this proceeding retroactively, if the Commission decides to give retroactive application to the transport rates, it must also apply the new switching rates retroactively. There is no legitimate basis for disparate treatment of the transport rates on the one hand, and the switching rates, on the other. The theory underlying the request for revisions, *i.e.*, that the rates established in the *Phase II Order* were in some material respect unreasonable, applies no less to the switching rates than to the transport rates.

With respect to the switching issues, there is unanimous agreement among Staff, Qwest, AT&T, and MCI that the Commission should correct the switching rates it ordered in the initial *Phase IIA Order*.[7] The need to correct these rates arises from the fact that the analog switch port rate of $1.61 that the Commission ordered is not consistent with the Commission's Phase IIA rulings relating to switching inputs and, therefore, is denying Qwest full recovery of the switching costs the Commission allowed. When 60% of the switching costs produced by HAI are assigned to the switch port, as the Commission ordered, all parties agree that the model produces a port rate of $2.44, along with the per minute of use rate of $0.00097.[8]

Consistent with the rate scheme it adopted in the *Phase IIA Order*, the Commission should continue to use both a per minute of use switching rate and a fixed rate for the analog switch port. The proposal of AT&T and MCI to use just a single flat rate for switching violates basic principles of cost causation. Switches are designed to account for different levels of usage, and usage, therefore has a direct effect on the switching costs a carrier incurs. The AT&T/MCI flat-rated approach ignores this relationship. As stated by the New Jersey Commission, "[c]learly, there are usage sensitive elements associated with switching, and to provide switching on any other basis would tend to send the wrong economic signals to CLECs and their customers."[9] Accordingly, as both Staff and Qwest agree, the Commission should adopt the same allocation of switching costs that it adopted in the *Phase IIA Order* and assign 60% of the

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[7] Phase IIA Opinion and Order, *Investigation into Qwest Corporation's Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-00000A-00-0194, Decision No. 65451 (rel. Dec. 12, 2002) ("*Phase IIA Order*").

[8] *See* Qwest Ex. 1 (Million Direct) at 10; Staff Ex. 1 (Dunkel Dir.) at 7; Staff Ex. 2 (Dunkel Reb.) at 6; Response of AT&T/MCI to Qwest Corporation's Second Set of Data Requests, (May 22, 2003) at 6; Response of Staff to Qwest Corporation's Third Set of Data Requests, (April 30, 2003) at 3-5.

[9] Decision and Order, *The Board's Review of Unbundled Network Elements, Rates, Terms, and Conditions of Bell Atlantic-New Jersey, Inc.*, Docket No. T000060356 (New Jersey Bd. of Pub. Util. rel. Nov. 20, 2001) ("*NJ UNE Order*").

costs to the port and 40% to usage. This hybrid approach has been adopted by all but a few state commissions in the country.[10]

Finally, the Commission should reject the request of AT&T and MCI to lower the loop rate to account for the increased switching rates that they acknowledge the Commission must adopt. The only issues the parties agreed to address and that are listed in the Procedural Order of April 11, 2003 concern the appropriate rates for transport and the analog switch port. There is no reference at all in either the stipulation or the Procedural Order to revisiting the rate for the unbundled loop. As Staff and Qwest agree, issues relating to the unbundled loop are outside the scope of this proceeding.

Argument

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

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

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

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[10] As Mr. Gillian acknowledged, only the state commissions of Minnesota, Illinois, Indiana, Utah, and Wisconsin have adopted the flat-rated approach. Tr. at 202-203 (Gillan Examination by ALJ Nodes).

would be based upon the same HAI-generated transport costs the Commission ordered in the *Phase II Order*, Qwest would be assured of the cost recovery that the Commission found was appropriate in that Order.

Qwest fully agrees that the Commission should establish separate charges for entrance facilities and DTT, and, indeed, Qwest's own transport cost study presented in Phase II established separate rates for these facilities. Qwest has proposed a logical methodology for implementing Staff Option 2, which divides the total transport costs produced in the HAI model (and adopted in the *Phase II Order*) into distinct DTT and entrance facility charges. Specifically, Qwest proposes to use the same ratio of entrance facility costs to direct trunk transport costs that the Commission established in the first generic cost docket.[11] Under this approach, the direct trunk transport rate is calculated by multiplying one minus the entrance facility ratio times the total HAI transport cost, and the entrance facility rate is determined by subtracting the DS1 and DS3 transport rates resulting from the above calculation from the total HAI transport costs.[12] Contrary to the testimony of MTI witness, Michael Lee Hazel, application of Qwest's proposal will produce completely distinct rates for direct trunk transport and entrance facilities; thus, the transport rate will not include any portion of charges for entrance facilities.[13]

Option 2 allows the Commission to maintain a consistent approach in setting UNE rates. In its *Phase II Order*, the Commission ruled that the HAI model sponsored by the CLECs would be used to determine the costs and rates for UNEs, stating that HAI "provides the most appropriate measure for determining TELRIC-compliant, forward-looking costs and prices for UNEs. . . ."[14] The Commission adopted HAI's transport rates after careful consideration and specifically rejected AT&T's and MCI's contention that their model should not be used for

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[11] Qwest Ex. 1 (Million Dir.) at 2-3.

[12] Qwest Ex. 1 (Million Dir.) at 3.

[13] Qwest Ex. 1 (Million Dir.) at 3; MTI Ex. 2 (Hazel Reb.) at 3.

[14] *Phase II Order* at 10.

transport. Stating that "any UNE pricing inquiry necessarily involves some cost averaging among different kinds of facilities[,]"[15] the Commission ruled that it was necessary to establish transport charges using the same approach employed to establish loop and switching rates. Underscoring the need for consistency, the Commission stated: "We believe that consistency requires adoption of the HAI model's result for both loop costs and transport."[16]

The need for consistency is more than just a matter of principle; it is essential to ensure that Qwest is compensated fully for providing transport. The undisputed testimony in this case and the stipulation between Qwest and AT&T/MCI establish that the HAI model allocates expenses among the different UNEs the model addresses and that there is, therefore, an interrelationship among the model's UNE cost estimates.[17] Qwest's cost witness, Teresa Million, explained this relationship:

> One reason that HAI produces lower loop costs is that the model allocates various expense factors to the non-loop facility costs it produces in proportion to their estimated direct costs. . . . This method of allocation assumes that in order to recover the entire . . . expense, Qwest must be able to charge rates produced by HAI for both loop and transport.[18]

Accordingly, as the Commission previously recognized, selective adoption of the HAI model for only certain UNEs – loop and switching, but not transport – will prevent Qwest from recovering all the expenses HAI generates and that the Commission has determined Qwest is entitled to recover.[19] And while Qwest agrees that the transport rates require recalculation, the need for consistency in order to ensure accurate cost recovery has certainly not diminished since adoption of the *Phase II Order*.

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[15] *Id.* at 79.

[16] *Id.*

[17] Qwest Ex. 4 (AT&T, MCI, and Qwest Stipulation).

[18] Qwest Ex. 1 (Million Dir.) at 5.

[19] *See Phase II Order* at 79.

MTI and Staff have both acknowledged that Option 2 is an acceptable approach for establishing interim transport rates.[20] Because only Option 2 achieves the objectives discussed above and is acceptable to Staff, MTI, and Qwest, the Commission should adopt that option for establishing the interim transport rates.

The adoption of the transport rates from the first generic cost docket, as proposed under Option 1, would result in an inconsistent approach and prevent Qwest from fully recovering its expenses under HAI. Unlike the transport rates now in effect or those proposed pursuant to Option 2, the old transport rates are not based upon the HAI model. As discussed above, since the Commission adopted the HAI model's methodology for establishing loop and switching charges, and there is a direct relationship in how HAI assigns expenses to different UNEs, the transport rates must also be based upon the HAI model. If they are not, Qwest will not fully recover its expenses.

Moreover, as also discussed above, in the *Feb. 15, 2001 Procedural Order*, the ALJ concluded that the Commission has never reviewed any of the UNE rates from the first generic cost docket, including the transport rate, to determine if they comply with the FCC's pricing rules. In that same order, the ALJ suggested that even as of February 2001 – more than two years ago – those rates may have been outdated: "[S]ince the Commission originally approved the UNE rates there have been factual and legal changes that support a review at this time."[21] Indeed, in contrast to its current support for resurrecting the old transport rates, Staff argued strenuously in 2001 that the UNE rates from the previous docket had to be reconsidered because the Commission had intended that they would be in effect only for one year:

> It is clear when one reads the transcripts of the Open Meetings at which Qwest's UNE rates were adopted, that the Commissioners contemplated

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[20] *See* MTI Ex. 2 (Hazel Reb.) at 3; Staff Ex. 1 (Dunkel Dir.) at 3 (". . . since I also presented option 2 as an acceptable interim solution, I do not have a strong objection to Option 2 being the interim solution."); Tr. at 224-25 (Hazel Cross).

[21] *Feb. 15, 2001 Procedural Order* at 3.

> that the UNE rates would remain in place for approximately one year and would be subject to review again at that time.[22]

Staff also emphasized that the Commission had never found that the old UNE rates, including the transport rate that would apply under Option 1, complied with the FCC's pricing rules: "[N]owhere in Decision No. 60635, does the Commission find that the UNE rates it adopted complied with all of the FCC's pricing rules which were not even in effect at that (*sic*) time that the Decision was issued."[23]

Like Staff, AT&T and MCI argued strongly in late 2000 and early 2001 that the UNE rates from the first generic cost docket were outdated and had to be replaced:

> The Commission must review the prices set in October 1997. Nearly four years have elapsed since this Commission took evidence to determine the wholesale prices for interconnection, UNEs, and resold services.
>
> * * *
>
> To rely on prices before there was any true competition, when the Commission now has three years of history, is to ignore reality and the factual events that have occurred since the passage of the federal Telecommunications Act of 1996.[24]

Thus, the old transport rates that the Staff and MTI would have the Commission resurrect under Option 1 are among the very rates that the Staff and the CLECs contended were outdated more than two years ago. If those rates were outdated then, as the Commission agreed through its adoption of new rates in the *Phase II Order*, they are certainly outdated now, almost six years after they were adopted.

Finally, there is no merit to MTI's claims relating to the alleged ease of implementing Option 1 as compared to Option 2 or to the alleged lack of harm that would result from adopting

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[22] Response of Staff to Qwest Corporation's Motion for Reconsideration at 3 (Jan. 22, 2001).

[23] *Id.* at 2.

[24] WorldCom's Response to Motion of Commission Staff for Clarification of Procedural Order at 5 (Nov. 27, 2000); *see also* AT&T's Memorandum in Support of Motion of Commission Staff for Clarification (Nov. 27, 2000).

the outdated transport rates proposed under Option 1. As Ms. Million testified, adoption of either Option 1 or Option 2 will produce separate rates for transport and entrance facilities, meaning Qwest will need to make similar changes to its billing systems regardless of the option the Commission adopts.[25] In fact, although Mr. Hazel testified that he believed Option 1 would be easier for Qwest to administer, he acknowledged in the hearing that he had little knowledge of the steps Qwest actually would have to take to implement the new transport rates.[26]

Equally baseless is the claim that any harm caused by implementation of outdated transport rates will be minimized by the fact that they will only be in effect for a limited, interim period. It would be improper to use outdated rates that the Commission has never found to be in compliance with the FCC's pricing rules no matter how small the harm. Here, pursuant to the *April 11, 2003 Procedural Order*, the interim transport rates will be in effect until the Commission adopts new UNE rates at the resolution of the Phase III reconsideration proceeding.[27] The Commission has not yet established a schedule for that proceeding, meaning the "interim" rates will be in effect for a substantial period and will have significant financial consequences for all parties.

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

Issue 2 of the Procedural Order is whether any revised transported rates "determined as a result of the expedited hearing should be made effective as of June 12, 2002," the date upon which the Commission adopted the transport rates currently in effect, "or from the effective date of the Order adopting" new transport rates. The answer to this question is provided under settled principles of controlling federal law, in addition to Arizona law: rates that are either prescribed

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[25] Qwest Ex. 2 (Million Reb.) at 4.

[26] Tr. at 221 (Hazel Cross).

[27] Procedural Order, *Investigation into Qwest Corp's Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-0000A-00-0194 (April 11, 2003) ("*April 11, 2003 Procedural Order*").

by the Commission, or otherwise approved as lawful may not be changed except on a prospective basis, notwithstanding any claim or subsequent finding by the Commission that the formerly prescribed or approved rates were unreasonable or otherwise unlawful. Accordingly, the new transport rates may apply from the effective date of the Order adopting them, and no earlier. As a matter of law, the application of the new rates as of June 12, 2002, or any sooner than the date upon which they are adopted, is prohibited.

An order making the new rates effective prior to the date of their adoption would violate the rule against retroactivity, which has been described as "a cardinal principal of retaking."[28] The leading case on retroactive ratemaking, *Arizona Grocery Co. v. Atichson, Topeka & Santa Fe Railway, Co.*, 284 U.S. 370 (1932), was decided by the United States Supreme Court. As the Court explained:

> Where the Commission, has, upon complaint and after hearing, declared what is the maximum reasonable rate to be charged by a carrier, it may not at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, by declaring its own finding as to reasonableness erroneous, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate."[29]

In *Arizona Grocery*, the Court invalidated a 1927 order by the Interstate Commerce Commission finding that the " maximum reasonable" rates prescrib[ed]" by it after a hearing in 1922 were in fact "unreasonable," and ordered the carrier to make "reparations" (*i.e.*, "true-ups") to its customers in an amount equal to the difference between the prescribed rate (or the rates actually collected by the carrier), and revised rates determined in a 1925 proceeding.[30] The proposal here to make the revised transport rates effective as of June 12, 2002, is in substance identical to the order invalidated in *Arizona Grocery*.

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[28] *City of Piqua v. FERC*, 610 F.2d 950, 955 (D.C. Cir. 1979).

[29] *Arizona Grocery*, 284 U.S. at 390.

[30] *Id.* at 382.

Indeed, the facts in *Arizona Grocery* are substantively indistinguishable from those here. Analogous to the rates at issue in *Arizona Grocery*, the current transport rates were prescribed by the Commission in the *Phase II Order*. In its decision, the Commission found that the rates it prescribed for UNEs, including the transport UNE rates, complied with the Telecommunications Act of 1996 ("the Act"). Specifically, the Commission found that "the prices for unbundled network elements are based on the cost (determined without reference to a rate of return or other rate-based proceeding) of providing the interconnection or network element . . .and are nondiscriminatory."[31] Like the subsequent proceeding in *Arizona Grocery*, this proceeding was initiated following a complaint by MTI, a non-party to the initial proceeding during which the challenged rate was prescribed. In essence, MTI is proposing that the transport rates prescribed by the Commission in *Phase II Order* be replaced by revised rates, and that the replacement be made retroactive to June 12, 2002, the date of the prescription.

Neither the Act nor the FCC's orders and regulations authorizes the retroactive application of UNE rates, especially UNE rates approved as permanent and lawful by the state commission, or suggests that the doctrine of retroactive ratemaking does not apply to rates and transactions governed by the Act. The FCC's *Local Competition Order* confirms that rates may be changed during the term of an agreement, if at all, solely on a prospective basis.[32] In particular, the FCC stated that where it is appropriate to replace rates with new ones, the replacement would "take effect at or about the time of the *conclusion*" of the state commission's subsequent proceeding, and that the new rates would "*apply from that time forward.*"[33] There is no mention of "true-ups" or retroactivity.

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[31] *Phase II Order* at 84.

[32] First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, FCC 96-325, 11 FCC Rcd 15499 at ¶ 693 (rel. Aug. 8, 1996) ("Local Competition Order").

[33] *Id.* at ¶ 693 (emphasis added); *see also id.* at ¶¶ 769, 782.

Against this background, it is clear that an order adopting MTI's retroactivity proposal would have the same fate on appeal as the reparations order invalidated in *Arizona Grocery*. Arizona law, even if applicable, would require the same result. Like federal law, Arizona law recognizes the rule against retroactive ratemaking by "administrative agencies."[34] As explained by the Arizona Court of Appeals, "[w]hen an agency approves a rate, and the rate becomes final, the agency may not later on its own initiative or as a result of collateral attack, make a retroactive determination of a different rate and require reparations."[35] Refunds or surcharges to correct the prior application of a commission-approved rate are permissible only upon a finding of unlawfulness is made by a court on appeal of the agency order adopting the prior rate.[36] That is why the Court of Appeals referenced the agency's "own initiative" and "collateral attacks" in describing the rule against retroactivity. In this case, because any express or implied findings of unlawfulness regarding the transport rates approved and prescribed in *Phase II Order* will be those of the Commission, not a court, this exception to the rule against retroactivity cannot save the MTI's proposal.

The MTI's proposal also would violate the Act by disregarding the rates, terms and conditions of the commission-approved interconnection agreements in effect on the dates of the UNE transactions at issue. Interconnection agreements are the "exclusive" source of the rates,

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

[35] *See Mountain States*, 604 P.2d at 1147.

[36] *Id.* Limiting the exception to the rule against retroactivity to cases where the rate previously approved by the Commission is invalidated on appeal to a court promotes not only certainty, but administrative efficiency. Had MTI participated during Phase II of the Commission's UNE rate proceeding, it could have then timely presented evidence and argument in an attempt to persuade the Commission to reach a different result, and if unsuccessful, pursued an appeal under 47 U.S.C. 252(e)(6) as "an *aggrieved* party." Ordering retroactivity in this case would not only reward MTI's failure to participate in Phase II, but would encourage parties to rest on the efforts of others in future Commission proceedings, and commence subsequent collateral attacks if they do not like the outcome.

terms and conditions of UNEs and other matters subject to section 251,[37] and have the "binding force of law."[38] Those agreements specify the period during which they are in effect, the rates and other terms that apply to transactions during that period, and the circumstances and procedures, if any, applicable to modifications of rates and other terms. A state commission may not issue in generic proceedings an order that purports to change the provisions of existing interconnection agreements, without reviewing those agreements to ensure that the ordered changes are consistent with the language of the applicable agreements. To paraphrase the Ninth Circuit Court of Appeals, an order that applies rates different than those set forth in interconnection agreements "effectively changes the terms of 'applicable interconnection agreements' in [Arizona], and therefore contravenes the Act's mandate that interconnection agreements have the binding force of law."[39] This principle proscribes not only retroactive rate changes, but any rate changes other than as authorized by the express terms of interconnection agreements between Qwest and CLECs.

Staff and MTI are likely to argue that Arizona Revised Statute § 40-252, which confers authority to the Commission to rescind, alter, or modify any order or decision, supports the proposition that any changes to the transport rates should be applied retroactively to June 12, 2002.[40] However, nothing in this statute provides that changes to permanent rates established by the Commission will apply retroactively; indeed, under the well-settled Arizona law described above, such a provision would plainly be unlawful. More important, even if such a statutory construction were colorable, it would directly conflict with the federal prohibition against retroactive ratemaking and, therefore, would be preempted by federal law.

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[37] *Verizon North v. Strand*, 309 F.3d 935, 941 (6th Cir. 2002).

[38] *Pacific Bell v. Pac-West Telecomm, Inc.*, 325 F.3d 1114, 1127 (9th Cir. 2003).

[39] *Id.*

[40] *See* MTI Ex. 2 (Hazel Reb.) at 5.

In addition, the Arizona legislature has established the general governing principle that legislative enactments do not apply retroactively.[41] Under Arizona law, Commission ratemakings are legislative in character[42] and, therefore, the general prohibition against legislative retroactivity applies. Nothing in Section 40-252 authorizes a different result. Accordingly, any change to the transport rate in this proceeding must only apply on a going-forward, prospective basis.

Finally, it bears emphasis that the request for retroactive application of the transport rates is premised on MTI's erroneous claim that Qwest inaccurately implemented the transport rates the Commission ordered in the *Phase II Order*. Testifying for MTI, Mr. Hazel argued that the rates Qwest has been charging for transport are unsupported by the *Phase II Order*, unlawful, and "unexpected" and, therefore, retroactive application of the new rates is appropriate.[43] To the contrary, the rates Qwest has been charging are the precise rates that the HAI model produces for transport. Not only are these rates supported by the *Phase II Order*, but Qwest is *required* to charge them based on the Commission's considered decision to use the HAI model for transport. In the hearing, in contrast to his written testimony, Mr. Hazel essentially conceded this point:

> Q. Mr. Hazel, isn't it a fact that the rates that Qwest has implemented are in fact the rates that the Commission ordered in Phase II?
>
> A. I believe that would be correct.[44]

As for MTI's claim that the new transport rates were "unexpected," even if this claim were supportable, it would not provide a basis for overcoming the legal prohibition against

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[41] *See* Ariz. Rev. Stat. § 1-244 ("No statute is retroactive unless expressly declared therein.").

[42] *See Arizona Corp. Comm'n v. Superior Court of Ariz.*, 107 Ariz. 24, 26-27 (1971) (quoting *Prentis v. Atlantic Coast Line Co.*, 211 U.S. 210 (1908)) ("The general rule is that rate-making is legislative in character. . . . 'Legislation . . . looks to the future and changes existing conditions by making a new rule, to be applied thereafter to all or come part of those subject to its power. *The establishment of a rate is the making of a rule for the future,* and therefore is an act legislative, not judicial, in kind.'") (emphasis supplied).

[43] MTI Ex. 1 (Hazel Direct) at 7-8.

[44] Tr. at 216 (Hazel Cross).

retroactive ratemaking. In any case, the claim is not supportable. Any surprise that MTI may have experienced is the result of its decision not to participate in the Phase II proceeding. As Mr. Hazel acknowledged, MTI decided not to participate in Phase II after considering the expense that would be involved and deciding that the investment would not be worth it.[45] Accordingly, by its own choice, MTI did not submit testimony, attend the Phase II hearing, or even read all of the testimony filed in Phase II.[46] Having made that choice, MTI cannot now legitimately invoke "surprise" as a basis for applying the new transport rates retroactively. To rule otherwise would perversely reward MTI and penalize Qwest for MTI's decision not to participate in Phase II.

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

As explained in Part I above, Qwest strongly believes that an order adopting the CLECs' proposal to make the revised transport rates retroactive would be unlawful. Should the Commission disagree, however, and adopt that proposal, Qwest requests that the Commission likewise order that the revised switching rates be made retroactive to the same date. There is no legitimate basis for disparate treatment of the transport rates on the one hand, and the switching rates, on the other. The theory underlying the request for revisions, *i.e.*, that the rates established in the *Phase II Order* were in some material respect unreasonable, applies no less to the switching rates than to the transport rates. The law neither requires nor permits favoritism toward CLECs and against ILECs. An order correcting an error through refunds of transport rates subsequently found excessive, but refusing to permit surcharges to correct an error resulting in unreasonably low rates for UNE switching, would be arbitrary and capricious.[47]

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[45] *Id.* at 215.

[46] *Id.* at 214-16.

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

During the hearing, Staff suggested through its questioning that the stipulation and the Procedural Order permit retroactive application of the new transport rates but not such application of the new switching rates. This contention is wrong. Staff points to the fact that the stipulation and the Procedural Order expressly identify the potential retroactive application of the new transport rates as an issue in this phase of the docket but do not identify the potential retroactivity of the switching rates as an issue. There is a logical reason for this difference. When the parties entered into the stipulation on April 8, 2003, they had agreed that this phase of the docket would result in new transport rates. Knowing that there would be new rates, MTI argued that the modified rates should apply retroactively. Although Qwest strongly disagreed, it recognized the efficiency and logic of addressing the issue in this phase of the docket and, therefore, consented to listing the issue in the stipulation.

By contrast, when the parties entered into the stipulation, they did not agree that this phase of the docket would produce new switching rates. Lacking such an agreement, the parties had no reason to list expressly in the stipulation whether new switching rates would apply retroactively. In any case, the stipulation and the Procedural Order have not been applied strictly to limit the issues in the docket. For example, although neither document lists any issues relating to the unbundled loop, AT&T and MCI were permitted to introduce testimony -- over Qwest's objection -- in which they argue that the recurring rate for the unbundled loop should be modified to account for the increase in the switching rates.[48] The issue of retroactive application of the switching rate is clearly more directly related to the issues expressly listed in the stipulation and the Procedural Order than is AT&T's/MCI's proposed change to the rate for the unbundled loop. It would be both inequitable and inconsistent to permit AT&T and MCI to introduce the loop-related testimony while barring Qwest from pursuing retroactive application of the switching rate.

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[48] *See* Tr. at 21-22 (Ruling Denying Qwest's Motion to Strike Loop-Related Testimony of Douglas Denney).

Finally, addressing the potential retroactive application of the new switching rates will not prejudice any party to the proceeding. Qwest expressly identified this issue in the direct testimony of Ms. Million filed on April 28, 2003, thereby giving all the parties the opportunity to address the issue in their rebuttal testimony, at the hearing, and in their post-hearing briefs.[49] Indeed, the lack of any prejudice is demonstrated by the fact that no party objected to Qwest's submission of testimony addressing this issue.

Accordingly, if the Commission orders retroactive application of the new transport rates, fairness requires that it also order retroactive application of the new switching rates.

II. The Commission Should Adopt the Switching Rates Proposed by Qwest and Staff.

A. All Interested Parties Agree the Switching Rates Must be Modified.

There is unanimous agreement among Staff, Qwest, AT&T, and MCI that the Commission should correct the switching rates it ordered in the initial *Phase IIA Order*. The need to correct the switching rates arises from the fact that the analog switch port rate of $1.61 that the Commission ordered is not consistent with the Commission's Phase IIA rulings relating to switching inputs and, therefore, is preventing Qwest from recovering all the switching costs the Commission allowed.

As Ms. Million explained, the HAI model that the Commission adopted for switching and other UNEs produces a total switching cost of $144,269,311 using the inputs the Commission ordered in the *Phase IIA Order*.[50] However, the port rate of $1.61, combined with the per minute of use rate of $0.00097 that the Commission ordered, allows Qwest to recover only $115,415,449, which is just 80% of the total switching costs HAI produces using the Commission's switching inputs.[51] This under-recovery stems from Staff's inadvertent but

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[49] Qwest Ex. 1 (Million Direct) at 7.

[50] Qwest Ex. 1 (Million Direct) at 11.

[51] *Id.*

erroneous use of either a 30% or 40% assignment of switch costs to the port in calculating the $1.61 port rate instead of the 60% assignment that the Commission ordered in the *Phase IIA Order*.[52] Staff witness, William Dunkel, explained this error and the improper effect it caused:

> The problem is that the $1.61 port rate was not based upon 60% of the switching costs being allocated to the port (The $1.61 was based on 30% of the switching being port costs). If both the $1.61 port rate, and the traffic sensitive rates (that are based on 40% of the switch costs as usage) continue to be used, then 100% of the switch costs would not be recovered. This is not a desirable result.[53]

Consistent with this testimony, Staff agrees that the Commission should correct the switching rates from the *Phase IIA Order* so that "the total cost of the switch (as determined by the HAI run) should be recovered in the sum of the port and traffic sensitive rates."[54] Likewise, AT&T and MCI agree that the rates should be corrected, as reflected by the statement of their cost witness, Douglas Denney, that they are "not opposed to using the results from the HAI Model, as was advocated by Qwest in their motion to reopen the record."[55]

When 60% of the switching costs produced by HAI are assigned to the switch port, as the Commission ordered, all parties agree that the model produces a port rate of $2.44, along with the per minute of use rate of $0.00097.[56] Staff argues that this increase in the port rate requires a reallocation of the overhead expenses included in HAI that should be accomplished by reducing the HAI-generated port rate to $2.36 and the per minute of use rate to $0.00094.[57] The Commission should reject this proposed adjustment. The practical reality is that there is often an

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[52] *Phase IIA Order* at 17-18; *see also* Qwest Ex. 1 (Million Direct) at 11-12.

[53] Staff Ex. 1 (Dunkel Direct) at 6.

[54] *Id.*

[55] AT&T/MCI Ex. 2 (Denney Direct) at 3.

[56] *See* Qwest Ex. 1 (Million Direct) at 10; Staff Ex. 1 (Dunkel Dir.) at 7; Staff Ex. 2 (Dunkel Reb.) at 6; Response of AT&T/MCI to Qwest Corporation's Second Set of Data Requests (May 22, 2003) at 6; Response of Staff to Qwest Corporation's Third Set of Data Requests (April 30, 2003) at 3-5.

[57] Staff Ex. 2 (Dunkel Rebuttal) at 5-6.

interrelationship among UNE rates. If the Commission were to adopt the practice of setting new UNE rates and then going back to modify all other affected UNE rates, there would never be finality to rates. For example, in Phase III of this docket, the Commission will set new rates for network elements and services, including transport. Because of the relationship between transport costs and switching and loops costs, the new Phase III transport rates will very likely affect the costs of switching and loops. However, it would not be appropriate to adjust switching and loop rates, as doing so would be administratively burdensome and would eliminate the rate finality that CLECs and Qwest require.

If the Commission does adopt Staff's proposed reallocation of expenses, however, the reallocation would have to account for the shift in expenses that would be required if the Commission adopts Staff's Option 1 relating to transport. As established by the stipulation between Qwest and AT&T/MCI, the decrease in transport rates that Option 1 would produce would "cause[] the HAI model to increase the amount of expenses assigned to the unbundled loop and switching elements."[58] While Qwest strongly opposes transport Option 1 for the reasons set forth above, if the Commission chooses that option and reallocates expenses as proposed by Staff, it should require the parties to include in their HAI switching compliance runs the increase in HAI's allocation of expenses to switching that would result from the decrease in transport rates.

B. The Commission Should Continue to Use the 60/40 Split it Adopted in Phase IIA and that Staff and Qwest are Supporting.

In the initial Phase IIA proceeding, with the agreement and support of AT&T and MCI, the Commission assigned 60% of switching costs to the analog port and 40% to usage.[59] While AT&T and MCI supported this allocation as being within a range of reasonableness, their preferred allocation would have assigned 70% of switching costs to usage and only 30% to the

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[58] Qwest Ex. 4 (AT&T, MCI, and Qwest Stipulation).

port.[60] Despite their support for this substantial allocation of costs to usage in testimony presented only 19 months ago, AT&T/MCI now claim that it would be highly improper to assign any switching costs to usage. As conceded by AT&T/MCI witness, Richard Chandler, however, there have not been any changes in switching technology since the initial Phase IIA proceeding that justify this dramatic reversal of position.[61] In fact, there is no evidence that justifies their new position; as most state commissions have found, switching costs are properly allocated between usage-based and fixed-cost components.[62]

Indeed, in previously supporting the two-tier rate structure in this proceeding, both Mr. Chandler and this Commission found it compelling that a New York Public Service Commission ALJ had determined that an appropriate rate design would assign up to 40% of switching costs to

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[59] *Phase IIA Order* at 17-18.

[60] Tr. at 170-172 (Chandler Cross). In recent cost proceedings in Arizona, Colorado, and Nebraska, AT&T and MCI also supported assigning substantial percentages of switching costs to usage. AT&T and MCI advocated setting the usage component of HAI at 40% in Colorado and 70% in Arizona and Nebraska.

[61] Tr. at 168-172 (Chandler Cross).

[62] *See, e.g.*, Arbitration Order, *Petition of MCImetro Access Transmission Services, LLC, Brooks Fiber Communications of Missouri, Inc., and MCI WorldCom Communications, Inc. for Arbitration of an Interconnection Agreement with Southwestern Bell Telephone Company under the Telecommunications Act of 1996*, Case No. T0-2002-222, 2002 Mo. PSC LEXIS 307, at *58 (Mo. PSC rel. Feb. 28, 2002) (declining to adopt a flat-rated switching structure); Order On Unbundled Network Element Rates, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, Case 98-C-1357, 2002 N.Y. PUC LEXIS 15, *66 (NY PSC rel. Jan. 28, 2002) ("*NY UNE Order*"); Decision and Order, *In the Matter of the Board's Review of Unbundled Network Elements, Rates, Terms, and Conditions of Bell Atlantic-New Jersey, Inc.*, Docket No. T000060356 (New Jersey Bd. of Pub. Util. rel. Nov. 20, 2001) ("*NJ UNE Order*"); Opinion and Order, *In the Matter of the Review of Ameritech Ohio's Economic Costs for Interconnection, Unbundled Network Elements, and Reciprocal Compensation for Transport and Termination of Local Telecommunications Traffic*, Case No. 96-922-TP-UNC, Case No. 00-1368-TP-ATA, 2001 Ohio PUC LEXIS 719 (OH PUC rel. Oct. 4, 2001) ("*Ohio UNE Order*").

usage.[63] More recently, the New Jersey Board of Public Utilities determined that a "two-tier rate properly reflects the cost causation associated with unbundled switching."[64] In rejecting the same arguments that AT&T and MCI have presented in this case, the New Jersey Board stated:

> Clearly, *there are usage sensitive elements associated with switching, and to provide switching on any other basis would tend to send the wrong economic signals to CLECs and their customers*. By accepting the WorldCom proposal, we would be encouraging tariff arbitrage by permitting CLECs to pick and choose the rate design that best suits its individuals customer characteristics. This is inconsistent with the average rate design philosophy that guides this Board in virtually all of its retail and wholesale rates, including those set forth in this docket and the two-tier switching rate design in virtually every other state. In keeping with our already stated objectives and conclusions regarding rate design, we hereby adopt [the ILEC's] two-tier rate structure.[65]

In a proceeding before the Public Utilities Commission of Ohio, AT&T and WorldCom proposed moving to a flat-rated switching rate structure, because "the pricing of unbundled network elements should be consistent with the manner in which the costs of providing the elements are incurred."[66] Consistent with the testimony of Mr. Gillan and Mr. Chandler in this proceeding,[67] AT&T and WorldCom also asserted in the Ohio proceeding that switches are generally installed with a certain maximum usage capacity based on CCS and are "engineered

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[63] *Phase IIA Order* at 17-18; Tr. at 169-170 (Chandler Cross).

[64] *NJ UNE Order* at 127.

[65] *Id.* (emphasis supplied).

[66] *Ohio UNE Order* at *43.

[67] AT&T/MCI Ex. 3 (Gillan-Chandler Joint Dir.) at 16.

and installed with sufficient CCS capacity to service all lines without blockage."[68] The Ohio Commission soundly rejected these arguments:

> The Commission adopts a bifurcated rate structure [for switching] consisting of a port charge and a usage sensitive per minute of use charge. . . . [T]he record indicates that usage is a driver of switching costs. We find that, while [the ILEC] pays vendors on a set rate per-line basis, it cannot be inferred that [the ILEC] forward-looking costs of providing switching service is independent of customer usage. . . . [A]s customer usage increases incrementally, switch investments have to be made in the form of CCS jobs. Further, as switching levels increase, additional equipment is needed in order to handle increased capacity. Accordingly, this rate structure is consistent with the way costs are incurred in [the ILEC's] network. . . .[69]

A two-tiered rate structure is also consistent with the FCC's recent finding supporting a state commission's allocation of switching costs to a usage component.[70]

These decisions correctly recognize that cost recovery must be based upon cost causation, and that switch designs and costs are directly affected by usage. As Mr. Linse and Ms. Million testified, while the costs for some parts of the switch are caused by the number of lines, an

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[68] *Ohio UNE Order* at *43-44.

[69] *Id.* at *47.

[70] *See* Memorandum Opinion and Order, *Application by Verizon New England Inc., Verizon Delaware Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization to Provide In-Region, InterLATA Services in New Hampshire and Delaware*, WC Docket No. 02-157, FCC 02-262, 17 FCC Rcd 61882, at ¶ 61 (rel. Sept. 25, 2002) ("The [switch] processor is a shared facility and our rules explicitly grant states discretion to recover costs of shared facilities on a usage-sensitive basis. . . . The Commission's rules also provide that local switching costs shall be recovered through a combination of a flat-rated charge for line ports . . . and one or more flat-rated or per-minute usage charges for the switching matrix and trunk port, which are shared facilities. . . . The New Hampshire Commission's allocation of the 'getting started' costs to the MOU element . . . is not unreasonable when considered in conjunction with other allocations it made to the fixed rate element."). Even those commissions that have recently migrated from such an approach, such as the Public Service Commission of Wisconsin, concede that a bifurcated design is the "traditional rate structure for unbundled switching" and do so only with some "reluctance." Final Decision, *Investigation Into*

engineer determines how much switch fabric and processor capacity to install based on average peak usage expected from the ports connected to the switch.[71] More usage translates into more trunks, conference circuits, interactive announcements and processors, and, thus, greater switching costs.[72] Mr. Dunkel has also explained that inside each switch there is a switching fabric that actually switches traffic and ". . . is therefore properly considered to be a traffic sensitive cost."[73]

As further proof of this point, Mr. Linse provided examples of recent situations in Arizona where Qwest has been required to increase the capacity of switches to accommodate increases in usage. As he explained, just a few months ago, Qwest upgraded a switch in Beardsley, Arizona, in response to increased usage.[74] That upgrade caused Qwest to incur approximately $370,000 in switching costs – costs that were caused directly by increased usage.[75] Similarly, Qwest will complete an augment of a switch in Sedona next October that is necessitated by increased usage.[76] In addition, Mr. Linse's testimony explains how increased usage resulting from dial-up Internet traffic has required Qwest to increase capacity of its switches, demonstrating again the relationship between usage and switch designs and costs.[77]

Ameritech Wisconsin's Unbundled Network Elements, 6720-TI-161, 2002 Wisc. PUC LEXIS 67, *127 (WI PSC rel. March 22, 2002).

[71] *See* Qwest Ex 3 (Linse Reb.) at 3; Qwest Ex 2 (Million Reb.) at 8.

[72] *See* Qwest Ex 2 (Million Reb.) at 8.

[73] Staff Ex. 1 (Dunkel Dir.) at 7; *see also* Staff Ex. 2 (Dunkel Reb.) at 3-4.

[74] Tr. at 110 (Linse Cross).

[75] *Id.* at 112.

[76] *Id.* at 152 (Linse Redirect).

[77] Qwest Ex. 3 (Linse Reb.) at 8-11.

Even Messrs. Chandler and Gillan agree that Qwest pays more for switching as capacity (*i.e.* usage) of the switch increases.[78] Throughout this proceeding, AT&T and MCI have also supported the proposition that switching costs should be recovered in the manner in which they are incurred.[79] Consistent with this principle, the evidence in this proceeding establishes that switching costs must be recovered, at least in part, through a usage-based rate.

There is no merit to AT&T's and MCI's contention that flat-rated switching is necessary to promote competition. As Mr. Dunkel explained, it would take a higher than average number of minutes of usage per line, per month (assuming the 1600 minutes of average per line usage employed in the HAI model) for the usage rate component incorporated in this proceeding to cause a total switching price in excess of the additional port rate proposed by AT&T and MCI.[80] Therefore, the proposed usage rate will not produce higher costs for the CLECs "unless AT&T and/or MCI plan to sign up a disproportionate share of high-volume customers (such as telemarketers) . . ." In other words, unless telemarketers are the CLECs' focus, as Mr. Dunkel concludes, ". . . paying the 'per minute' rate should not place them at any disadvantage."[81] In any event, AT&T and MCI will be able to charge customers a flat rate, like Qwest, regardless of how switching costs are calculated.

Finally, flat-rated switching would result in low volume users, such as residential customers, subsidizing the costs generated by high volume customers (that exceed 1600 MOU

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[78] AT&T/MCI Ex. 3 (Gillan-Chandler Joint Dir.) at 20; Tr. at 177 (Chandler Cross) (concurring that a carrier would pay more for a switch with an 8 CCS capacity, than a switch with a 4 CCS capacity).

[79] *See, e.g.*, AT&T/MCI Ex. 3 (Gillan-Chandler Joint Dir.) at 5.

[80] Staff Ex. 2 (Dunkel Reb.) at 4.

[81] Staff Ex. 2 (Dunkel Reb.) at 4.

per line, per month). As Mr. Dunkel put it, assigning all switching costs to the flat-rated port charge will lead to a subsidy because:

> you are effectively charging low users for an average level of usage, which may overcharge them. You're charging high users for an average level of usage which may undercharge them.[82]

For this reason, the adoption of flat-rated switching is undesirable public policy, as it would create incentive for carriers to target high volume customers that generate disproportionately large volumes of incoming traffic, such as Internet Service Providers, to the exclusion of other, potentially underserved, customers.

IV. Conclusion

For the reasons stated, the Commission should adopt Qwest's proposed rates for transport and switching and should not apply those rates retroactively. Alternatively, if the Commission orders retroactive application of rates, it should apply both the transport and switching rates retroactively.

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Respectfully submitted,

Qwest Corporation

By: _____

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

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

Attorneys for Qwest Corporation

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[82] Tr. at 58-59 (Dunkel Cross).

ORIGINAL and 13 copies of the
foregoing hand-delivered for
filing this 1st day of July , 2003 to:

Docket Control
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

COPY of the foregoing hand-delivered
this 1st day of July, 2003 to:

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

Christopher Kempley
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

Dwight D. Nodes
Hearing Division
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

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

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

COPY of the foregoing mailed
this 1st day of July, 2003 to:

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

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

Michael W. Patten
ROSHKA HEYMAN & DEWULF
400 E. Van Buren Street, Suite 800
Phoenix, AZ 85004

Michael Grant
Todd C. Wiley
GALLAGHER & KENNEDY
2575 E. Camelback Rd.
Phoenix, AZ 85016-9225

Thomas H. Campbell
LEWIS & ROCA
40 N. Central Avenue
Phoenix, AZ 85007

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

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

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

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

Ray Heyman
ROSHKA HEYMAN & DeWULF
400 E. Van Buren Street, Suite 800
Phoenix, AZ 85004

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

Harry Pliskin
COVAD COMMUNICATIONS COMPANY
7901 Lowry Boulevard
Denver, Colorado 80230

Lisa Crowley
COVAD COMMUNICATIONS COMPANY
4250 Burton Drive
Santa Clara, CA 95054

Greg Kopta
DAVIS WRIGHT TREMAINE LLP
2600 Century Square
1501 Fourth Avenue
Seattle, WA 98101-1688

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

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

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

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

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

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

Janet Livengood
Z-TEL COMMUNICATIONS, INC.
601 South Harbour Island
Suite 220
Tampa, Florida 33602

Andrea Harris
ALLEGIANCE TELECOM
2101 Webster
Suite 1580
Oakland, CA 94612

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

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

Jacqueline Manogian
MOUNTAIN TELECOMMUNICATIONS, INC.
1430 W. Broadway Road, Suite A200
Tempe, AZ 85282

Darren S. Weingard
Stephen H. Kukta
SPRINT COMMUNICATIONS CO
1850 Gateway Drive, 7th Floor
San Mateo, CA 94404-2467

Jeffrey W. Crockett
Jeffrey B. Guldner
SNELL & WILMER
One Arizona Center
Phoenix, AZ 85004-2202

Joyce B. Hundley
Unites States Department of Justice
Antitrust Division
City Center Building
1401 H. Street, NW, Suite 8000
Washington, DC 20530

Kimberly M. Kirby
DAVIS DIXON KIRBY LLP
19200 Von Karman Avenue
Suite 600
Irvine, CA 82612

E. Jeffrey Walsh
GREENBERG TRAURIG
2375 E Camelback Road
Suite 700
Phoenix AZ 85016

PHX/1436990.1/67817.240