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BEFORE THE ARIZONA CORPORATION COMMISSION

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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
PHASES II AND II-A

QWEST CORPORATION'S MOTION FOR RECONSIDERATION OF
ORDER RELATING TO WHOLESALE RATES FOR SWITCHING AND
TRANSPORT

I. INTRODUCTION AND SUMMARY

Qwest Corporation ("Qwest") respectfully brings this motion for reconsideration of the Commission's Supplemental Opinion and Order issued October 6, 2003 that establishes new rates for transport and switching and applies the transport rates, but not the switching port rate, retroactively to June 12, 2002.

1 Phase II and IIA Supplemental Opinion and Order Regarding Transport and Analog Port Rate Issues, Generic Investigation into U S WEST Communication's, Inc.'s nka Qwest Corporation Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts, Docket No. T-00000A-00-0194, Decision No. 66385 (ACC Oct. 6, 2003) ("Supplemental Opinion and Order").

Qwest is compelled to bring this motion because of its serious concerns about the *Supplemental Opinion and Order's* inconsistent treatment of the transport and switching rates. Specifically, the *Supplemental Opinion and Order* does not and cannot justify the application of the new transport rates retroactively and the refusal to apply the new switching port rate retroactively as well. These rulings are, in fact, irreconcilable and, accordingly, the Commission should modify them.²

As Qwest demonstrated in its post-hearing brief and exceptions to the ALJs' recommended opinion and order ("ROO"), retroactive application of any of the new rates is prohibited by the rule against retroactive ratemaking.³ But, if the Commission continues to adhere to its view that retroactive rates are permissible, consistency requires that *both* the transport and switching rates apply retroactively. Indeed, the Commission's ruling that the transport rates should apply retroactively is premised upon its conclusion that the initial rates were derived through a mistaken factual assumption.⁴ While there is significant disagreement about the accuracy of this finding, all parties agree that the initial switching rates were understated because of a basic calculation error that had to be corrected.⁵ If a *disputed* "mistake" relating to the transport rates justifies retroactive application, for the Commission's rulings to have any consistency, the *admitted* mistake underlying the switching port rate must also justify retroactive application of that rate.

² It bears repeating that the parties find themselves confronted with addressing the revised transport rates because Mountain Telecommunications, Inc. ("MTI") chose not to participate in the Commission's cost docket and then, after the rates had been established, requested modifications. The Commission, Staff, and the other cost docket participants expended considerable resources establishing the transport rates in Phase II. The Commission should not encourage parties to "sit out" such important generic proceedings by granting retroactive relief when those parties do not like the resulting rates.

³ Qwest hereby incorporates its post-hearing brief and exceptions briefs.

⁴ See *Supplemental Opinion and Order* at 6-7. Qwest disagrees with this conclusion and, as discussed below, even if there were a mistake, that would not make retroactive application of the new transport rates lawful.

⁵ See Transcript of September 30, 2003 Open Meeting at 59 (noting that Staff and Qwest both identified mistake in calculation) ("*Sept. 30 Tr.*").

At the Open Meeting, Qwest pointed out the inconsistency of applying the transport rates retroactively but not according the same treatment to the switching rates. The Commission appeared to believe, however, that the switching port rate did not involve a mistake.⁶ Qwest explained that there was indeed an undisputed mistake in the calculation of the port rate, and ALJ Nodes later agreed with Qwest's representation:

[T]here was a \$1.61 rate implemented. However, as Staff pointed out as well as Qwest, *there was an internal inconsistency in the order*. Because by adopting in another section of the order the 60 percent on port and 40 percent on usage, the actual recovery based on \$1.61 would not allow Qwest to fully recover its costs related to the switch.⁷

Despite this confirmation and Qwest's request that if the Commission apply rates retroactively, it do so consistently,⁸ the *Supplemental Opinion and Order* does not explain why one admittedly mistaken rate should apply prospectively only while the other allegedly mistaken rate applies retroactively.

The inconsistent treatment of the switching and transport rates in the *Supplemental Opinion and Order* is arbitrary and capricious, and therefore, Qwest urges the Commission to reconsider its ruling. The Commission should not apply any rates retroactively but, if it applies the transport rates retroactively, it should also give retroactive application to the switching port rate.

Qwest also requests reconsideration of the Commission's ruling that retroactive application of the transport rates is warranted by a "mistake exception" to the rule against retroactive ratemaking. As discussed below, no such exception exists under federal or state law; the assumption that there is a mistake exception is an error of law.

Finally, the Commission should reconsider its adoption of Staff's proposed "Option 1" for transport rates. As discussed below and at the Open Meeting, the rates under that option do not

⁶ *Id.* at 33.

⁷ *Id.* at 59.

⁸ *Id.* at 72.

comply with the FCC's TELRIC pricing rules. Moreover, contrary to the suggestions at the Open Meeting, Qwest can implement the Option 2 rates produced by the HAI model, which all parties agree are acceptable. Given the choice between rates that do not comply with TELRIC and the Option 2 rates that the Commission has found do comply with TELRIC, the Commission should adopt Option 2.

II. ARGUMENT

A. **Because The Law Does Not Permit Retroactive Ratemaking, The Commission Should Reconsider The Retroactive Application of Rates.**

Under federal and state law, rates that are prescribed by the Commission or otherwise approved as lawful at the time of their adoption may not be changed except on a prospective basis. Accordingly, the new transport and switching rates the Commission adopted should 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 new rates effective prior to the date of their adoption would violate the rule against retroactivity, "a cardinal principal of ratemaking."⁹ As the Supreme Court held in *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway, Co.*,¹⁰ the seminal case on retroactive rulemaking, a commission cannot establish what it deems to be a reasonable rate and later require carriers conforming to that rate to pay reparations in response to a later rate revision.¹¹ 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" (or "true-ups") to its customers in an amount equal to the difference between the prescribed rate (or the rates

⁹ *City of Piqua v. FERC*, 610 F.2d 950, 955 (D.C. Cir. 1979).

¹⁰ 284 U.S. 370 (1932).

¹¹ *Id.* at 390.

actually collected by the carrier), and revised rates determined in a 1925 proceeding.¹² The Commission's order to make the revised transport rates effective as of June 12, 2002, suffers from the same infirmities as the ICC order the Supreme Court struck down in *Arizona Grocery*.¹³

The retroactive ratemaking in the *Supplemental Opinion and Order* cannot be sustained on grounds that the Telecommunications Act of 1996 ("the Act") may in some way be different from the statutes at issue in *Arizona Grocery*. Neither the Act nor the FCC's orders and regulations authorize the retroactive application of UNE rates, especially UNE rates approved as permanent and lawful by the state commission. Similarly, neither the Act nor any FCC order suggests that retroactive rate adjustments by a state commission are permissible. The Act requires that Commission-approved interconnection agreements govern the relationship between incumbent LECs and their competitors. 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.¹⁴ In particular, the FCC stated that where it is appropriate to revise rates, the new rate 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*."¹⁵ The FCC made no mention of "true-ups" or retroactive application of rates. Recently, the FCC issued a notice of proposed rulemaking in which it confirms that its precedents are limited to true-ups of rates only "*when permanent rates under the governing cost methodology have not yet been set*."¹⁶ Accordingly,

¹² *Id.* at 382.

¹³ Qwest incorporates the arguments in its exceptions regarding the unlawfulness of retroactive rates.

¹⁴ 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*").

¹⁵ *Id.* at ¶ 693 (emphasis added); see also *id.* at ¶¶ 769, 782.

¹⁶ Notice of Proposed Rulemaking, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, FCC 03-224 ¶ 151 (rel. Sep. 15, 2003) ("*TELRIC NPRM*") (emphasis added).

nothing in the Act sanctions retroactive ratemaking, and the long-standing prohibition of such practices applies with equal force to rate determinations made under the Act.

Arizona law also recognizes the rule against retroactive ratemaking by "administrative agencies."¹⁷ 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."¹⁸ Refunds or surcharges to correct the prior application of a Commission-approved rate are permissible only upon a finding of unlawfulness made by a *court* on appeal of the agency order adopting the prior rate.¹⁹

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 also administrative efficiency. As discussed in footnote 2 above, if MTI had 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.

¹⁷ *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 Corp. Comm'n*, 51 F.2d 573, 577 (D. Az 1931) ("we are convinced that when the ACC has approved and authorized a rate to be collected, and the carrier has collected that rate and nothing in excess thereof while the rate was in force, the Commission has no authority to order a reparation, even though it should thereafter find, as it did in this case, that the rate so prescribed was excessive").

¹⁸ See *Mountain States*, 604 P.2d at 1147.

¹⁹ *Id.*

Despite the law and policy against retroactive rulemaking, the *Supplemental Opinion and Order* finds that the law permits retroactive adjustments based on "mistake" or "surprise."²⁰ However, the order fails to cite any case to support that proposition. Although counsel for Mountain Telecommunications, Inc. cited a case that purported to support retroactive rate adjustments, that case does not. *Mountain States* refers to the situation where a court overturns a Commission rate determination, and the Commission, *after judicial review*, modifies the rate in response to the court's determination.²¹ Here, there has been no judicial review and therefore, the long-standing doctrine against retroactive ratemaking precludes rewarding MTI for failing to participate in the Phase II proceedings.

Counsel for MTI also cited Arizona Revised Statute § 40-252 as support for the Commission's retroactive application of rates.²² This provision permits the Commission to modify or rescind its determinations. It does not, however, address the issue in dispute—whether the Commission can apply a revised determination retroactively. Instead, the Arizona and federal court precedent *Qwest* has cited hold that modified determinations of the Commission apply prospectively only.

²⁰ *Supplemental Opinion and Order* at 6-7. The *Supplemental Opinion and Order* also rests on an incorrect factual conclusion because there was no surprise or mistake about implementing the HAI transport rates. As set forth in *Qwest's* exceptions to the ALJ's ROO, *Qwest* originally proposed separate transport and entrance facility rates because these elements have different costs and different carriers order different elements. AT&T insisted that all entrance facilities are essentially the same as transport and filed the HAI which averages all the expenses of an entrance facility into a single transport element. Because the *Qwest* cost model, ICM, produced lower rates for both transport and entrance facilities, AT&T then filed testimony urging adoption of the *Qwest* model (with certain reductions not relevant here) and rejection of the separate higher entrance facility rate in ICM. After the Commission adopted the HAI model for DS-0 loops, *Qwest* then urged the Commission to use the HAI model for transport as well. The parties filed briefs in February 2002 discussing this issue and whether consistency required that the Commission use the HAI for both loops and transport regardless of the effect on individual rates. The ALJs then issued another ROO which opted for the HAI model to maintain consistency, and the Commission denied all exceptions on this issue. *Qwest* subsequently submitted its compliance filing in accordance with that determination, and Staff concurred in that filing. Thus, as set forth in more detail in *Qwest's* exceptions, there is no "surprise" or "mistake" at issue.

²¹ 604 P.2d 1144 (Az Ct. App. 1979).

²² *Sept. 30 Tr.* at 46.

The Act, FCC rules, and federal and state law all prohibit the retroactive adjustment of rates. Moreover, there is no "surprise" or "mistake" exception that would permit a violation of the requirement that rates apply prospectively only. Accordingly, the Commission should reconsider its decision to apply a retroactive true up of the transport rate.

B. The Commission's Inconsistent Application Of Rate Retroactivity Is Arbitrary and Capricious.

Although Qwest opposes any retroactive adjustment to unbundled network element ("UNE") rates, if the Commission continues to impose a retroactive true up of transport rates, it must retroactively true up the switching rate as well. There is no valid basis for disparate treatment of the transport rates on the one hand, and the switching rates, on the other.²³ The theory underlying the request for revisions, *i.e.*, that the rates established in the *Phase II Order*²⁴

²³ The only explanation provided in the *Supplemental Opinion and Order* for the disparate treatment of the switching rate is a footnote that references a April 8, 2003 stipulation regarding adjustment of transport rates. *Supplemental Opinion and Order* at 7 n. 1. The *Supplemental Opinion and Order* claims that this stipulation permits retroactive application of the new transport rates, but does not mention the effective date for adjustments to the new switching rates. *Id.* From this, the order concludes that the stipulation permits the Commission to treat the switching rate disparately. *Id.* This contention is wrong. When the parties entered into the April 8, 2003 stipulation, 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. The Commission, therefore, cannot rely on this stipulation to preclude consistent treatment of the effective date of the switching rate. Moreover, neither the stipulation nor the April 11, 2003 Procedural Order has been applied strictly to limit the issues in this 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 argued that the recurring rate for the unbundled loop should be modified to account for the increase in the switching rates. Finally, the effective date of the switching rate has in fact been litigated in this docket through both testimony and briefing. If the April 8 stipulation had "precluded" a true up of the switching as the *Supplemental Opinion and Order* claims, then this issue would not have been addressed by the parties and certainly would not have received the extensive attention it has received in the testimony, briefing, and arguments before the Commission.

²⁴ 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 (June 12, 2002) ("*Phase II Order*").

were mistaken, applies no less to the switching rates than to the transport rates. Indeed, revision of the switching rate is more defensible, because all parties agreed that the rate had been mistakenly calculated. An order correcting a *disputed* error through refunds of transport rates set by mistake, but declining to permit surcharges to correct an *admitted* mistake resulting in unreasonably low rates for UNE switching, is arbitrary and capricious.²⁵ Courts have recognized that "inconsistent application of agency standards to similar situations lacks rationality and is arbitrary."²⁶

Accordingly, if the Commission orders retroactive application of the new transport rates, fairness and consistency require that it also order retroactive application of the new switching rates. The conflicting treatment of these rates should be modified.

C. Consistency In Application Of The Commission's Recent UNE Cost Findings Requires The Use Of The HAI Model For Transport Rates.

Qwest also moves for reconsideration of the Commission's adoption of Staff's Option 1 for establishing transport rates. The adoption of the transport rates from the first generic cost docket, Option 1, results in an inconsistent costing approach that prevents Qwest from fully recovering its expenses under HAI. Option 1 is also inconsistent with the Commission's most recent TELRIC pricing determinations.

As set forth in Qwest's prior briefing, adoption of Option 2 meets all the important criteria for establishing transport rates. First, by producing separate rates for entrance facilities and direct trunk transport ("DTT") based on the HAI model, Option 2 eliminated the alleged problem of CLECs paying for entrance facilities they do not need. Moreover, Option 2 bases the new transport rates on the costs generated by the HAI model, and it is, therefore, the only option

²⁵ See generally *Arizona Corp. Comm'n 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").

²⁶ *Contractors Transport Corp. v. United States*, 537 F.2d 1160, 1162 (4th Cir. 1976). See also *Vargas v. INS*, 938 F.2d 358, 362 (2d Cir. 1991) (agency's inconsistent application of rules to similarly situated parties is arbitrary and capricious).

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.*"²⁷ Finally, as Qwest set forth in its exceptions and post-hearing brief, no carrier seriously opposed the application of Option 2.

During the Commission's Open Meeting, the Commissioners expressed concern that the rates it adopted continue to comply with TELRIC principles.²⁸ According to a previous ruling of the ALJ, however, adoption of Option 1 would not be consistent with TELRIC. In the February 15, 2001 Procedural Order in this docket, the 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.²⁹

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."³⁰

Option 2 avoids the pitfalls the ALJ identified in the *Feb. 15, 2001 Procedural Order* and allows the Commission to maintain a consistent approach in setting UNE rates. In its *Phase II Order*, the Commission ruled that the HAI model the CLECs sponsored would determine the costs and rates for UNEs, stating that HAI "provides the most appropriate measure for

²⁷ *Phase II Order* at 79 (emphasis added).

²⁸ See, e.g., *Sept. 30 Tr.* at 7-8.

²⁹ 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*").

³⁰ *Id.* at 3.

determining TELRIC-compliant, forward-looking costs and prices for UNEs"³¹ The Commission adopted HAI's transport rates after careful consideration and specifically rejected AT&T's and MCI's contention that their model should not be used for transport. Stating that "any UNE pricing inquiry necessarily involves some cost averaging among different kinds of facilities[,]"³² 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."³³ The FCC, too, has recently emphasized the need for consistency in setting UNE rates in its TELRIC rulemaking proceeding.³⁴

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.³⁵ Accordingly, as the Commission previously recognized, selective adoption of the HAI model for only certain UNEs – loop and

³¹ *Phase II Order* at 10.

³² *Id.* at 79.

³³ *Id.*

³⁴ See, e.g., *TELRIC NPRM* ¶ 9 ("Our objective in this proceeding is to modify or clarify the [FCC's] rules in order to help state commissions more easily develop UNE prices and resale discounts that meet the statutory standards established by Congress in Section 252(d) and to provide more certainty and consistency in the results of these state proceedings"); see also *id.* ¶ 7 ("The lack of predictability in UNE rates is difficult to reconcile with our desire that UNE prices send correct economic signals"); ¶ 54 (seeking comment on whether approach to network investment would "produce results that are more consistent across states and send better entry and investment signals to incumbents and competitors"); ¶ 56 (asking parties to explain how their proposed definition of the network "will produce more accurate economic signals and more consistent results than our current regime").

³⁵ Qwest Ex. 4 (AT&T, MCI, and Qwest Stipulation); Qwest Ex. 1 (Million Dir.) at 5.

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.³⁶

Finally, there is no merit to the claims relating to the alleged ease of implementing Option 1 as compared to Option 2 or to the alleged lack of harm that would result from adopting the outdated transport rates proposed under Option 1. As Ms. Million testified, adoption of either Option 1 or Option 2 will produce separate rates for transport and entrance facilities, meaning Qwest will need to make similar changes to its billing systems regardless of the option the Commission adopts.³⁷ At the hearing Ms. Million further testified that implementation of Option 2 is no more difficult than Option 1 because Qwest has already implemented new rates produced by the HAI model.³⁸ Ms. Million further testified that billing and implementation of Option 2 is just as easy as Option 1.³⁹ In fact, although Mr. Hazel of MTI 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.⁴⁰ Ms. Million's hearing testimony confirms that there is simply no support for a conclusion that it is easier to implement Option 1 over Option 2.

³⁶ See *Phase II Order* at 79.

³⁷ Qwest Ex. 2 (Million Reb.) at 4.

³⁸ Hearing Transcript of May 28, 2003 at 75-76 (Million Cross).

³⁹ *Id.* ("So, administratively, it's neither here nor there to us."); *id.* at 150-151 ("You won't implement one faster than the other. Once the team gets the two rates that result from this proceeding, it will take the same amount of time for both").

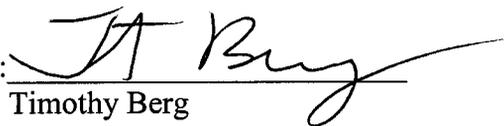
⁴⁰ Tr. at 221 (Hazel Cross).

III. CONCLUSION

For the foregoing reasons, the Commission should grant Qwest's Motion for Reconsideration regarding the Commission's order on wholesale rates for switching and transport.

Respectfully submitted this 27th day of October 2003.

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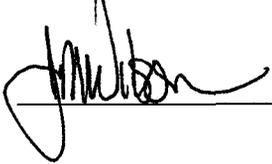
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