



0000106228

RECEIVED
AZ CORP COMMISSION

JAN 6 12 22 PM '97

DOCUMENT CONTROL

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
CARL J. KUNASEK
COMMISSIONER
JAMES M. IRVIN
COMMISSIONER

IN THE MATTER OF THE PETITION
OF MCIMETRO ACCESS TRANSMISSION
SERVICES, INC., FOR ARBITRATION
OF INTERCONNECTION RATES,
TERMS, AND CONDITIONS PURSUANT
TO 47 U.S.C. § 252(b) OF THE
TELECOMMUNICATIONS ACT OF 1996.

DOCKET NO. U-3175-96-479
DOCKET NO. E-1051-96-479

U S WEST COMMUNICATIONS,
INC.'S APPLICATION FOR
REHEARING

I. INTRODUCTION

Pursuant to A.R.S. § 40-253 and A.A.C. R14-3-111, U S WEST Communications, Inc. ("USWC") applies for rehearing of Decision No. 59931 (the "Decision"), entered by the Arizona Corporation Commission (the "Commission") on December 18, 1996, because the Decision is unlawful and unreasonable for the reason set forth below.

The Commission should grant rehearing and amend the Decision on the following issues. First, the Commission should establish the levels of reciprocal compensation paid by USWC and MCI Metro Access Transmission Services, Inc. ("MCI") for call termination and reject the use of bill and keep as an interim solution. Alternatively, the Commission should require that any use of bill and keep be subject to a true-up at the end of the bill and keep period if traffic was out-of-balance during that period. The FCC Rules provide for

1 adoption of a true-up mechanism where bill and keep is adopted. See
2 First Report and Order, Implementation of the Local Competition
3 Provisions in the Telecommunications Act of 1996, CC Docket No. 96-
4 98 (August 8, 1996) at ¶ 1114 (the "FCC First Order"). Second, the
5 Commission should determine that the interim rate for unbundled
6 loops and other unbundled elements should be set at the USWC-
7 proposed TELRIC-based prices. Since the Eighth Circuit Court of
8 Appeals has stayed the FCC pricing provisions, the Commission may
9 not apply the FCC proxy rate for interconnection and unbundled
10 elements. Because Section 252(d) of the Act requires the Commission
11 to determine just and reasonable rates for interconnection and
12 unbundled elements based on the cost of their provision, the
13 Commission should adopt USWC's cost-based pricing proposals, the
14 only cost-based proposals supported by credible evidence in the
15 record. Third, the Commission should determine what services may be
16 purchased from USWC at wholesale prices and resold by MCI. The
17 Commission must also determine the appropriate interim wholesale
18 discount for resold services. Because Section 252(d)(3) of the Act
19 requires the Commission to determine wholesale rates based on "costs
20 that will be avoided by the local exchange carrier" and the only
21 credible evidence in the record of the avoided costs is contained in
22 the USWC cost studies and the testimony of Ms. Santos-Rach, the
23 Commission must adopt USWC's proposed wholesale discounts. Fourth,
24 the Commission should not permit sham unbundling which will signifi-
25 cantly erode the development of facilities-based competition and
26 undercut the role of legitimate resale in Arizona. Fifth, the

1 Commission should permit USWC to charge MCI cash in advance for
2 special construction of any facilities by USWC specifically to serve
3 MCI.

4 As will be more fully described hereafter, USWC urges
5 reconsideration of several of the findings and rulings in the
6 Decision. The rulings cause substantial prejudice and harm to USWC
7 in the following ways:

8 1. The rates will not allow USWC to recover the cost of
9 providing the services. Therefore, the Decision constitutes a
10 confiscatory taking under the 5th and 14th Amendments to the
United States Constitution and Article II, Section 4 of the
Arizona Constitution.

11 2. By not allowing USWC to recover the cost of providing the
12 services or in not providing a mechanism for the recovery of
13 certain costs, the Decision is inconsistent with the provisions
14 of the Act. Therefore, the Decision directly violates the
statutes governing the Commission's actions in this matter and
is in excess of the Commission's authority. As such, the
Commission's actions are contrary to law.

15 3. In several instances, the findings in the Decision are not
16 based on substantial evidence in the whole record before the
17 Arbitrators and the Commission. To the contrary, the
18 substantial evidence in the record would mandate that the
Commission find that proposals made by USWC must be adopted as
fair and reasonable.

19 4. The scope of the Commission's authority to arbitrate
20 issues is limited by Section 252(c) to those open issues to (i)
21 ensure compliance with Section 251 and the FCC regulations, and
22 (ii) establish rates pursuant to Section 252(d) and to provide
23 a schedule for implementation. No other authority is granted
24 to the Arbitrators by the Act. Thus, where the parties have
25 not agreed on contract provisions, such as those involving
26 indemnity or limitation of liability, the Commission may not
impose these provisions in its final order because to do so
would exceed the scope of the Commission's authority under the
Act.

5. The provisions of the Decision challenged hereafter are
arbitrary, capricious, an abuse of discretion and in violation
of the Act.

1 II. RECIPROCAL COMPENSATION

2 The Act requires that, in order for rates to be just and
3 reasonable, reciprocal compensation must "provide for the mutual and
4 reciprocal recovery by each carrier of costs associated with
5 transport and termination." Act § 252(d)(2)(A)(i). The FCC has
6 determined that for shared transmission facilities between tandem
7 switches and end offices, states may establish usage-sensitive or
8 flat-rate charges to recover those costs. States may further use,
9 as a default proxy, the rate derived from the incumbent local
10 exchange carrier's ("ILEC's") interstate direct-trunked transport
11 rates in the same manner that the FCC derives presumptive price caps
12 for tandem switched transport under the interstate price cap rules.
13 (FCC First Order ¶ 822). The FCC has also determined that a bill
14 and keep arrangement is appropriate only when rates are symmetrical
15 and traffic is in balance, a situation not likely to occur in
16 Arizona. (FCC First Order ¶ 1111; see also, A.A.C. Rule R14-2-
17 1304). Nonetheless, the Decision adopts bill and keep for two years
18 from the date an agreement is approved. The Decision is contrary to
19 the Act, is not supported by substantial evidence, and should be
20 reconsidered.

21 Until MCI can directly trunk to each end office over its
22 facilities, MCI's exchange of traffic with USWC will necessarily
23 impose additional costs on USWC. The existing USWC network routes
24 traffic directly from end office to end office through the use of
25 direct trunks. Traffic during unusual calling patterns or peak
26 usage periods may overflow to the local tandem switches. MCI would

1 use trunks to the tandem not as overflow routers, but rather as
2 primary call routers, causing USWC to add capacity to its tandem
3 switches and tandem transport facilities to accommodate the
4 increased traffic. This will result in USWC's cost of terminating
5 MCI's traffic exceeding MCI's cost of terminating USWC's traffic,
6 even if the volume were the same. Further, traffic that has
7 historically been intraoffice in nature (e.g., calls between
8 neighbors served by the same USWC central office) will be converted
9 to interoffice (e.g., calls between a USWC end office and an
10 interconnector's end office), representing an increased traffic load
11 on the USWC interoffice transport network. Under the Act, USWC must
12 be allowed to recover the costs of this transport. Bill and keep
13 does not allow USWC to recover these costs. Even if the minutes of
14 use balance, the cost of each minute will differ and thus the costs
15 will not balance.

16 **A. Bill and Keep**

17 Bill and keep is also inappropriate because it does not
18 permit USWC to recover the cost of terminating MCI's traffic. Any
19 assumption that USWC's terminating traffic and MCI's terminating
20 traffic would be in balance or that USWC's cost of terminating calls
21 is the same as MCI's, which are key assumptions under any bill and
22 keep system, is patently unreasonable. Because MCI can choose to
23 target particular types of customers (such as businesses), and
24 because different customers have different patterns of originating
25 and terminating traffic, traffic is not likely to be in balance
26 between USWC and MCI. Given the different network architectures,

1 the cost of termination for each of the carriers will not be the
2 same.

3 Further, MCI is not required to and cannot provide ubiquitous
4 service on its network. The difference in size of networks and
5 number of customers served by the networks will create an imbalance
6 in both traffic and the cost of termination. Because bill and keep
7 will prevent USWC from recovering its real cost of terminating MCI's
8 traffic, it will inevitably result in under-recovery by USWC and is,
9 therefore, confiscatory.

10 Other commissions have rejected bill and keep for a number of
11 compelling reasons in addition to its unwarranted assumption that
12 traffic will inevitably balance. First, these commissions have
13 recognized that bill and keep does not reflect the different costs
14 of the respective networks of the local exchange carriers ("LECs")
15 and the new entrants. Second, bill and keep creates the opportunity
16 for new entrants to shift costs to the LECs through selection of
17 meet points. Third, bill and keep assumes that costs will be equal
18 and does not recognize the additional cost incurred by LECs in
19 providing transport. The Decision's adoption of bill and keep
20 should be rejected, and USWC's rates for call transit, transport and
21 termination should be adopted instead.

22 At a minimum, the Decision should be amended to provide that
23 bill and keep is subject to a true-up at the end of the interim
24 period during which it is in effect. Otherwise, the interim
25 implementation of bill and keep will result in USWC not recovering
26 its costs of terminating traffic for the period bill and keep is in

1 effect and will result in the illegal confiscation of USWC's
2 property. The FCC First Order also interprets the Act to allow
3 commissions to adopt true-ups in connection with bill and keep. The
4 Commission, therefore, cannot simply rely on the absence of a true-
5 up mechanism in its Rules, but not consider whether such a true-up
6 is appropriate under the evidence in the record.

7 **B. Interconnection**

8 The Decision permits MCI to select a single point of
9 interconnection ("POI") in each LATA. Establishing a single POI per
10 LATA will lead to inefficient engineering of the network and will
11 impose significant additional costs on USWC, who will have to back
12 haul traffic from the single POI if and when MCI chooses to offer
13 facilities-based local service outside the Phoenix calling area. To
14 discourage the establishment of inefficient POIs, USWC should be
15 permitted to charge construction costs to MCI if MCI chooses a POI
16 that requires USWC to construct additional facilities to carry MCI's
17 traffic.

18 Because the Decision adopts bill and keep, USWC cannot recover
19 the additional costs of hauling this traffic. Further, the Decision
20 permits MCI to interconnect at USWC's access tandem. This will
21 further increase the costs that USWC cannot recover. The Decision
22 should be amended to require MCI to establish one POI per local
23 calling area at a place agreed upon by the parties. Alternatively,
24 MCI should, at a minimum, establish its local POI at points of
25 presence ("POPs") in Arizona for the provision of long distance
26 service.

1 Additionally, MCI's switch should be treated as an end office
2 switch rather than a tandem switch for call termination rates for
3 reciprocal compensation even if MCI enters into an agreement with
4 its long distance affiliates permitting MCI to use the affiliates'
5 facilities to terminate calls. MCI's switch does not and will not
6 serve the same geographic area and provide the same tandem switching
7 functions as USWC's tandem. MCI's switch is much more equivalent to
8 MFS's switch, which the Commission treated as an end office switch,
9 then TCG's switch, which it treated as a tandem switch. Compare MFS
10 Order at 6-7 to TCG Order at 9-10. Accordingly, MCI's switch ought
11 to be treated as an end office switch rather than a tandem switch,
12 see FCC First Order ¶ 1090, and USWC should not pay tandem rates for
13 its use. USWC Ex. 1 at 85-86 (Mason); USWC Ex. 2 at 68-70 (Harris).

14 **III. DARK FIBER**

15 USWC opposes the unbundling of dark fiber as outside the scope
16 of the Act. Section 251(c)(3) of the Act requires the unbundling of
17 "network elements." Analyzing the issue of whether to require
18 unbundled access to dark fiber, the FCC concluded:

19 We also decline at this time to address unbundling of an
20 incumbent LECs' "dark fiber." Parties that address[ed] this
21 issue [did] not provide us with information on whether dark
22 fiber qualifies as a network element under sections 251(c)(3)
23 and 251(d)(2).

24 FCC First Order at ¶ 450. Unlike in other parts of the FCC First
25 Order, the FCC did not leave the dark fiber issue open to the
26 states: "We will continue to review and revise our rules in this
area as necessary." Id.

 The record in this docket does not support the required

1 unbundling of dark fiber. No witness demonstrated that failure to
2 provide unbundled dark fiber "would impair the ability of the [CLEC]
3 seeking access to provide the services that it seeks to offer." 47
4 U.S.C. § 251(d)(2)(B). Other competitive local exchange carriers
5 ("CLECs") such as MFS, TCG, ACSI and Brooks have constructed fiber
6 optic SONET rings in the Phoenix or Tucson metro area. Obviously,
7 lack of access to USWC dark fiber has not "impaired" their ability
8 to construct SONET rings and to offer services using those SONET
9 facilities. Moreover, because the Act requires USWC to provide non-
10 discriminatory access to its ducts, conduit or rights-of-way,
11 nothing prevents a CLEC from pulling its own fiber through USWC's
12 existing pathways. Dark fiber is simply not an essential facility.

13 MCI's demand for access to USWC's dark fiber essentially boils
14 down to a request by a competitor for exclusive use of USWC's spare
15 network capacity. The Decision requires USWC to turn over detailed
16 information on the amount and location of its spare capacity.
17 Forcing USWC to make its network capacity available to competitors
18 like MCI constrains USWC's ability to fulfill its statutory provider
19 of last resort obligations. Thus, USWC should be granted rehearing
20 on the dark fiber issue because the Decision violates the Act and is
21 not based on substantial evidence.

22 In addition, the reciprocity requirement in the Decision is not
23 effective until "such time as all CLECS in U S WEST's service
24 territory reach a combined total of 200,000 access lines." Decision
25 at 8. By imposing the 200,000 line minimum, the Decision misapplies
26 A.A.C. R14-2-1307. The rule was designed to require that small LECs

1 with less than 200,000 access lines be exempt from the unbundling
2 requirements in the rules which did not anticipate unbundling of
3 dark fiber. It was intended to create an exemption for small
4 carriers who would never reach such a capacity, and not to create a
5 cushion for large carriers like MCI. Indeed, based on the evidence
6 at the hearing, MCI may well have more dark fiber than USWC. (Tr.
7 620) (Powers).

8 IV. UNBUNDLED LOOP AND OTHER ELEMENT PRICES

9 The Decision orders an interim unbundled loop price of \$21.76
10 by averaging USWC's proposed unbundled loop price of \$30.67 and the
11 FCC proxy price of \$12.85. It also determines the rate for other
12 unbundled elements not on the basis of cost but on the rates
13 established in the MFS and TCG orders. Section 252(d) of the Act
14 requires the Commission acting as arbitrator to determine just and
15 reasonable rates for interconnection and unbundled elements --
16 "based on the cost" of their provision. These rates are not cost-
17 based because they simply average USWC's proposed rates and the FCC
18 proxies. Averaging of proposed prices violates the "cost-based"
19 requirement in Section 252(d).¹ The Commission should delete the
20 unbundled loop price of \$21.76 and adopt USWC's proposed price for
21 the unbundled loop and other elements. Because the Eighth Circuit
22 has stayed the FCC's pricing rules, including the FCC's
23 establishment of so-called "proxy prices", the Commission may not
24 use the proxy prices to set rates or to average against USWC's cost-

25
26 ¹ Moreover, the rates are not based on substantial evidence in
the record.

1 based prices. To the extent that the Decision leaves these pricing
2 issues for resolution following a later generic proceeding, it is
3 inconsistent with the Act and should be amended. Therefore, the
4 Commission should adopt an unbundled loop price of \$30.67 based on
5 USWC's cost studies. The adoption of a rate less than the proposed
6 USWC rate would be inconsistent with the mandate of the Act and
7 constitute an illegal taking of USWC's property.

8 USWC's proposed unbundled loop price and prices for other
9 unbundled elements are based on a Total Element Long Run Incremental
10 Cost ("TELRIC") study as testified to by Ms. Santos-Rach. USWC's
11 studies and prices are specifically tailored to Arizona and provide
12 a realistic estimate of the forward-looking costs of building a
13 network in this state. In sharp contrast, the cost studies
14 submitted by MCI rely almost exclusively on national, unverifiable
15 data and fail to take into account conditions unique to Arizona.

16 Dr. Harris explained that USWC's cost model uses its actual
17 experiences in building a network in Arizona and elsewhere to
18 project forward-looking costs. Dr. Harris worked closely with USWC
19 employees over the past year to ensure that the assumptions and
20 values in the model follow actual experience and the field
21 conditions that would exist if a new entrant were to build a
22 network.

23 USWC issued requests for proposals ("RFPs") to construct out-
24 side plants that would provide complete telephone service. USWC
25 issued these RFPs to compare the bids that USWC received against the
26 cost results of USWC's model. Responsive bids almost equaled the

1 same cost per line calculations produced by the USWC model,
2 confirming the model's reliability.

3 The painstaking process USWC followed to construct and verify
4 its cost study resulted in a model that estimates forward-looking
5 costs realistically and reliably. The model uses fill factors that
6 follow USWC's actual experience in Arizona and that take into
7 account its legal obligations to provide service upon demand and to
8 serve as the carrier of last resort. Similarly, the model reflects
9 USWC's actual experience in Arizona relating to sharing with other
10 utility companies the cost of installing cable and building
11 structures.

12 MCI's proffered evidence based on the Hatfield model does not
13 constitute substantial evidence to support the interim rates in the
14 Decision. The Hatfield model stands in sharp contrast to the USWC
15 cost model; it uses a myriad of insupportable, unrealistic
16 assumptions that artificially depress the costs of building a new
17 network. There is no evidence substantiating the engineering
18 assumptions and inputs within the Hatfield model. Despite MCI's
19 claims, the model is not publicly available and cannot be verified
20 because the inputs remain secret or rest on the judgment of Hatfield
21 employees and consultants.

22 First, the model assumes that a carrier building a new network
23 would share the costs of building and installing much of the network
24 -- cables, conduits, and poles -- with other utilities, so that the
25 carrier would only have to bear one-third of these costs. This
26 assumption reduces the results produced by the Hatfield model,

1 because the costs of building facilities and structures are a
2 substantial percentage of the overall costs of building a new
3 network. USWC's actual experience in Arizona demonstrates that
4 cost-sharing among utilities typically occurs only when cable and
5 other structures are installed in new housing developments.

6 Second, the Hatfield model uses unrealistic fill factors do not
7 account for the immediate ready-to-serve obligations that Arizona
8 law imposes on USWC, and are not achievable by any local exchange
9 carrier. In practice, efficient carriers routinely lay excess cable
10 in anticipation of future growth because it is significantly less
11 costly to do so than to retrench and add additional cable to
12 accommodate increased demand. Even MCI recognizes this practice as
13 cost-efficient and reasonable.

14 Third, the Hatfield model uses unrealistic assumptions about
15 the existing field conditions under which a carrier would have to
16 build a new network. The Hatfield model fails to account for the
17 higher costs required to install conduits and cables in populated
18 areas, in order to dig up and repair roads, lawns, and gardens.

19 Additional flaws in the Hatfield model include the following:

20 Capital costs -- estimated at 10.24% -- are not forward-
21 looking, are not based upon actual conditions prevailing
22 in debt and equity markets, and do not account for the
23 increased risks USWC faces in a competitive environment;

24 The model assumes a uniform depth for trenches of one foot,
25 failing to recognize that deeper trenching -- and higher
26 trenching costs -- often is called for by soil conditions and
27 local regulation; and

28 The model fails to use forward-looking economic depreciation
29 lives, using, for example, a life of 15 years for digital and
30 office switching, even though MCI itself uses a 9.7 year life
31 for digital switching.

1 In sum, as these fundamental flaws demonstrate, the Hatfield
2 model does not provide a realistic estimate of the costs of building
3 a network. USWC's TELRIC estimates are far more realistic and
4 reliable. Accordingly, the Commission should adopt USWC's proposed
5 price of \$30.67 for an unbundled loop and adopt USWC's other
6 proposed rates as the interim rates, subject to true-up.

7 **V. COMBINATION OF UNBUNDLED ELEMENTS ("SHAM UNBUNDLING")**

8 The Decision allows carriers, such as MCI, to purchase
9 unbundled elements and combine them into a service to be offered for
10 resale. The ability to combine unbundled elements and offer the
11 service for resale in this fashion is known as "sham unbundling."
12 Sham unbundling will lead to severe rate arbitrage between resale
13 prices and unbundled element prices. To prevent rate arbitrage,
14 sham unbundling should not be permitted until USWC has been allowed
15 to re-balance its retail rates.

16 Under the Decision, MCI can purchase the equivalent of a
17 "finished" service solely through the purchase of unbundled network
18 elements at "cost-based" rates. Thus, MCI can order USWC to provide
19 a finished retail service at a cheaper price than the Act's resale
20 price (retail less cost avoided) by utilizing the fiction that MCI
21 is buying unbundled network elements -- when in reality there is no
22 unbundling involved. In this manner, MCI can completely circumvent
23 the resale provisions of the Act - engaging in "sham" unbundling.

24 In effect, sham unbundling upsets the balance between resale
25 and unbundling that was established in the Act. Congress realized
26 that both unbundling and resale are critical to the development of

1 meaningful competition. It therefore crafted a carefully balanced
2 mechanism to allow new entrants to enter local markets rapidly,
3 through resale, while developing their facilities-based networks
4 with the purchase of unbundled network elements from ILECs. The
5 Decision misapplies the Act and is inconsistent with it.

6 Congress also realized that the state commissions have set
7 prices for some retail services to include large contributions to
8 help support residence basic exchange service. Therefore, Congress
9 defined "*margin neutral*" resale rules in §§251(c) and 252(d)(3) of
10 the Act to allow the purchase of retail services by resellers at
11 wholesale rates, based on the retail price less avoided costs.
12 Thus, the margins that existed for these retail services and the
13 contributions to other services would be preserved.

14 In summary, sham unbundling allows new entrants to arbitrage
15 the resale of local exchange service and violates the objectives of
16 the Act. The overwhelming weight of the evidence mandates that the
17 Commission modify the Decision to prohibit sham unbundling and there
18 is no substantial evidence to support the adoption of sham
19 unbundling.

20 VI. RESALE

21 A. Resale Wholesale Rates.

22 The Decision orders a discount rate of 17%, the low end of
23 the FCC proxy price range. The Eighth Circuit stay precludes the
24 Commission's reliance on the proxy discounts. Section 252(d)(3) of
25 the Act requires the Commission as arbitrator to determine wholesale
26 rates "on the basis of retail rates ... excluding the portion

1 thereof attributable to ... costs that will be avoided by the local
2 exchange carrier." (Emphasis added). Thus, the discount price for
3 resale services should be set at USWC's retail rate for the relevant
4 service less USWC's avoided cost.

5 Again, the only credible evidence of avoided costs introduced
6 by either party was USWC's avoided cost study and Ms. Santos-Rach's
7 testimony concerning that study. USWC's study sets proposed
8 wholesale rates that accurately reflect the costs USWC will
9 eventually avoid in a wholesale setting. To calculate these rates,
10 USWC formulated six product categories, identified all retail
11 elements included in offering each product, and determined the
12 TELRIC for each element that will be avoided when USWC offers the
13 service for resale. USWC also identified the portion of shared
14 costs that would be avoided for the wholesale products in each
15 category. USWC's calculation of "avoidable" costs also includes a
16 prorated share of common costs. Through this methodology, USWC has
17 calculated discount rates that realistically reflect avoidable
18 costs, which range from 0-9% depending on the service. Rather than
19 adopting a point in the FCC proxy range, the Commission should adopt
20 cost-based rates.

21 MCI's avoided cost study does not provide substantial evidence
22 to support the Decision. MCI's avoided cost study proposes a
23 wholesale discount of 22% for all services. The study dramatically
24 overstates the costs USWC would avoid in providing service to a
25 reseller instead of an end user customer.

26 First, under the Act, avoided costs are "marketing, billing,

1 collection, and other costs that will be avoided by the local
2 exchange carrier" if it provides service on a wholesale, rather than
3 retail basis. The avoided costs must be calculated on a net basis,
4 adding back the additional marketing costs of serving resellers.
5 The FCC has endorsed this "net" approach, acknowledging that some
6 new expenses may be incurred in addressing the needs of resellers as
7 customers. FCC First Order at ¶ 911. Hence, in calculating avoided
8 costs, these additional costs should be considered.

9 However, MCI's study subtracts avoided retail costs from the
10 retail price, but it does not add in the wholesaling costs USWC will
11 incur. This approach conflicts directly with the Act and ensures
12 that any discount rate MCI proposes will be grossly inflated. The
13 MCI study also provides no basis to support its discount for repair
14 and maintenance and uses an improper denominator that excludes
15 intrastate access, thus overstating the discount.

16 Second, MCI's study improperly assumes that USWC will have no
17 marketing or billing expenses in providing services to resellers.
18 Although USWC may eliminate some marketing expenses, significant
19 marketing and other expenses will remain: USWC employees still must
20 interact with resellers, provide customer service, process service
21 orders, and maintain customer service needs. MCI also assumes that
22 USWC will completely avoid product management expenses, but ignores
23 that the product management services USWC provides are required
24 regardless of whether the service is provided on a retail or
25 wholesale basis. With respect to billing expenses, how could MCI
26 assume that USWC will avoid these expenses when selling wholesale?

1 USWC will bill for the exact same facilities it provides, whether on
2 a retail or wholesale basis, and it will continue to incur real
3 costs in doing so.

4 **B. Resale Restrictions.**

5 The Decision requires that the following services be made
6 available for resale at a discount: (1) private line transport
7 (special access and private line) services, (2) services subject to
8 volume discounts, and (3) basic residential services.² The Decision
9 misapplies the standards of the Act, reaches conclusions unsupported
10 by any substantial evidence, and will result in confiscatory rates.

11 USWC should not be required to provide private line services to
12 resellers at a discount because these services are already sold at
13 wholesale prices. In Arizona, private line services are sold to
14 carriers and end users from the special access tariff. Further,
15 private line services are already discounted in Arizona as wholesale
16 services and require no further discounts to set a wholesale price.
17 The FCC First Order provides that exchange access services are not
18 subject to resale requirements even though these services are
19 offered to and taken by end users as well as carriers. (FCC First
20 Order ¶¶ 873-874). The FCC also recognizes that LECs do not avoid
21 any retail costs if access services are offered at wholesale to
22 competitors. Id. Because private line and special access are the
23 same service, provided out of the same tariff, they should not be
24 available to resellers at a discount.

25 _____
26 ²The parties agree that enhanced services, deregulated
services, and promotions of less than 90 days, need not be provided
to MCI for resale.

1 The Decision should also not require USWC to offer further
2 discounts on resellers services that are already offered at a volume
3 discount.³ Services that are provided to large customers, such as
4 Motorola, are already priced to reflect the fact that USWC avoids
5 many of the usual costs of selling at retail. Further, discounts
6 are based primarily on commitments to receive specified quantities
7 of service for defined terms. The discounts therefore reflect costs
8 avoided because of the quantities and the term of the contract. For
9 example, marketing expenses such as advertising are avoided when
10 selling a large volume of service to a customer for an extended
11 period. It makes no sense to apply the same discount to these
12 services on the basis that USWC has avoided significant costs. If
13 a new entrant is allowed to compete with USWC, both by selling its
14 own services and by reselling USWC's service at a discount in excess
15 of the avoided cost, USWC cannot unable to effectively compete. At
16 the very least, the Commission in the generic pricing proceeding
17 should establish separate discount rates for these services.

18 USWC should not be required to offer basic residential service
19 for resale at a wholesale discount. The only evidence in the record
20 confirms that USWC's current 1FR rate of \$13.18 does not cover its
21 cost. Requiring USWC to discount a below-cost service will force
22 USWC to subsidize competitors, such as MCI, with revenues from

23
24 ³ The FCC Order is unclear in its treatment of volume discount
25 services. The FCC requires that discounted services be provided to
26 resellers at the discount rate less the avoided cost. However, to a
large extent, the FCC has left the determination of "the substance
and specificity of rules concerning such discount and promotion
restrictions may be applied to resellers in marketing their services
to end users" to state commissions. (FCC First Order ¶¶ 951-952).

1 USWC's retail customers. Basic residential service is priced below
2 cost in order to ensure universal service. Therefore, it is not
3 appropriate for resellers to obtain this below-cost service at a
4 discount. Further, if USWC is required to provide residential
5 service to resellers at a price below cost, it will retard the
6 development of facilities-based competition. New entrants in the
7 market will have no incentive to build facilities if they can
8 purchase USWC services for less than their cost to construct new
9 facilities. The Commission should grant rehearing and amend the
10 Decision to remove the requirement that these service be provided to
11 MCI at a discount.

12 **VII. UNBUNDLED SWITCHING**

13 The Decision adopts MCI's request that vertical features be
14 included in unbundled local switching rather than being treated as
15 separate services that are subject to resale. Although the FCC has
16 defined unbundled local switching to include vertical features, this
17 is inconsistent with the provisions of the Act. Vertical features
18 are in fact finished retail services offered by USWC to its end
19 users. Under the Act, retail services are not provided to the CLECs
20 as unbundled elements, but are available for resale at an avoided
21 price discount. The Decision should be amended to provide that MCI
22 must purchase vertical features as resale services.

23 **VIII. INTERCONNECTION**

24 The Decision permits MCI to select a single POI in each LATA.
25 Establishing a single POI per LATA will lead to inefficient
26 engineering of the network and will impose significant additional

1 costs on USWC, who will have to back haul traffic from the single
2 POI if and when MCI chooses to offer facilities-based local service
3 outside the Phoenix calling area. To discourage the establishment
4 of inefficient POIs, USWC should be permitted to charge construction
5 costs to MCI if MCI's meet point is more than a mile from a USWC end
6 office.

7 Because the Decision adopts bill and keep, USWC cannot recover
8 the additional costs of hauling this traffic. Further, the Decision
9 permits MCI to interconnect at USWC's access tandem. This will
10 further increase the costs that USWC cannot recover. The Decision
11 should be amended to require MCI to establish one POI per local
12 calling area at a place agreed upon by the parties. Alternatively,
13 MCI should, at a minimum, be required to compensate USWC for
14 additional switching and transport resulting from MCI's refusal to
15 install a POI in local calling areas.

16 **IX. COLLOCATION**

17 **A. Collocation of Remote Switching Units.**

18 USWC opposes the collocation of remote switching units
19 ("RSUs") in its end offices. The Commission should refuse to order
20 collocation of RSUs because: (1) the FCC First Order excludes
21 switching equipment; (2) it is not necessary for interconnection or
22 access to unbundled elements; (3) it creates a significant threat of
23 bypass of switched access services; (4) it will exacerbate space
24 limitation problems in USWC central offices; and (5) alternatively,
25 MCI can locate its RSU where its POP is located or at some other
26 location and connect to USWC's central office without collocating

1 the RSU.

2 The FCC specifically required ILECs to permit collocation of
3 transmission equipment, including any type of equipment used to
4 terminate basic transmission facilities. FCC First Order at ¶ 580.
5 Despite the specific requests of the CLECs, the FCC declined to
6 order that the ILECs permit collocation of switching equipment
7 "since it does not appear that [switching equipment] is used for the
8 actual interconnection or access to unbundled elements." Id. at
9 ¶ 581. An RSU is switching equipment and not transmission
10 equipment; it is not primarily used for interconnection or access to
11 unbundled elements but, as configured by MCI with trunking capacity,
12 for other purposes.

13 Further, placing a trunking-capable RSU in USWC's central
14 office raises a significant prospect of access by-pass. Collocating
15 an RSU, which is trunked directly to other MCI switches or to other
16 CLEC's switches, creates a significant possibility of by-pass. Id.
17 at 500. USWC cannot effectively monitor MCI's use of its RSU to
18 ensure that by-pass was not occurring, and there is no method to
19 program or otherwise disable the RSU so that it could not be used
20 for by-pass. MCI promised not to use RSU's for by-pass; however,
21 because USWC collected \$238,000,000 from interstate and intrastate
22 switched access charges in Arizona, and MCI has substantial market
23 penetration in Arizona, MCI would have a powerful incentive to by-
24 pass whenever the opportunity arises.

25 Collocating RSUs in USWC central offices also will exacerbate
26 serious space limitations in those offices. When RSUs with trunking

1 functionalities are deployed in a USWC central office, additional
2 transmission equipment must also be installed, placing further
3 demands on scarce space.

4 Finally, MCI can often place its RSU within the space currently
5 leased or owned for its POP used to deliver interstate and interLATA
6 traffic to USWC or in other space located near USWC's central
7 offices and avoid collocating those facilities in USWC central
8 offices. It is technically feasible for MCI to collocate RSUs in
9 MCI space near USWC's central offices and connect to USWC through
10 MCI or USWC facilities. For these reasons, the Commission should at
11 a minimum order MCI to locate its RSUs in its own premises or in
12 premises obtained by MCI where technically feasible and economically
13 reasonable as Brooks Fiber agreed.

14 **B. Other Collocation Issues.**

15 The Decision permits MCI to collocate at any technically
16 feasible point and rejects USWC's proposal that the space available
17 to any single new entrant for collocation in a given central office
18 be limited so as to make space available for other new entrants.
19 This portion of the Decision is not supported by substantial
20 evidence and is contrary to sound public policy.

21 In order to protect the rights of all potential competitors,
22 USWC argued that the agreement must contain some limitation on the
23 amount of floor space in a central office, made available to MCI for
24 physical collocation. USWC will have to provide physical
25 collocation to a number of new entrants, and there will be limits on
26 the available amount of floor space, particularly in light of the

1 space limitation problems USWC already faces in some of its Arizona
2 central offices. USWC has proposed that MCI and each other new
3 entrant be limited to 400 feet in any single central office. MCI
4 offered no reasonable alternative suggestion, and the Decision
5 simply fails to address this issue.

6 An even more significant issue with respect to collocation is
7 the premises at which collocation should be offered. The Decision
8 simply adopts the FCC's broad definition of "premises" without
9 considering the significant evidence of problems created by a
10 general rule that new entrants can collocate at manholes, vaults and
11 other locations outside the central office. Although the FCC First
12 Order states that USWC should offer collocation at its "premises",
13 USWC proposed that the presumptive point of collocation be in USWC's
14 central offices, with other arrangements to be made on an as-needed
15 basis. Because the most efficient form of interconnection would be
16 for MCI to interconnect at USWC's end office or tandem switches, and
17 because collocation at other points raises serious issues concerning
18 adverse service impacts, it makes sense for collocation to occur in
19 the central offices. MCI has not requested collocation at any
20 "premise" other than a USWC central office, nor has it given an
21 example about what such a request might possibly be. Alternatively,
22 the Decision should require the parties to use the best and final
23 offer process to resolve such issues.

24 Finally, the Decision adopts MCI's request that no restriction
25 be placed on the types of cable used for entry into collocated
26 space. Where entry into the collocated space is through USWC's

1 conduit or ducts, the use of copper facilities will lead to a
2 quicker exhaust of that conduit and duct and it may well be
3 impossible to build more. The use of fiber facilities for
4 connection of the RSUs would require significantly less duct or
5 conduit. This will preserve the space for use by MCI and other
6 CLECs as well as USWC. The Decision should be amended to provide
7 that the parties should mutually agree on the type of facilities
8 used to enter collocated space and that where technical feasibility
9 requires the use of fiber, USWC may require MCI to enter the central
10 office on fiber facilities.

11 **X. MISCELLANEOUS CONTRACTUAL TERMS**

12 **A. The Commission should endorse USWC's proposed bona fide**
13 **request process.**

14 USWC's best and final offer to MCI contains a proposed
15 bona fide request process that CLECs can use to request
16 interconnection or additional unbundled network elements on a
17 case-by-case basis. The time frames within this process are
18 reasonable and comply with the applicable rules of the FCC and the
19 Commission. USWC Ex. 8 at 11-13 (Mason).

20 The proposed response time, Tr. 144 (Laub); MCI Ex. 4 at 36
21 (Laub), is unreasonable and unnecessary. Initial requests often
22 lack complete information on the scope of the request, Tr. 552
23 (Mason), and MCI plainly will not be able to deploy a service within
24 this short time in any event. See Tr. 148-49 (Laub).

25 **B. MCI should pay for the full construction costs**
26 **incurred by USWC to provide additional unbundled**
elements and facilities for resale.

1 New entrants, such as MCI, who request additional
2 unbundled elements, require the construction of additional
3 facilities for resale. Other special construction is often desired
4 in connection with collocation. New entrants should pay for the
5 construction costs incurred by USWC -- they should not shift these
6 costs to USWC and its retail customers.

7 Requiring that any carrier requesting an additional network
8 element pay the cost that USWC incurs to unbundle and provide that
9 element, such as special construction charges, follows the FCC First
10 Order, which permits ILECs to recover the costs of unbundling
11 network elements from requesting carriers. In addition, the only
12 way to insure that the benefits of unbundling will exceed the costs
13 is to have the requesting party pay.

14 The Decision provides that USWC may collect up-front
15 construction charges from a new entrant only if USWC end users would
16 pay these charges pursuant to USWC's tariffs. This is both
17 inconsistent with the Act -- because it does not require new
18 entrants to pay the true cost of providing the service -- and
19 confiscatory. The Decision should be reconsidered and amended to
20 require that USWC be compensated up-front by MCI for construction
21 costs if USWC has to construct new facilities to enable it to
22 provide services at resale or on an unbundled basis to MCI, and
23 should not be limited only to situations in which an end-user tariff
24 is involved. If USWC is required to build facilities, then MCI
25 should also pay a construction charge whether an end-user tariff is
26 involved or not.

1 Further, the Decision, in discussing several issues, provides
2 that USWC should recover specific costs of providing service to new
3 entrants but fails to provide for a recovery mechanism. Under the
4 Act, USWC is entitled to recover its cost of providing service to
5 the new entrants. The Decision does not grant USWC a means to
6 recover the costs due from MCI. The Decision is, therefore,
7 contrary to the Act and confiscatory. The Commission should grant
8 rehearing and amend the Decision to grant USWC a means to recover
9 the costs.

10 C. The Commission should permit USWC to impose reasonable
11 minimum purchase requirements for space on poles, in ducts
and in conduits.

12 The Commission should not permit MCI and other requesting
13 carriers to use pole and conduit space in an inefficient or
14 disruptive manner. The Commission should permit USWC to impose
15 reasonable minimum purchase requirements so that MCI or another CLEC
16 cannot tie up long lengths of conduit or pole runs by selecting
17 individual poles or very short spans of conduit. USWC Ex. 8 at 105
18 (Mason).

19 **XI. LEGAL ISSUES**

20 A. Application of State and Federal Law

21 In deciding the various issues before them, the Commission
22 should look to and rely on the Act and then state law and policy
23 where there is no inconsistency with federal law. Preemption should
24 not be presumed. Congress can preempt state law only if it
25 evidences an intent to occupy a given field. If Congress has not
26 entirely displaced state regulation, state law is preempted only to

1 the extent it actually conflicts with, or stands as an obstacle to,
2 federal law. California Coastal Comm'n v. Granite Rock Co., 480
3 U.S. 572, 580, 107 S. Ct. 1419, 1425 (1987).

4 The Act clearly does not evidence an intent by Congress to
5 preempt the entire field of telecommunications regulation. The Act
6 explicitly recognizes the importance of the state commissions' role
7 in implementing congressional intent underlying the Act; it
8 expressly preserves the right of the Commission to apply state law
9 where not inconsistent with the Act. See, e.g.,
10 §§ 252(e)(2)(A)(ii); 252(e)(3); 252(f)(2); 253(b); 253(c). The
11 Eighth Circuit stay in Iowa Utilities Board reaffirms the states'
12 rights to make final decisions in these arbitrations. See also
13 O'Melveny & Myers v. Federal Deposit Ins. Corp., 512 U.S. 79, 114 S.
14 Ct. 2048, 2054 (1994) (matters left unaddressed in a comprehensive
15 federal regulatory scheme are presumptively subject to disposition
16 by state law). Therefore, absent a conflict with state law, the Act
17 does not preempt state law regarding telecommunications regulation.

18 If the Commission determines that the FCC First Order conflicts
19 with the Act, they must decline to follow the FCC First Order and
20 instead comply with the Act. A federal agency must promulgate rules
21 consistent with Congress' intent in enacting the enabling
22 legislation from which authority to promulgate the rules is derived.
23 Federal Election Comm'n v. Democratic Senatorial Campaign Committee,
24 454 U.S. 27, 31, 102 S. Ct. 38, 42 (1981). Put simply, regulations
25 inconsistent or in conflict with provisions of the Act cannot stand.
26 NLRB Union v. Federal Labor Relations Authority, 834 F.2d 191, 195

1 (D.C. Cir. 1987); McNabb v. Bowen, 829 F.2d 787, 791 (9th Cir.
2 1987); Rakes v. Housing Authority of Dunbar, 765 F. Supp. 318, 320
3 (S.D.W.Va. 1991). Ultimately, federal courts must resolve any such
4 conflicts pursuant to § 252(e)(6) of the Act. Nonetheless, in
5 issuing their decision in this arbitration, the Commission must, if
6 it cannot reconcile provisions of the FCC First Order with the Act,
7 reject the offending portions of the order and comply with the Act.

8 Courts and quasi-judicial bodies are not required to adhere to
9 unlawful statutes or regulations. Accordingly, if the Commission
10 concludes that provisions of the FCC First Order are inconsistent
11 with the Act or exceed the FCC's authority, it should exercise its
12 regulatory authority by not enforcing the unlawful provisions. In
13 determining whether provisions of the FCC First Order are unlawful,
14 the Commission should analyze whether any of the provisions
15 improperly interfere with the Commission's authority over intrastate
16 matters. See Louisiana Public Service Comm'n v. Federal
17 Communications Comm'n, 476 U.S. 355, 374 (1986) (FCC regulations
18 preempting state depreciation regulations are ultra vires).

19 Section 252(e)(6) of the Act, which grants federal district
20 courts jurisdiction to review the decisions of state arbitrators,
21 confirms the Commission's obligation to resolve issues in a manner
22 consistent with the Act -- as opposed to the FCC First Order. That
23 section provides that a party aggrieved by the arbitration process
24 may bring an action in federal court "to determine whether the
25 agreement or statement meets the requirements of section 251 and
26 this section." (Emphasis added.) This language establishes that

1 federal courts must review arbitration decisions for compliance with
2 the Act, not for compliance with the FCC's First Order. It follows,
3 therefore, that the ultimate obligation of these and other state
4 arbitrators is to ensure compliance with the Act. Moreover,
5 Congress directed that state arbitrators must interpret the Act in
6 a manner that will "protect the public safety and welfare, ensure
7 the continued quality of telecommunication services, and safeguard
8 the rights of consumers." 47 U.S.C. § 253(b). This provision
9 further supports the Commission's obligation and authority to
10 resolve issues consistently with the Act and in furtherance of the
11 public interest.

12 Finally, the Tenth Amendment prohibits the federal government
13 from improperly stripping states of control over state policies. As
14 one court recently stated, the "Tenth Amendment confirms that the
15 power of the Federal Government is subject to limits that may, in a
16 given instance, reserve power to the States." Koog v. United
17 States, 79 F.3d 452, 455 (5th Cir. 1996). The federal government
18 lacks the "power to compel the states to require or prohibit
19 [certain] acts." Id. at 456, citing New York v. United States, 505
20 U.S. 144 (1992).. The federal government "may not compel the states
21 to enact or administer a federal regulatory program." Id.

22 In sum, even though the Commission acts under congressional
23 mandate, principles of state law, including the broad constitutional
24 and statutory authority vested in the Commission concerning the
25 regulation of telecommunications providers, should guide its
26 decisions.

1 **B. UNCONSTITUTIONAL CONFISCATORY TAKINGS**

2 Under the Takings Clause of the United States
3 Constitution, public utilities are entitled to just and reasonable
4 utility rates. Federal Power Comm'n v. Hope Natural Gas Co., 320
5 U.S. 591, 603 (1944). "If the rate does not afford sufficient
6 compensation, the State has taken the use of utility property
7 without paying just compensation. . . ." Duquesne Light Co. v.
8 Barasch, 488 U.S. 299, 308 (1989). Indeed, utilities are entitled
9 to a reasonable opportunity to recover not only their costs but a
10 reasonable profit as well. Hope, 320 U.S. at 603; Duquesne, 488
11 U.S. at 310. The Takings Clause of the Arizona Constitution, art.
12 2, § 17, bars confiscatory takings as well. Thus, under both the
13 United States and Arizona Constitutions, the Commission must set
14 rates that permit USWC at least to recover all of the actual costs
15 incurred for unbundled network elements and resale. It may not set
16 below-cost rates.

17 **C. SUBSTANTIAL EVIDENCE STANDARD**

18 Submitting a proposed interconnection agreement does not
19 put all issues or language in that proposed agreement before the
20 Commission. The Act provides, "The State Commission shall limit its
21 consideration of any petition under paragraph (1) (and any response
22 thereto) to the issues set forth in the petition and in the
23 response." 47 U.S.C. § 252 (b) (4) (A). In this proceeding MCI
24 introduced testimony that highlighted key issues in dispute with
25 USWC, but did not identify with specificity all of the disputed
26 terms and conditions of the proposed interconnection agreements or

1 provide testimony in support of all these terms and conditions.

2 Under Arizona law a court will examine the decision of the
3 Commission to determine if it is supported by substantial evidence.
4 U S WEST Communications, Inc. v. Arizona Corp. Comm'n, 185 Ariz.
5 277, 281-82, 915 P.2d 1232, 1236-37 (App. 1996); Tucson Elec. Power
6 Co. v. Arizona Corp. Comm'n, 132 Ariz. 240, 241, 645 P.2d 231, 232
7 (1982); Simms v. Round Valley Light & Power Co., 80 Ariz. 145, 154-
8 55, 294 P.2d 378, 384 (1956). Furthermore, a Commission order may
9 be unlawful even though supported by substantial evidence if the
10 evidence was improper or illegal. Arizona Corp. Comm'n v. Citizens
11 Utility Co., 120 Ariz. 184, 187-88, 584 P.2d 1175, 1178-79 (App.
12 1978). Accordingly, those issues without substantial evidentiary
13 support are not properly before the Commission.

14 Moreover, section 252 of the Act limits the matters at issue in
15 an arbitration to section 251, section 252 (d) and the establishment
16 of an implementation schedule. 47 U.S.C. § 252(c). If a party
17 requests the Commission to adopt other terms and conditions of a
18 proposed interconnection agreement, the Commission need not resolve
19 issues concerning those other matters.

20 XII. CONCLUSION

21 The Commission should grant rehearing and amend the Decision
22 as set forth herein, thereby adopting a resolution to the disputed
23 issues that fairly balances the interests of USWC and its ratepayers
24 with the interests of MCI and the other new entrants. The Decision,
25 with its use of uneconomic and unrealistic proxy prices and its
26 authorization of price arbitrage through sham unbundling, unfairly

1 disadvantages USWC and in customers. USWC has offered evidence of
2 its costs of service that form a just, reasonable and fair basis on
3 which to establish interim prices and interim wholesale discounts.
4 Because any interim rates are subject to true-up following the
5 permanent pricing proceeding, MCI and the other new entrants will
6 not be prejudiced by the use of interim rates based on USWC's cost
7 studies.

8 Therefore, based on the reasons set forth above, USWC asks that
9 the Commission grant USWC a rehearing to modify the Decision as
10 requested herein.

11 DATED this 6th day of January, 1997.

12 Respectfully submitted,

13 U S WEST LAW DEPARTMENT
14 Norton Cutler
15 1801 California Street
16 Suite 5100
17 Denver, Colorado 80202
18 (303) 672-2720
19 AND
20 FENNEMORE CRAIG, P.C.

21 By Timothy Berg
22 Timothy Berg
23 Theresa Dwyer
24 Two North Central Avenue
25 Suite 2200
26 Phoenix, Arizona 85004-2390
(602) 257-5421

Attorneys for U S WEST
COMMUNICATIONS, INC.

24 ORIGINAL and 10 copies of
25 the foregoing delivered for
26 filing this 6th day of
January, 1997 to:

1 Docket Control
Arizona Corporation Commission
2 1200 WEST Washington Street
Phoenix, AZ 85007

3
4 FOUR COPIES of the foregoing delivered
this 6th day of January, 1997 to:

5 Hearing Division - Arbitration
Arizona Corporation Commission
6 1200 WEST Washington Street
Phoenix, AZ 85007

7
8 COPY of the foregoing delivered
this 6th day of January, 1997 to:

9 Thomas H. Campbell
Lewis & Roca
10 40 North Central Avenue
Phoenix, AZ 85004-4429
11 Attorneys for MCImetro Access Transmission Services, Inc.

12 COPY of the foregoing mailed
this 6th day of January, 1996 to:

13
14 Thomas F. Dixon
Senior Attorney
MCI Telecommunications Corporation
15 201 Spear Street, 9th Floor
San Francisco, CA 94105
16 Attorneys for MCImetro Access Transmission Services, Inc.

17 
18

19
20
21
22
23
24
25
26