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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF U S WEST COMMUNICATIONS, INC.'S COMPLIANCE WITH § 271 OF THE TELECOMMUNICATIONS ACT OF 1996	DOCKET NO. T-00000A-97-0238
IN THE MATTER OF QWEST CORPORATION'S COMPLIANCE WITH SECTION 252(e) OF THE TELECOMMUNICATIONS ACT OF 1996	DOCKET NO. RT-00000F-02-0271
ARIZONA CORPORATION COMMISSION Complainant. v. QWEST CORPORATION Respondent.	DOCKET NO. T-01051B-02-0871 **AT&T'S INITIAL BRIEF**

AT&T Communications of the Mountain States, Inc. and TCG Phoenix (collectively, "AT&T") hereby file their initial brief on the global Settlement Agreement filed jointly by the Staff of the Arizona Corporation Commission ("Staff") and Qwest Corporation ("Qwest").

I. INTRODUCTION

The Settlement Agreement dated and filed July 25, 2003, is intended to settle 3 proceedings and the Section 271 sub-docket.[1] All 3 of these proceedings were highly contested. AT&T expended considerable time and resources on these proceedings advocating its positions and supporting Staff. In the Section 252(e) and Show Cause cases, briefs have been filed and the parties were waiting on the Administrative Law Judges' ("ALJ") Recommended Order and Opinions. In the Section 271 sub-docket, the Staff has filed its Staff Report and the parties have filed their comments. As the final hour approached on all 3 cases, Qwest and Staff chose to settle the cases.

AT&T relied on Staff's testimony and remedies in the Section 252(e) case. AT&T filed its own testimony in the Show Cause case but, once again, AT&T relied on Staff's testimony and proposed remedies. And in addition, AT&T relied on Staff's findings in the Section 271 docket to demonstrate Qwest's Section 271 application was not in the public interest. Other parties relied on Staff's proposed remedies as well. All of this is for naught. The Settlement Agreement ends all 3 proceedings, leaving the CLECs to pursue, individually and on their own, any claims they may have against Qwest. Many CLECs may not pursue their intrastate and interstate claims at all because of the cost and expense of filing the claims in both the state and federal jurisdictions and

[1] Docket No. RT-00000F-02-0271 is a docket initiated by the Commission to review Qwest's compliance within Section 252(e) of the Telecommunications Act of 1996 ("Act"). The docket was initiated by the Commission at the request of Staff after Staff became aware of agreements that Qwest had with certain competitive local exchange carriers ("CLECs") that had not been filed with the Commission for approval pursuant to Section 252(e) of the Act. Docket No. T-01051B-02-0871 was initiated by the Commission at the request of Staff after Staff became of aware in October 2002 that Qwest had not implemented the Commission's June 12, 2002, order in the Wholesale Cost Case (Decision No. 64922). Staff also determined that Qwest's processes for implementing wholesale rate changes were unreasonable and discriminatory. Docket No. T-00000A-97-0238 was initiated by the Commission to evaluate Qwest's compliance with Section 271 of the Act. The Settlement Agreement only resolves the 271 sub-docket, which was intended to resolve the question whether terms contained in certain agreements between Qwest and CLECs that prohibited certain CLECs from participating in the Section 271 docket may have interfered with the Section 271 regulatory process.

fighting Qwest. The cost to recover any damages could exceed the amount of the damages the CLECs would be entitled to recover.

It speaks volumes that none of the CLECs have agreed to the terms of the Agreement. The Residential Utility Consumer Office ("RUCO") also has elected not to sign on. The only justifications Staff has provided for entering into the Settlement Agreement is the "[l]itigation has risks" and "[t]here are times where litigants believe that it would be more preferable to have certainty instead of uncertainty."[2] Staff and Qwest may have obtained some certainty, but the CLECs are now faced with the uncertainty of filing their complaints before the Commission to resolve their intrastate claims. It is not in the public interest to leave the CLECs' claims unresolved. Nor is it in the public interest for the Commission to be placed in the position of having to resolve multiple claims involving the same issue. The settlement simply does not foster administrative efficiency.[3]

Furthermore, in exchange for some certainty, Staff has substantially retreated from positions it advocated in testimony, briefs, and reports, to the benefit of Qwest. However, the Settlement Agreement is so flawed that the Staff may have bargained away whatever certainly it sought to obtain.

The Settlement Agreement also points out the need for the Commission to promulgate rules that address the Staff's ability to settle cases. Generally, AT&T does not object to Staff settling cases. This is not a case, however, where one party settles

[2] Direct Testimony of Ernest Johnson Utilities Director, Utilities Division, Arizona Corporation Commission, dated August 1, 2003, at 3. Staff Ex.1 (Johnson Direct).
[3] It is noteworthy that Qwest and Staff disagree over the terms of the Settlement Agreement before it has even been approved by the Commission. It is Qwest's interpretation that Staff is precluded from taking part in any complaints filed by the CLECs with the Commission. TR 79. Staff believes it can participate. TR 345. If Qwest's interpretation is correct, obviously the Settlement Agreement is not in the public interest.

with another party and the case proceeds with other parties' claims. TR 279 – 281. This settlement terminates the litigation in three separate proceedings. The CLECs were excluded from negotiations until after the Outline of Principles had been agreed to by Qwest and Staff.[4] Staff claimed during the hearings the Principles were something to which Staff could agree (TR 347 & 348)[5]; however, Qwest made clear it had agreed to Principles and believed Staff had also. TR 82. Furthermore, even after the meetings with the CLECs, no substantive changes were made to the Settlement Agreement and principles contained in the Outline of Principles did not change. TR 83 & 349.

This is not a case of simple Qwest bashing by the CLECs. The issues being addressed directly affected the CLECs and other carriers. The Section 252(e) case reviewed the filing of contracts between Qwest and CLECs and the CLECs' opt-in rights under Section 252(i). There was evidence that CLECs were discriminated against. In the Show Cause case, it was clear that Qwest's implementation process for wholesale rate changes was discriminatory and unreasonable and the CLECs waited months to obtain the benefits of the new rates. The point is, the CLECs were integral to the cases. They should have been involved in negotiations from the onset. Staff cannot know with any certainty what the CLECs' priorities are when attempting to settle the cases, even if it believes it knows the CLECs' respective positions, and more than the CLECs could know the Staff's priorities.[6]

[4] Mr. Johnson testified that prior to July 3, 2003, none of the CLECs were involved in discussing and formulating the Outline of Principles. TR 339.
[5] Staff attorney's questioning suggests that the settlement points were agreed to by Staff and Qwest. TR 281.
[6] The voluntary contributions are a perfect example. It would be impossible for AT&T to determine from Staff's testimony in these proceedings that unserved and underserved areas were a concern to Staff.

AT&T is frustrated with the manner in which the settlement was arrived at. After spending all the time and energy in the proceedings, having fully briefed the issues, after agreeing with and relying on Staff's positions to address the harm to competition and CLECs, it was a extremely disappointing to AT&T to obtain an Outline of Principles and find out that Staff had retreated substantially from its positions, to the detriment of the CLECs.

The Commission should carefully review the Staff's initial testimony and initial briefs filed in the proceedings before making any decision on the Settlement Agreement. Without knowing the facts of the case or placing the terms of the Settlement Agreement in the proper context, the Commission cannot determine the reasonableness of the Settlement Agreement. Staff and Qwest would have the Commission believe the settlement is worth $20 million and that the size of the settlement is indicative that the Settlement Agreement is in the public interest. This figure is extremely misleading, as a substantial portion represents money that will be spent on projects Qwest will retain the ownership and benefit of or expenditures that Qwest would have to make in the ordinary course of business.

The Settlement Agreement is unreasonable, bad policy, is not supported by the evidence in the record and should be rejected. Unless the concerns of the CLECs are met, the Commission should instruct the ALJ to prepare recommended opinions and orders, and the Commission should decide the cases on their merits.

II. ARGUMENTS

A. The Settlement Process

The Commission needs to establish a process that Staff must follow to settle cases. AT&T understood that the Commissioners had directed Staff to notify all the parties of settlement discussions in its open meeting held February 8, 2001. Obviously, that process was not followed here.[7] It was the decision not to include CLECs in the settlement negotiations from the beginning that created the disagreements over the Settlement Agreement.[8]

The record is clear that Qwest approached Staff's witness, Mr. Ernest Johnson, on April 29, 2003, about the feasibility of settling the three cases. TR 198. RUCO was contacted by Qwest about June 11; however, there was some disconnect and apparently RUCO was never included in discussions between Qwest and Staff. TR 198-201.

On June 27, 2003, Qwest and Staff filed a Joint Motion to Extend Time for Procedural Conference in the Section 271 proceeding. Language in the Joint Motion publicly advised for the first time that Staff and Qwest were in the process of negotiating a settlement agreement that involved the Section 271 sub-docket.

On Thursday, July 3, 2003, the day before the Independence Day holiday, the Staff provided certain, limited CLECs with a list of settlement principles agreed to by Staff and Qwest.[9] Parties were asked to provide brief comments on the principles by

[7] If there is some question whether the procedure discussed by the Commissioners on February 8, 2001, applied to the 3 proceeding at issue, this only serves to highlight the need for formal rules.
[8] AT&T understands that a settlement agreement may not have resulted if the CLECs had been involved in the negotiations from the beginning. AT&T understands that there was a higher likelihood that Staff and Qwest would arrive at a settlement without the involvement of the CLECs. However, because the CLECs were such an integral part of the cases, AT&T believes that deciding the case on the merits would have been preferable to settling the case by a settlement agreement none of the CLECs could agree to.
[9] *See* David Zeigler Rebuttal Testimony in Support of Proposed Settlement Agreement on Behalf of Qwest Corporation, Qwest Ex. 2 (Ziegler Rebuttal), Ex. DZ-2. The CLECs notified in the e-mail were AT&T,

July 8, 2003 – two business days later. A meeting was held on July 10, 2003, at which Qwest, Staff and certain other interested parties discussed the terms of the settlement.[10] AT&T clearly expressed its concerns and objections to the Outline of Principles.

On Friday, July 11, Staff distributed a draft Settlement Agreement that reflected the settlement principles discussed on July 10, and that included none of the changes to the Outline of Principles proposed by the CLECs. Staff requested that the parties provide proposed revisions in summary and red-line form by 11:00 a.m. Monday, July 14. AT&T did not submit any changes to the document because it fundamentally disagreed with it, and it contained none of the changes to the Outline of Principles discussed with Qwest and Staff on July 10. A final meeting was held on July 14 at 2:00 p.m. to discuss further changes to the Settlement Agreement.[11]

The Outline of Principles and the terms of the initial draft Settlement Agreement were negotiated by Qwest and Staff without any input from the CLECs. TR 339. It was only after Qwest and Staff had negotiated the fundamental terms of a settlement that the CLECs' input was solicited. None of the fundamental settlement principles were changed in response to the CLECs' concerns. TR 83 Thus, the CLECs were basically placed in a take-it-or-leave-it position. It is disingenuous to claim the CLECs had an opportunity to negotiate the terms of the Settlement Agreement if Qwest and Staff had agreed to the Outline of Principles before the CLECs were involved. That is not negotiation as AT&T understands the term. The manner in which the terms of the

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Covad, Eschelon, McLeod and MCI. RUCO and Mr. Michael Patten were also notified, although it is not clear from the e-mail who Mr. Patten represents.

[10] Staff and Qwest did not notify *all* of the CLECs that are parties to the Litigation, as defined in the Settlement Agreement, of the settlement negotiations or the settlement principles, nor did they invite all of the parties to the meetings.

[11] Some changes were made to the terms of the Settlement agreement in response to CLEC input. TR 216-218. However, none of the principles on the Outline of Principles changed. TR 83 & 349.

Settlement Agreement were arrived at goes a long way in explaining why none of the CLECs signed on.

The guidelines established by the Commission in its open meeting on February 8, 2001, were not adhered to. The Commissioners should establish a rule for settlements that is publicly available.

B. Standards of Review

Qwest has testified that the proposed Settlement Agreement is in the public interest and "represents a reasonable compromise of between positions of the parties …" Qwest Ex. 1 (Zeigler Direct) at 3 & 20. Staff has testified that it believes the Agreement is in the public interest. Staff Ex. 1 (Johnson Direct) at 12. AT&T compared the Settlement Agreement to Staff's initial filings to determine whether the "Agreement is fair, and reasonable, in the public interest and supported by the evidence." AT&T Ex. 1 (Pelto Direct) at 4 – 5.

The question is, what is the standard the Settlement Agreement should be judged against. If an agreement is not consistent with the evidence can it be in the public interest? Can an agreement that requires the payment of a sizeable sum of money but fails to remedy the wrongs reflected in the evidence be in the public interest? More importantly, if all the parties do not sign on and the settlement extinguishes the litigation, must the settlement be based on the evidence? Can the evidence be ignored? Not only do these questions highlight the need for a formal rule on settlements, they raise legal issues as well.

In *BPI v ICC*, 136 Ill. 2d 192; 555 N.E. 2d 693 (1989), mod. on denial of reh., the Illinois Supreme Court reviewed the adequacy of a settlement agreement approved by the Illinois Commerce Commission that had not been signed by all parties.

In that case, the Illinois Staff filed a settlement agreement that sought to resolve a rate proceeding with Commonwealth Edison. The Commission issued a Fifth Order that stated that it proposed to enter the attached draft Sixth Order incorporating the settlement if Commonwealth Edison agreed to be bound by the terms of the Sixth Order. Edison's agreement was necessary because it contained terms the Commission could not legally implement under its authority. Edison agreed to the Sixth Order and it subsequently was entered. *BPI* at 696.

The question arose whether the Commission had authority to enter the Sixth Order. Intervenors contended that the Commission could not approve the settlement because not all the parties and intervenors had agreed to it.[12] They "contend[ed] the Commission entered into an illegal rate deal or bargain with Edison rather than decide the case based on the evidence in the record." *Id.,* at 700. The Commission argued that the Sixth Order did not adopt the settlement but entered the Sixth Order and settlement based on traditional rate-making principles and the record. *Id.,* at 699 – 700.

The Court stated that "[i]n order for the commission to dispose of a case by settlement, however, all of the parties and intervenors must agree to the settlement. (*See* *Mobile Oil Corp. v Federal Power Comm'n* (1974), 417 U.S. 283, 313, 94 S.Ct. 2328, 2348, 41 L. Ed. 2d 72, 98 …)" *Id.*, at 700. The Court noted that the Commission claimed that it did not judge the settlement by settlement standards but by traditional rate-making principles, *id.* at 701; however, the Court found that, based on its review, "the

[12] Only Edison, Staff and one other intervenor agreed to the Sixth Order. Seven intervenors did not.

Commission treated the Sixth Order as a settlement and failed to base its decision 'exclusively on the record.'" *Id.,* at 702.

The Court noted that the "Commission repeatedly emphasized in the Sixth Order that the Settlement was an 'integrated whole.'… Thus the Commission did not base its decision on the record before it. Rather than decide each issue on the merits based on the evidence, the Commission balanced the results of its decision on various issues between Edison and the rate payers; this balancing act displays the settlement character of the Sixth Order." *Id.*

The Court quoted language from Mobile.

> If a proposal enjoys unanimous support from all of the immediate parties, it could certainly be adopted as a settlement agreement if approved in the general interest of the public. But even if there is a lack of unanimity, it may be adopted as resolution *on the merits,* if FPC make an independent finding supported by "substantial evidence on the record as a whole" that the proposal will establish "just and reasonable" rates for the area. (Citation omitted; emphasis in original.)

The Illinois Court concluded:

> We first note that neither the Act nor the IAPA set out the settlement procedures the Commission must undertake. Likewise, Edison, the Commission and the ILEC have not referred us to any Commission rules on the subject. Second, Mobil dealt with Federal law and a Federal agency; Federal procedures are not necessarily consistent with Illinois law and procedures.
>
> Nevertheless, our decision is not inconsistent with Mobil. Mobil provides that if a settlement proposal has *unanimous* support, an agency could adopt it as a settlement agreement. Mobil also holds, however, that if such a proposal lacks unanimous support, the agency may adopt it as a resolution on the merits. In other words, if the agency makes an independent finding, supported by substantial evidence in the record as a whole that the proposal would

> establish just and reasonable rates, the agency may adopt a settlement proposal which fails to garner unanimous support.
>
> Our decision mirrors this holding. The Commission stated in the Sixth Order that the Sixth Order was an order based on the merits, not a settlement agreement. We hold, however, that the Sixth Order, in reality, reflects a settlement agreement. Consequently, because the Sixth Order did not have unanimous support, it is invalid. We also hold that even if the Sixth Order is not a settlement, but a decision on the merits, it is still invalid because (1) the Commission did not have statutory authority to enter two of the provisions, and (2) the Sixth Order was not independently supported by the evidence in the record.

BPI at 704 (emphasis in original).

BPI is on point. First, according to *Mobil*, if a settlement is signed by all parties the standard is whether the settlement is in the public interest. If the settlement is not signed by all the parties, based on *Mobil* and *BPI*, the agency must make independent findings supported by substantial evidence in the record as a whole, that the proposal is just and reasonable.

Since the Settlement Agreement in these proceedings was signed only by Staff and Qwest the latter legal standard applies, not the public interest standard. The Commission must, for each component of the Settlement Agreement, make an independent finding, supported by substantial evidence in the record as a whole, that the component is just and reasonable, and the Commission must have the legal authority to impose the terms based on the evidence.

C. Calculations of Staff's Initial Penalties

In response to questions inquiring into what uncertainty Staff believed existed to warrant reducing the proposed penalties, the only answer that was given was a question regarding the scope of the Commission's authority to level fines. TR 343 - 344. Therefore, it may prove useful to understand how Staff calculated its initial penalties and the legal basis for these penalties.

1. <u>Section 252(e) Proceeding</u>

In the Section 252(e) case, Staff proposed penalties in the amount of $15,000,000 and $47,000 based on A.R.S. §§ 40-424 and 40-425, respectively. A.R.S § 40-424 allows the Commission to assess penalties for contempt or a failure to comply with a Commission order rule or requirement. The statutes allow the Commission to fine a company in the amount not less than $100 no more than $5,000. The remedy in this section shall be cumulative. Staff claimed that "[a]s March 20, 2003, Qwest was intentionally and willfully in contempt of Commission rules for a total of 8,848 days for not filing twenty-four separate agreements. The Commission may impose a penalty against Qwest for each day, or a total penalty under Section 424 of between $884,000 and 44,240,000. Staff's recommendation of $15,000,000 is well within that range." *See* Initial Post Hearing Brief at 20 (citations omitted).

Qwest still has not filed the 24 agreements. Therefore, it is still in contempt.[13] Since March 20, 2003, 210 additional days have passed. Multiplying 210 by 24 there are an additional 5040 days of potential fines, or between $504,000 and 25,200,000, that up to now have been ignored. Therefore, the maximum penalty under Section 424 is $65,440,000.

[13] A footnote in Staff's brief notes that the penalties are "rising each day Qwest continues to fail to file the necessary unfiled interconnection agreements." *Id.*

Qwest, in its initial brief in the section 252(e) case, did not argue that the Commission did not have the authority to fine on a daily basis. It was not until its reply brief that it raised this issue.[14]

The $47,000 penalty is calculated under A.R.S. § 40-425. Section 425 permits a fine of not less than $100 nor more than $5000. There were 42 agreements that Staff identified and concluded should have been filed for Commission approval. Since Section 425 states that "violations continuing from day to day are one offense," Staff took the position that permissible penalties range from $4200 to $210,000. Staff recommended $47,000 (or $1719.05 per agreement).

2. <u>Show Cause Proceeding</u>

In the Show Cause proceeding, Staff proposed penalties for the failure of Qwest to notify and obtain Commission approval of the delayed implementation of the wholesale rate changes that were effective June 12, 2002. Staff found Qwest in contempt for 126 days (August 11, 2002, to December 15, 2002, the implementation date).[15] As noted earlier, A.R.S. § 40-424 allows minimum and maximum penalties of $100 and $5000, respectively. Based on 126 days, penalties could range between $12,600 and $630,000. Staff recommended a fine in the amount of $750 per day for a total of $94,500.[16]

Staff also found Qwest in contempt for intentionally delaying the implementation of the Commission's Decision No. 64922. Using the same analysis as above, Staff

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[14] Docket No. T-00000A-02-0271, Qwest Corporation's Memorandum in Reply to Post-Hearing Briefs of Other Parties, at 15-16.
[15] Staff gave Qwest credit for 60 days for implementation of the wholesale rate changes in its calculation of penalties.
[16] Docket No T-01051B-02-0871, Staff's Closing Brief at 7-8.

recommended penalties of $94,500. Staff's Closing Brief at 9. The total penalty in the Show Cause proceeding was $189,000.

3. <u>Section 271 sub-docket</u>

In the Section 271 sub-docket Staff Report, Staff concluded that the completeness of the Commission's Section 271 record was adversely affected as a result of the nonparticipation clauses contained in a number of agreements between Qwest and certain CLECs and Qwest's conduct was intentional. Staff proposed the maximum amount of fines allowed by A.R.S. § 40-424. Staff looked at the days the relevant agreements were in effect or the date the agreement was filed with the Commission. Staff arrived at a total penalty of $7,415,000.[17]

4. <u>Daily Penalties</u>

The predecessor of A.R.S. §40-424 and § 40-425, Law 1912, chapter 90, was reviewed in *Van Dyke v. Geary,* 218 F. 111(1914) by the federal District Court in Arizona. The Arizona Commission had issued an order against the Van Dykes. The Van Dykes initially filed a motion for rehearing. The motion was denied. The Van Dykes then filed a motion requesting a 60 day suspension of the order to allow the Van Dykes to apply to a state court for review, and they alleged that unless the order was suspended they would, pending a determination of the validity of the order, be subject to fine and imprisonment. *Van Dyke* at 115. The motion was denied.

The District Court reviewed the Supreme Courts decision in *Ex parte Young,* 209 U.S. 123; 521. Ed 714. In *Young,* the Supreme Court reviewed a similar Minnesota

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[17] Docket No T-00000A-97-0238, Section 271 sub-docket – Staff Report and Recommendation date May 6, 2003, at 19 (Table A).

statute. The Court quoted Justice Brewer in *Cotting v Kansas City Stockyards Company,* 183 U.S. 79, 46L. Ed 92, at 102:

> It is doubtless true that the state may impose penalties, such as will tend to compel obedience to its mandates by all, individuals or corporations, and if extreme and cumulative penalties are imposed only after there has been a final determination of the validity of the statute, the question would be very different from that here presented. But when the Legislature, in an effort to prevent an inquiry of the validity of a particular statute, so burdens any challenge thereof in the courts the party affected is necessarily constrained to submit rather than take the chances of the penalties imposed, then it becomes a serious question whether the party is not deprived of the equal protection of the laws.[18]

The *Young* Court concluded:

> We hold, therefore, that the provisions of the acts relating to the enforcement of the rates, either for freight or passengers, by imposing such enormous fines and possible imprisonment as a result of an unsuccessful effort to test the validity of the laws themselves, are unconstitutional on their face, without regard to the question of the insufficiency of those rates.

Accordingly, the *Van Dyke* court concluded:

> On the authority of these cases and on principle we are of the opinion, and so decide, that said Act 90 of the First Legislature of the state of Arizona imposes such penalties and imprisonment as to practically deprive the complainant of the right to appeal to the court determine the validity of the law and orders of the corporation commission, and is therefore unconstitutional *in that particular.* Van Dyke at 121 (emphasis added).

[18] Note that the Court does not rule out "extreme and cumulative penalties" in all cases.

The decision by the *Young* Court and the *Van Dyke* Court in a narrow one – do the fines or criminal penalties practically deprive the complainant the right to appeal to the court to determine the validity of the law or order.[19] That is the only issue decided by the *Van Dyke* Court. The *Young* Court was explicit that had there had been a final determination of the validity of the statute, the question presented would be far different

In the Section 252(e) case, the Staff recommended fines in the amount of $15,000, 000 for Qwest's failure to follow A.A.C. R14-2-1506. That rule has been on the books for years. Qwest has never challenged, and is not now challenging, the validity of the order implementing R14-2-1506. The penalties are not being proposed while Qwest is taking an appeal of R14-2-1506. The time for an appeal has long passed. Qwest is being penalized for the failure to comply with a lawful rule. This is not the fact situation decided by *Van Dyke*.

The $47,000 fines assessed under A.R.S. § 40-425 are based on a one-time assessment for each of the 42 agreements Qwest did not file. This is consistent with the terms of the statute. Fines were not assessed on a daily basis.

In the Show Cause case, Staff assessed two fines. One fine was assessed under A.R.S. § 40-424 for Qwest's failure to notify and obtain Commission approval for delay implementing the wholesale rate change. The other was for the intentionally delaying the implementation of the Order.

The Wholesale Rate Order that was the subject of the fines is under appeal. Qwest did not seek a stay of the Order. The two fines total $189,000. The fines are fixed and do not continue to accrue. Even Qwest did not argue it did not have to implement the Order during the appeal. The total amount of penalties do not practically deprive Qwest

[19] Act 90 was amended to delete criminal sanctions.

the opportunity to challenge the Wholesale Rate Order. Furthermore, Qwest has agreed to withdraw the appeal as part of the terms of the Settlement Agreement. A.R.S. § 40-424 cannot be construed under these facts to practically deprive Qwest the equal protection of the laws.

In the Staff Report in the Section 271 sub-docket, the Staff recommended fines for Qwest's interference with regulatory process, citing A.C.C. R14-3-104 and the Commission's December 8, 1999, Procedural Order. Staff Report at 15. Once again, Qwest is not being held in contempt and fined daily during the course of an appeal to challenge a Commission's rule or order. Once an order is entered ordering the penalties, AT&T assumes the penalties would not continue to accrue if Qwest's wishes to appeal any order. In any event, the penalties proposed by Staff are not the type of penalties prohibited by *Van Dyke*.

Van Dyke does not hold that the Commission may not assess daily fines under Section 424 for violation of Commission's orders, rules or requirement. It simply holds that penalties cannot accrue post-order that would practically deprive the person or corporation the right to challenge the validity of the order. The penalties proposed by Staff are not similar or analogous.

D. Cash Payment

The Settlement Agreement provides that Qwest will pay the following penalties:

1. $5,000,000 for resolving the penalties in the Section 252(e) proceeding and the Section 271 sub-docket;
2. $47,000 in additional penalties for the Section 252(e) proceeding; and
3. $150,000 for the Show Cause proceeding.

A total of $5,197,000, therefore, would be paid to the General Fund. This is approximately one-fourth of the total amount of fines proposed by Staff in the three proceedings.

In the Section 252(e) proceeding, Staff proposed that Qwest be required to pay a total cash penalty of $15,047,000.[20] In the Section 271 sub-docket, Staff recommended a cash penalty of $7,415,000. Finally, in the Show Cause proceeding, Staff recommended a cash penalty in the amount of $189,000. Thus, Staff's total recommended penalties for the three proceedings was $22,651,000. AT&T Response at 4 – 5; AT&T Ex. 1 (Pelto Direct) at 7.

1. Staff's Proposed Penalties Already Represented a Substantial Reduction From Maximum Allowable Penalties.

The penalties originally proposed by Staff were far less than the maximum penalties allowed by law. Staff maintains that the maximum allowable penalty for the Section 252(e) case is $44,450,000,[21] for the Section 271 sub-docket, $7,415,000,[22] and for the Show Cause proceeding, $1,260,000,[23] for a maximum total penalty in the amount of $53,125,000.[24] Staff's recommended penalties represented only 43% of the total possible penalty. The settlement amount represents only 10% of the maximum allowable penalty. AT&T's Response at 5; AT&T Ex. 2 (Pelto Direct) at 7.

[20] As noted earlier, the penalties continue to accrue. An additional $25,200,000 in penalties could be assessed.
[21] Docket No. RT-00000F-02-0271, Staff Initial Post-Hearing Brief at 21.
[22] Staff is recommending the maximum penalty allowed in the Section 271 sub-docket.
[23] Docket No. T-01051B-02-0871, Direct Testimony of Mathew J. Rowell dated April 17,2003, at 14-16 ("Rowell Direct").
[24] This does not include the $25 million in penalties that have accrued since March 20, 2003.

2. The Settlement Penalties are Inadequate Based on the Evidence.

Arguably, in light of the intentional and egregious nature of Qwest's conduct,[25] the Staff's initial recommendations were too low. In any event, there is absolutely no basis for slashing the penalties recommended by Staff by 75%. The three proceedings that the Staff and Qwest seek to settle are extraordinary. In each case, Staff has found that Qwest engaged in intentional and willfully improper behavior.

AT&T does not understand why Staff, after having made the findings that it did, would so greatly reduce the penalties without any explanation for the changes. Staff's witness testified that he believed Staff was objective, tries to make an independent assessment based on the facts, and that the normal process was for testimony and reports to go through legal review. TR 340-341. He also reviewed Ms. Kalleberg's testimony before it was filed and it would have been the normal process for him to review Mr. Rowell's testimony and the Staff Report. TR 336 - 337. However, Staff inexplicably has backed off from its earlier, appropriate, conclusion that "[t]he signal must be sent that Qwest's actions were highly egregious and unacceptable."[26]

AT&T believes that the penalties initially proposed by Staff should be imposed and that settlement should accordingly be rejected. AT&T's Response at 5 – 8; AT&T Ex. 2 (Pelto Direct) at 10.

[25] *See* AT&T's Response at 6 – 8 and AT&T Ex.2 (Pelto Direct) at 7 – 10 for a list of some of Staff's conclusions in each of the cases.

[26] Docket No. RT-00000F-02-0271, Direct testimony of Marta Kalleberg dated February 21, 2003 (confidential), at 76. ("Kalleberg Direct")

E. Voluntary Contributions

One of the more troubling aspects of the Settlement Agreement is the section labeled "voluntary contributions."[27] Not only does this section artificially inflate the apparent value of the settlement, it also gives Qwest credit for legal obligations it already has, or forces new obligations on Qwest, that are unrelated to the issues raised in the proceedings. It permits Qwest to convert what should be a penalty into company benefits. The three proceedings focus on harm to competition and to the CLECs. The remedies should therefore focus on remedying the harm to competition and the CLECs.[28] Voluntary contributions have no place in the Settlement Agreement, regardless of the merits of the expenditures. TR 285 - 286.

If the Commission believes that education, economic development or infrastructure investment is necessary, and it has the constitutional and statutory authority to address these issues, it should do so on the record, with an explanation as to why doing so is just, reasonable and in the public interest. If Qwest has legal obligations to serve unserved or underserved areas, the Commission should initiate a show cause proceeding to determine why Qwest is not serving such areas. If it does not, Staff should not be using these proceedings to force Qwest to serve areas it has no legal obligation to serve.[29]

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[27] There is nothing "voluntary" about the "contributions." If Qwest had not agreed to Staff's conditions, there would be no Settlement Agreement. Nor are the expenditures contributions because Qwest is not foregoing the right to obtain tax deductions and return on its investment.

[28] Section 20 of the Settlement Agreement states that the Agreement represents a "mutual desire to compromise and settle all disputed claims at issue in the Litigation in a manner consistent with the public interest *and based upon pre-filed testimony and exhibits and the evidentiary record developed in the Litigation.*" (Emphasis added). AT&T could not find any reference to "voluntary contributions" in the record except for RUCO's recommendation that Qwest be required to accelerate its deployment of broadband services.

[29] Staff's witness testified that he is not aware if Staff has initiated an investigation to address unserved areas. TR 333.

During the hearings Qwest's witness made it clear that Qwest's position was that it had no legal obligation to serve unserved areas. TR 91. Qwest also stated that it would make a filing with the Commission to obtain authority to serve any unserved areas it invests in. *Id.* Qwest expects to receive a return on the investment. TR 110-111. Qwest's witness also acknowledged that Qwest would obtain tax benefits from the investment, for example, depreciation deductions. TR 98. Furthermore, Qwest will own and operate the investments and receive revenues from the services providing those investments.

Section 503(c)(3) organizations are charities. Charitable contributions are not penalties. Furthermore, Qwest will receive goodwill and tax deductions for any charitable contributions.

The settlement also would allow Qwest to take credit for investment in advanced services. The Federal Communications Commission recently released its order in the Triennial Review proceeding. CLECs will not have access to Qwest's investment in advanced services on a resale or wholesale basis under the Act. It is inappropriate to permit Qwest to make investments in advanced services -- investments CLECs will not have access to under Section 251(b) and (c) -- as a remedy for Qwest's harm to competition and to the CLECs. TR 314.

Furthermore, the language permits investment that promotes "the general welfare or safety of consumers." This language is so broad that arguably *any* investment would qualify. And although the Agreement tries to limit voluntary contributions to investment that is not already planned, this provision is meaningless and subject to manipulation by Qwest.

Qwest's witness testified that Qwest will not have a construction budget for 2004 until the December – January timeframe. TR 100. Qwest's long range planning does not even list specific projects. TR 103. Qwest can easily manipulate the budget on the expectation that the voluntary contributions in the Settlement Agreement will be approved. There will be no way for Staff to prove that Qwest omitted a planned investment it later submits for consideration as a voluntary contribution.

Finally, Qwest's witness acknowledged that two of the benefits of competition are consumer choice and lower rates. He also acknowledged that voluntary contributions do not affect either of these two benefits. TR-86 – 87. Furthermore, the remedies should be structured to remedy the harm to competition in a manner that brings the benefits to the greatest number of consumers. The voluntary contributions do not do this. The investment will serve only a very limited number of consumers, not the service territory as a whole.

The Commission should reject the settlement because of these flaws in the voluntary contribution provisions. *See* generally AT&T Response at 9 – 11; AT&T Ex. 2 (Pelto Direct) at 11 – 13.

F. Discount Credits

The Settlement Agreement provides for a one-time credit to eligible CLECs of 10% of the total *Section 251(b) and (c) services* purchased from January 1, 2001, to June 30, 2002. A CLEC must release *all* claims it may have to obtain credit for only Section 251(b) and (c) services.[30]

[30] Mr. Zeigler has testified that interstate claims would not be subject to the release. There is some question whether the last version of the release requires CLECs to release interstate claims. Since signing of a release is integral to the Settlement Agreement, AT&T believes a release should be finalized and reviewed by the Commission before a CLEC is required to execute one.

From the CLECs' perspective, the problem with this provision is that it does not include all of the services that Eschelon and McLeod received discounts on. Staff's brief noted that "[t]he most significant concession provided to both Eschelon and McLeod in their unfiled agreements was a 10 percent discount on all of the carriers' purchases of Qwest's services, including but not limited to, Section 251(b) and (c) services...."[31] Eschelon and Qwest received discounts on Section 251(b) and (c) services, intrastate and interstate switched access, special access and private line, and all other services Eschelon and McLeod purchased from Qwest. There is no reason to limit the remedy and scope of the discount that the other CLECs would receive under the settlement.[32]

There is no question that Eschelon and McLeod received discounts on services in addition to Section 251(b) and (c) services. Since not all CLECs purchase the same services or have the same product mix, by eliminating certain services, the remedy will treat all CLECs differently. For example, CLECs purchasing special access will receive no discount under the plan, although another CLEC purchasing network elements will. Thus, the remedy as structured is inherently discriminatory. To remedy past discrimination and harm, all services must be included in the settlement provisions.

It is a violation of State law to provide discounts on tariffed services in a manner that discriminates among carriers. A.R.S. § 40-334(A); *Southern Pac Co. v. State Corp.*

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[31] Staff's Initial Post-Hearing Brief at 16-17.

[32] Staff's witness was asked if Staff objected to allocating the $6 Million in voluntary contributions to the discount credits to cover intrastate services. Mr. Johnson responded that Staff believes that the voluntary contributions are a "worthwhile component" of the Agreement. TR 359. Mr. Johnson went on to state, "The problem with that in retrospect was that there were no direct benefits to consumers. ...I was personally aware of concerns that had been raised at this Commission relative to issues of ineptly served or underserved areas that was of some concern to me as I participated in these discussions." TR 359 - 360. The problem with Mr. Johnson's rationale is there was no *direct* harm to consumers. Little, if any, mention was made of direct harm to consumers. In fact, when RUCO suggested that broadband investment in rural areas be included, Staff's witness opposed RUCO's suggestion by responding "The focus of this docket is on competition rather than on infrastructure." Kalleberg Direct at 95.

Comm., 39 Ariz 1, 3 P. 2d 518 (1931). A.R.S. § 40-374 prohibits rebates and discount agreements. By failing to include tariffed services within the scope of the discount credit, these obvious violations of State law goes unremedied.[33]

This discount should be paid retroactively and on prospectively on future purchases made by CLECs. Although the Commission may no have jurisdiction to include interstate claims in the discount credits, it can order retroactive and prospective discount to approximate the harm done to the CLECs. Qwest calculates that harm at $28.5 to 30.5 Million if all section 251(b) and (c), intrastate and interstate services are included. By ordering retroactive and prospective remedies consistent with Staff's original testimony, competitive restitution is addressed more appropriately. TR 245-247.

Eschelon and McLeod had the opportunity to make prospective business decisions with the knowledge that they had a discount of 10% on all future purchases for the length of the contracts. To help remedy the harm to the CLECs and competition, the remedy should be structured so all other CLECs also have the opportunity to make investment decisions going forward with the knowledge they will receive a discount of 10% on all purchases. This puts the other CLECs in the same position Eschelon and McLeod were in. The remedial effect on competition and the CLECs obviously will be greater. In addition to receiving a one-time, lump-sum credit for purchases made in the past, CLECs would receive a 10% discount on all purchases going forward. These purchases represent investments in *future competition*, that promote competition. TR 271 – 272, 275, 295 – 297. Although a one-time payment to the CLECs will remedy some of the harm incurred by the CLECs, a one-time payment on past purchases is less effective in promoting and remedying the harm to competition.

[33] Staff has not made any final determination to initiate a proceeding to address this issue. TR 357.

Qwest and Staff have limited the discount credit to Section 251(b) and (c) services; however, the Release of All Claims requires the CLECs to release Qwest from *all* intrastate discriminatory and unlawful conduct. Qwest expects the CLECs to waive all State tariff claims they have against Qwest because Qwest unlawfully provided Eschelon and McLeod with discounts of 10% on all intrastate and interstate services, but the settlement omits the same set of services from the calculations of the discount. AT&T Ex. 1 (Pelto Direct) at 24.

The discount provision is the most important and relevant term of the Settlement Agreement because it is specifically related to addressing the harm to competition and to the CLECs. The penalties go to the State of Arizona; the voluntary contributions benefit Qwest. Yet, over one-half of the alleged value of the settlement does not benefit competition or provide competitive restitution. The section on discounts needs to be modified to provide for retroactive and future discounts on all services purchased by CLECs for a period of 23 months. Until the flaws are remedied, the Settlement Agreement should be rejected. AT&T's Response at 11 – 15.

G. Access to Line Credits and UNE-P Credits

The Settlement Agreement provides for access line credits and UNE-P credits. These two credits are based on provisions contained in Eschelon's agreements. The credits should be prospective and should be for 23 months instead of 16 months. As noted in its discussion of the discount credits, these changes would provide greater remedial benefits. To the extent the DUF problem is remedied, the payments should be minimal.

AT&T also is concerned with the problem of documentation. The period that is subject to recovery ended several years ago. This will make the retrieval and production of documentation more difficult. AT&T's concern is heightened by the language in the Settlement Agreement which allows Qwest to reject the CLECs' documentation. Section 5.D. The greatest flexibility possible should be afforded the CLECs in substantiating the basis for their credits. Moreover, the problem of documentation would be eliminated if the credits were provided prospectively. AT&T's Response at 15 – 16.

H. Additional Voluntary Contributions

The section on additional voluntary contributions highlights the fundamental flaws with the Settlement Agreement: 1) the remedies are not focused on addressing the harm to the CLECs and competition; and 2) the Settlement Agreement inflates the value of the settlement.

The settlement consists of the following monetary allocations:

1. Penalties	$5.197 Million
2. Voluntary Contributions	$6.0 Million
3. Discount Credits	$8.1 - 8.9 Million
4. Access Line Credit	$.6 – .66 Million
5. UNE-P Credit	$.5 – .55 Million
Total	$20.397 – 21.317 Million

As noted earlier, Qwest receives the value of the voluntary contributions. It retains ownership of the facilities invested in or built. Therefore, the claimed value of the settlement must be reduced by at least $6 million.

Furthermore, since the discount credits, access line credits, and UNE-P credits are paid on claims actually made by CLECs, there is a high probability that Qwest will not pay to CLECs the level of fines represented in the Settlement Agreement. Many of the CLECs that no longer exist may not submit any claims. Some CLECs may not participate because they would have to release *all* intrastate claims against Qwest. Therefore, to the extent Qwest is not required to disburse the funds allocated to the CLECs, the funds are reallocated and subject to the voluntary contribution provision. Accordingly, Qwest retains a larger share of the settlement and benefits.

The Commission should set the level of penalties based on the evidence in each proceeding, without regard to some arbitrary total settlement value. Next, the Commission should order remedies that serve to remedy the harm to competition and to the CLECs. The credits, structured as recommended by AT&T, would attempt to address those harms.

I. Wholesale Rate Implementation

In the Show Cause case, "Staff recommended that Qwest be ordered to implement billing and systems process changes that will allow it to implement wholesale rates within 30 days."[34] In the Settlement Agreement, Staff agrees to language that states that "Qwest shall implement prospectively all ordered wholesale rates within 60 days from the effective date of the final Commission decision approving rates and setting forth the numeric wholesale rates to be implemented." Section 15. There is no explanation for the change from 30 days to 60 days. AT&T's Response at 18. If Qwest is unable to make the changes within 30 days, Qwest should have the opportunity to prove that and get a

[34] Rowell Direct at 20.

waiver, but there is no evidence that justifies 60 days in all cases. AT&T Ex. 1 (Pelto Direct) at 21.

J. Requirement to Support and Defend Agreement

The Agreement contains a provision that requires a signatory party to support and defend the Agreement "before the Commission or other regulatory agency or before any court in which it may be an issue." Section 23. This provision creates difficulties for CLECs wishing to sign on to the Agreement. If a CLEC disagrees with many of the provisions in the Agreement but wants to obtain the benefit of some of the provisions, it would have to waive its objections and support the Agreement as a whole, even provisions it may have fundamental disagreements with. Furthermore, there is some question as to whether a CLEC could criticize the Agreement before regulatory agencies in other jurisdictions where Qwest's compliance with Section 252 is an issue. The ambiguity inherent in this section raises concerns with AT&T. AT&T's Response at 18 – 19.

III. CONCLUSION

AT&T believes the public would be better served by deciding the cases based on the evidence in the record. The *Mobil* and *BPI* cases requires no less. The direct harm was to the State of Arizona, competition and the CLECs. Any settlement should be structured in a manner to resolve this harm. Although AT&T understands the Staff's desire to provide direct benefits to consumers, there was no direct harm to them. If the harm to competition and the CLECs is addressed, the consumers will indirectly benefit through lower rates and more choices. But the direct harm to the CLECs should not be ignored to provide benefits to consumers that suffered only indirectly.

If the Commission decides to leave the voluntary contributions in any final Settlement Agreement, it should also include intrastate services within the scope of the discount credits, on both a retroactive and prospective basis. If the intrastate services are omitted, the CLECs will be forced to fend for themselves at a time when their resources are severely constrained and limited. This is the same as no remedy at all.

This case also provides a basis to review the need to promulgate rules on settlement cases of this nature. Had rules been in place that required that the CLECs be involved in negotiations from the onset, there may have been less disagreement over the terms of the Agreement.

Dated this 15th day of October, 2003.

AT&T COMMUNICATIONS OF THE MOUNTAIN STATES, INC. AND TCG PHOENIX

By ______________________

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CERTIFICATE OF SERVICE

(Docket No. T-00000A-97-0238, RT-00000F-02-0271, T-01051B-02-0871)

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