OAH Docket No. 12-2500-17246-2
MPUC Docket No. P-421/C-05-1996

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE PUBLIC UTILITIES COMMISSION

In the Matter of a Potential Proceeding to Investigate the Wholesale Rates Charged by Qwest Corporation

FINDINGS OF FACT, CONCLUSIONS, AND RECOMMENDATION

This matter came on for hearing on April 9-10, 2008, before Administrative Law Judge Steve M. Mihalchick in the offices of the Minnesota Public Utilities Commission (Commission or MPUC), 350 Metro Square Building, 121 Seventh Place East, St. Paul, Minnesota. The OAH record closed on October 6, 2008. Administrative Law Judge Kathleen D. Sheehy assisted in preparing this Report.

Joan C. Peterson, Esq., 200 South Fifth Street, Room 2200, Minneapolis, MN 55402; and John Devaney, Esq., Perkins, Coie, 607 14th Street NW, Washington, DC 20005, appeared for Qwest Corporation (Qwest). Dan Lipschultz, Esq., Moss & Barnett, 90 South Seventh Street, Suite 4800, Minneapolis, MN 55402, appeared for the CLEC Coalition. Linda S. Jensen, Assistant Attorney General, 1400 Bremer Tower, 445 Minnesota Street, St. Paul, MN 55101, appeared for the Department of Commerce (Department). Ganesh Krishnan participated on behalf of Commission staff.

STATEMENT OF ISSUES

The issue in this case is whether Qwest's wholesale rates for intrastate services are just and reasonable; and, if they are not, what remedial action should the Commission take? [1]

Based on the evidence in the hearing record, the Administrative Law Judges makes the following:

FINDINGS OF FACT AND CONCLUSIONS

Background

1. Until the 1990s, states regulated local telephone service by granting an exclusive franchise in each local service area to a local exchange carrier (LEC), which owned, among other things, the local loops, switches, and transport trunks that constitute a local exchange network. The Federal Commerce Commission, on the other hand, had authority over interstate communications. The Telecommunications Act of

[1] Notice and Order for Hearing at 7 (Part II: Issues to be Addressed).

1996 was intended to uproot the monopoly held by LECs over local telephone markets and to foster greater competition within each local service area, in exchange for which LECs would be allowed to provide long-distance service.[2]

2. Under the Act, requesting carriers (referred to as competitive local exchange carriers, or CLECs) can obtain access to an incumbent LEC's (ILEC's) network by purchasing service at wholesale rates for resale to end users, by leasing network elements on an "unbundled" basis, or by interconnecting their own facilities with the ILEC's network.[3] Congress left it to the FCC to determine which network elements should be made available on an unbundled basis.[4] Requesting carriers can negotiate an agreement with the ILEC; but if they are unable to agree on the terms and conditions, either party can petition the state commission to arbitrate open issues.[5] State commissions are obligated to resolve open issues consistently with the requirements of 47 U.S.C. § 251 and to establish rates for interconnection, services, or network elements that are just, reasonable, and nondiscriminatory.[6]

3. The FCC has required that states set rates based on the total element long-run incremental cost (TELRIC) of an element.[7] The TELRIC cost of an element is measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of an incumbent's wire centers.[8]

4. In addition, the 1996 Act permits Bell operating companies (BOCs) to re-enter the long-distance market if they can demonstrate that they provide access and interconnection in compliance with the "competitive checklist" contained in 47 U.S.C. § 271(c)(2). The FCC has exclusive authority to approve a § 271 petition, after consultation with the relevant state commission to verify the BOC's compliance with the competitive checklist.[9] The FCC also has authority to enforce compliance with § 271 after approval of an application by ordering a company to correct a deficiency, imposing a penalty, or suspending or revoking approval to provide long-distance service.[10]

5. Qwest is an incumbent local exchange carrier (ILEC) in Minnesota. As an ILEC it is subject to 47 U.S.C. § 251. It is obligated to provide interconnection and access to requesting carriers at TELRIC rates, and the Commission is charged with the responsibility to set those rates in Minnesota using the TELRIC methodology devised by the FCC.

[2] *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999).
[3] 47 U.S.C. § 251(c)(2)-(4).
[4] 47 U.S.C. § 251(d)(2).
[5] 47 U.S.C. § 252.
[6] 47 U.S.C. § 252(d)(1)(A).
[7] 47 C.F.R. § 51.505(b). The FCC's decision to use this pricing methodology was upheld in *Verizon Communications, Inc., v. FCC*, 535 U.S. 467, 523 (2002).
[8] 47 C.F.R. § 51.507(c).
[9] 47 U.S.C. § 271(d)(3).
[10] 47 U.S.C. § 271(d)(6).

6. Qwest is also a Regional Bell Operating Company (RBOC). As an RBOC, it is subject to 47 U.S.C. § 271. The FCC granted Qwest's application to provide long-distance service in Minnesota after extensive state proceedings in 2002 to investigate Qwest's compliance with the competitive checklist.

7. Initially the FCC required that most § 251 network elements be "unbundled" and made available to competing carriers. In the *TRO*[11] and *TRRO*[12], the FCC revised its unbundling framework. It adopted a wire-center-based analysis that uses the number of access lines and fiber collocations in a wire center as proxies to determine impairment for high-capacity loops and dedicated transport. Where the triggers are not met, the ILEC must make these elements available under § 251 at TELRIC rates. Where the triggers are met, the wire centers are deemed "unimpaired," which means that various elements are no longer available as § 251 UNEs at TELRIC rates. RBOCs must still provide "access" to these elements, however, if they wish to retain their § 271 authority to provide long-distance service. The FCC has indicated that elements provided as required by § 271 are not subject to TELRIC pricing but, rather, to the basic "just, reasonable, and nondiscriminatory" pricing standard of 47 U.S.C. §§ 201 and 202.[13]

8. Specifically, the FCC has said:

> Whether a particular checklist element's rate satisfies the just and reasonable pricing standard of section 201 and 202 is a fact-specific inquiry that the Commission will undertake in the context of a BOC's application for section 271 authority or in an enforcement proceeding brought pursuant to section 271(d)(6). We note, however, that for a given purchasing carrier, a BOC might satisfy this standard by demonstrating that the rate for a section 271 network element is at or below the rate at which the BOC offers comparable functions to similarly situated purchasing carriers under its interstate access tariff, to the extent such analogues exist. Alternatively, a BOC might demonstrate that the rate at which it offers a section 271 network element is reasonable by showing that it has entered into arms-length agreements with other, similarly situated purchasing carriers to provide the element at that rate.[14]

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[11] *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Service Offering Advance Telecommunications Capability*, CC Docket Nos. 01-338, 96-98 and 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 19020 (Aug. 21, 2003) (*TRO*), *vacated in part, remanded in part, U.S. Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004).

[12] *In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Order on Remand, 20 FCC Rcd 2533 (Feb. 4, 2005) (*TRRO*).

[13] *TRO* ¶ 659, 663.

[14] *TRO* ¶ 664. Two years later, in the *TRRO*, the FCC rejected the argument advanced by ILECs that access to UNEs should be barred whenever competitive carriers would be able to compete using tariffed special access services. The Commission concluded that in such a situation, an incumbent would have a

9. Qwest is also a "price-cap incumbent" for purposes of the FCC's interstate access regime.[15] In 1991, the FCC "capped" the prices that could be charged in federal interstate access tariffs, which provide the terms, conditions, and prices available to interexchange (long-distance) carriers and other telecommunications companies for local connectivity. In 1999, the FCC issued its Pricing Flexibility Order, which permitted the deregulation of prices for dedicated access services in metropolitan statistical areas (MSAs) where price-cap incumbents could show that certain "competitive triggers" have been met. Depending on the extent of competitive collocation in incumbent wire centers, the FCC grants either partial or full pricing flexibility to the price-cap incumbent carriers. "Phase I" flexibility allows price-cap incumbents to offer customized contracts to customers that provide discounts off the price-capped "list prices." The contract terms must be filed with the FCC and made available to other customers that meet the specified terms and conditions. Alternatively, for customers that do not sign up for contracts, incumbents are required to offer dedicated access at price-capped prices, which may include term and volume discounts. In MSAs where price-cap incumbents can demonstrate a higher level of competitive collocation, the FCC may grant "phase II" flexibility, which permits an incumbent to raise or lower its list prices. Price-cap incumbents must still file their "price-flex" list prices with the FCC, and they may offer contracts providing additional discounts to customers.[16] The FCC has granted Qwest's petition for "Phase II" price flexibility in wire centers in Rochester and St. Cloud, Minnesota. The Minneapolis Downtown and St. Paul Market wire centers are still subject to price-cap rates.[17]

10. Qwest is a "telephone company" as defined by state law.[18] It is required to file tariffs and price lists with the Department showing specific rates, tolls, and other charges. Tariffs and price lists remain in effect until superseded by tariffs and price lists subsequently filed, canceled, or withdrawn or as ordered by the Commission.[19] By and large, Qwest's intrastate access tariff prices were set before enactment of the Telecommunications Act of 1996, at a time when telephone companies were subject to rate-of-return regulation by state commissions. Under rate-of-return regulation, prices for business services were permitted to incorporate relatively higher returns because these services typically subsidized residential rates. The PUC has authority to ensure

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substantial incentive to raise prices to levels close to or equal to the associated retail rate, creating a "price squeeze" and foreclosing competition based on use of the tariffed wholesale input. *TRRO* ¶ 59.

[15] 47 U.S.C. §§ 203, 204 (tariff filing requirements applicable to common carriers).
[16] Access Charge Reform, CC Docket No. 96-262, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999) (*Pricing Flexibility Order*), aff'd, *WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).
[17] Ex. 6 (Denney Direct) at DD-1; Ex. 16 (Brigham Direct) at 48, n. 62. *See generally* Ex. 11 (Ankum Direct), Attachment (GAO Report to the Chairman, Committee on Government Reform, House of Representatives, FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services) (*GAO Report*).
[18] Minn. Stat. § 237.01, subd. 7 (2008). All references to Minnesota Statutes are to the 2008 edition.
[19] Minn. Stat. § 237.07, subd. 1; Minn. R. 7810.8400, subps. 1 & 5 (2007).

that the rates, tolls and charges in Qwest's intrastate access tariffs are fair and reasonable.[20]

11. The parties have engaged in some semantic jousting with regard to the label to be attached to the facilities that were formerly required to be made available under § 251, but are now required to be available under § 271. Qwest calls these elements "271 elements;" the CLEC Coalition variously refers to these elements as "271 elements" and as "wholesale intrastate rate elements." Integra calls the applicable rates for these elements "non-UNE rates" or "wholesale rates," and the Department calls them "non-251 elements." Whatever the label, it must be noted that the facilities used to provide local exchange service, whether they are available pursuant to § 251 or § 271, are functionally the same as certain of the facilities that provide dedicated interstate or intrastate access services.[21] In addition, a facility provided through the interstate or intrastate tariff, if used for the purpose of providing local exchange service, is not necessarily an "interstate" or "intrastate" service; Qwest's obligation to provide it derives from either § 251 or § 271. The statutes and tariffs simply provide the mechanism through which telecommunications companies obtain access to Qwest's last-mile network (meaning the loop facility connecting each home and business to the wireline network). The names of the facilities may be different—for example, the connection between a customer and a serving wire center is called a "loop" in the parlance of § 251 and § 271, and the same facility is called a "channel termination" in the access tariffs.[22] The critical difference, for purposes of this case, is the pricing available under each regime.

12. Qwest has petitioned the FCC seeking forbearance of obligations to provide unbundled loop and transport pursuant to §§ 251 and 271 of the Act; and for mass market and enterprise services, Qwest seeks forbearance from dominant carrier tariffing requirements, price cap regulations, and a variety of other regulatory provisions in the Minneapolis-St. Paul MSA.[23] The FCC initially denied the petition but recently sought comments on how the decision should be reconsidered in light of *Verizon v. FCC*.[24]

13. In connection with Qwest's forbearance petition, the Department surveyed the ten CLECs with the largest number of lines in the Twin Cities MSA at the end of 2006. These CLECs provided 137,000 lines to medium-sized business customers

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[20] Minn. Stat. §§ 237.06, 237.011, 237.081, subd. 4.
[21] Ex. 6 (Denney Direct) at 30.
[22] Ex. 6 (Denny Direct) at 17 n. 32, 20.
[23] *See In the Matter of the Minnesota Public Utilities Inquiry Regarding the Petition for Qwest Corporation, Filed with the Federal Communications Commission, for Forbearance Pursuant to 47 U.S.C. Section 160(c) in the Minneapolis-St. Paul Minnesota Metropolitan Statistical Area*, Docket No. P-421/CI-07-661; *Petitions of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas*, WC Docket No. 07-97, Memorandum Opinion and Order, 23 FCC Rcd 11729, 11730 (2008) (*Qwest 4 MSA Forbearance Order*), *remanded, Qwest Corp. v. FCC*, No. 08-1257 (D.C. Cir. Aug 5, 2009).
[24] *See* Wireline Competition Bureau Seeks Comment on Remands of *Verizon 6 MSA Forbearance Order* and *Qwest 4 MSA Forbearance Order*, WC Docket No. 09-1835, Public Notice, DA 09-1835 (WCB Aug. 20, 2009).

(between four and 200 lines) and 17,000 small business customers (from one to three lines) using Qwest § 251 UNEs. In total, CLECs use § 251 UNEs to provision 92% of the lines sold to this customer type, as opposed to using other methods (such as constructing their own facilities, negotiating commercial agreements, or using special access tariffs). The alternatives to using § 251 UNEs accounted for only 1% of the medium-sized businesses. On the other hand, CLECs provided 93,000 lines to large business customers using their own facilities and only 16,000 lines using Qwest § 251 UNEs.[25] In the one wire center where DS1 UNE loops are not available at TELRIC prices—Minneapolis Downtown—60% of medium-sized business customer lines are served via Qwest UNEs.[26]

14. The record accordingly reflects that the CLECs' provision of service to medium-sized business customers is highly dependent on the use of § 251 UNEs and that there are few realistic alternatives to the use of Qwest facilities for this customer type.

Qwest Prices

15. In Minnesota, Qwest has successfully petitioned the PUC to have approximately 22 wire centers in Minnesota classified as either Tier 1 or Tier 2 non-impaired.[27] Accordingly, UNE DS1 and DS3 transport are not available between Tier 1 offices, and UNE DS3 transport is not available between a Tier 2 office and other Tier 1 or Tier 2 offices.

16. In the *TRRO*, the FCC determined that dark fiber loops need not be unbundled.[28] Dark fiber transport, like DS3 dedicated transport, was removed from § 251 only between wire centers that have been classified as Tier 1 or 2. Qwest plans to offer interoffice dark fiber, however, through a commercial agreement on routes where interoffice dark fiber is no longer required by § 251.[29]

17. The wire centers deemed to be unimpaired include the Minneapolis Downtown and St. Paul Market wire centers, which contain a significant number of business lines in the Qwest territory. The Minneapolis Downtown wire center contains 9% of the DS1 facilities in the state; the Minneapolis Downtown and St. Paul Market wire centers combined contain 32% of the DS3 and higher facilities in the state.[30]

[25] Ex. 21 (Fagerlund Rebuttal) at 27.
[26] Ex. 18 (Brigham Rebuttal) at 32.
[27] Ex. 6 (Denney Direct) at DD-1. *See also In the Matter of Qwest's Petition for Approval of Additions for 2008 to the Non-Impaired Wire Center List*, Docket No. P-421/AM-08-726, Order Granting Non-Impairment Status to Nine Wire Centers (Oct. 23, 2008); Order Approving Petition to Reclassify the Little Falls Wire Center as Tier 2 Impaired (Jan. 8, 2009); and Order Approving Petition With Respect to the Bloomington South Wire Center (Apr. 13, 2009).
[28] *TRRO* ¶ 182.
[29] Ex. 21 (Fagerlund Rebuttal) at 7.
[30] Ex. 7 (Denney Rebuttal) at 7.

18. In this case, the elements at issue in various wire centers are high-capacity loops (DS1 or DS3), high-capacity transport (DS1 and DS3), multiplexing, interconnection tie pairs (ITPs), and dark fiber loops and transport.[31] The parties have compared Qwest's prices for several different scenarios in the Minneapolis Downtown and St. Paul Market wire centers. Prices are generally lower in more dense zones (UNE Zone 1), and they tend to increase in the less dense zones (UNE Zones 2, 3, and 4). The testimony in this docket was filed before completion of the recent generic cost docket, so some of the TELRIC prices have been changed.[32] The discussion of these scenarios assumes, however, that the interstate and intrastate access rates have not changed since the testimony was filed in this docket.[33]

19. In the first scenario, a CLEC is collocated in a Qwest office and wants to purchase access from its collocation to an end user customer located in the serving area of the same Qwest office. This scenario requires a DS1 loop and a DS1 ITP to connect the collocation to the end of the DS1 loop. In the Minneapolis Downtown wire center, which is the only wire center at which Qwest is relieved from unbundling DS1 loops, the TELRIC price for the DS1 loop was $27.14 before the wire center was deemed to be unimpaired. The current TELRIC price for a DS1 ITP is $0.63.[34] The total price for these facilities in Qwest's interstate access tariff is $93.57 ($87.59 for the DS1 loop and $5.98 for an ITP).[35] The price in Qwest's intrastate private line transport service (PLTS) tariff is $300 ($150 for the first DS1 loop, then another $150 for a second DS1 loop used in lieu of an ITP).[36] In testimony filed in this case, Qwest offered to provide a DS1 ITP through the intrastate tariff at the same price ($5.98) as in its interstate tariff.[37] Incorporation of this proposed change would result in an intrastate tariff price of $155.98.

20. In the second scenario, a CLEC uses a DS1 loop to connect an end user to the central office, where it is multiplexed to a DS3 (the equivalent of 28 DS1s) and terminated at the CLEC's collocation. The TELRIC rate in the Minneapolis Downtown wire center was formerly $35.56; the current TELRIC price would be $52.85 using prices established in the recent generic cost case ($27.14 for the DS1 loop, $8.42 for the 3/1 multiplexing, and $17.29 for the DS3 ITP).[38] The interstate tariff rate is $96.89 ($87.59 for the loop, $8.36 for 3/1 multiplexing, and $0.94 for the DS3 ITP); and the intrastate access rate is $208.56 ($150.00 for the loop, $12.76 for 3/1 multiplexing, and

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[31] Ex. 1 (Starkey Direct) at 3.
[32] *In the Matter of Qwest Corporation's Application for Commission Review of TELRIC Rates Pursuant to 47 U.S.C. § 251*, MPUC Docket No. P-421/AM-06-713, Revised Ex. A (Feb. 26, 2009) (*Revised Ex. A*).
[33] Qwest's interstate tariff requires that if a private line circuit is utilized more than 10% to carry interstate traffic, the circuit must be purchased from the interstate tariff. *See* Ex. 16 (Brigham Direct) at 37; Section 2.3.11 of Qwest Interstate Tariff No. 1. Consequently, it is highly likely that if UNEs are replaced with tariffed services, the circuits will be purchased from the interstate tariff. Ex. 16 (Brigham Direct) at 38.
[34] *Id*., *Revised Ex. A*, § 9.1.2.
[35] The interstate access rates are calculated assuming the carrier receives a 22% discount through the Regional Commitment Plan. *See* Ex. 6 (Denney Direct) at 24.
[36] Ex. 6 (Denney Direct) at 22-23.
[37] Ex. 16 (Brigham Direct) at 52.
[38] Ex. 6 (Denney Direct) at 24; *Revised Ex. A* §§ 9.1.3, 9.2.3.3.1, and 9.6.8.2). The multiplexing rate is divided by 28 to obtain a cost figure per DS1 loop.

$45.80 for the DS3 ITP).[39] The intrastate access rate would be reduced to $189.02 if Qwest changed the DS3 ITP price as indicated in testimony.[40]

21. In the third scenario, a CLEC wishes to serve a customer in a wire center where the CLEC is not collocated and must transport the DS1 loop back to an office with a CLEC collocation. This combination is referred to as a point-to-point DS1 Extended Enhanced Loop, or DS1 EEL. For the Minneapolis Downtown wire center, the TELRIC rate was formerly $127.79 ($27.14 for the DS1 loop plus $100.65 for the DS1 transport); current TELRIC prices would be $128.42 ($27.14 for the DS1 loop, $100.65 for the DS1 transport, and $0.63 for the DS1 ITP).[41] The interstate tariff rate is $277.65 ($87.59 for the loop, $184.08 for transport, and $5.98 for the ITP); and the intrastate tariff rate is $635.00 ($150.00 for each of two DS1 loops plus $335.00 for DS1 transport). The intrastate tariff rate would be reduced to $490.98 if Qwest changed the DS1 ITP rate as offered in testimony.[42] This scenario could occur as a commingled arrangement, depending on the wire center involved.

22. The fourth scenario is similar to the second, except that the CLEC is not collocated in the office serving the end user customer, and thus the multiplexed facility requires DS3 transport to the CLEC collocation. For the Minneapolis Downtown wire center, the TELRIC rate was formerly $50.92; the current TELRIC price would be $140.82 ($27.14 for the DS1 loop, $8.42 for the 3/1 multiplexing, $87.97 for DS3 transport, and $17.29 for the DS3 ITP).[43] The interstate tariff rate is $136.31 ($87.59 for the loop, $8.36 for 3/1 multiplexing, $39.42 for DS3 transport, and $0.94 for the DS3 ITP). This rate appears to be lower than the current TELRIC rate. The intrastate tariff rate is $241.06 ($150 for the DS1 loop, $12.76 for the 3/1 multiplexing, $32.50 for DS3 transport, and $45.80 for the DS3 ITP).[44] If Qwest were to decrease the intrastate tariff price for the DS3 ITP to that contained in the interstate tariff, the price would be reduced to $196.20.[45]

23. In the fifth scenario, a DS3 loop connects an end user to a CLEC collocation. DS3 loops are not available as UNEs in the Minneapolis Downtown or St. Paul Market wire centers (UNE Zone 2). For the St. Paul Market wire center, the TELRIC rate was formerly $605.96; the current TELRIC rate would be $623.25 ($605.96 for the DS3 loop and $17.29 for the DS3 ITP).[46] The interstate tariff rate is $1,118.26 ($1,092 for the DS3 loop and $26.26 for the DS3 ITP); and the intrastate tariff rate is $2,565 (two DS3 loops, each at $1,282.50).[47] If Qwest were to change the intrastate rate for the ITP as indicated in testimony, the intrastate tariff rate would be $1,308.76.[48]

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[39] Ex. 6 (Denney Direct) at 24.
[40] Ex. 16 (Brigham Direct) at 55.
[41] Ex. 6 (Denney Direct) at 25; *Revised Ex. A* §§ 9.2.3.3.1, 9.6.2.1, and 9.1.2.
[42] Ex. 6 (Denney Direct) at 25; Ex. 16 (Brigham Direct) at 55.
[43] Ex. 6 (Denney Direct) at 26; *Revised Ex. A*. §§ 9.1.3, 9.2.3.3.1, 9.6.3, and 9.6.8.2).
[44] Ex. 6 (Denney Direct) at 26.
[45] Ex. 16 (Brigham Direct) at 55.
[46] Ex. 6 (Denney Direct) at 27: *Revised Ex. A*. §§ 9.2.3.4.2 and 9.1.3.
[47] Ex. 6 (Denney Direct) at 27.
[48] Ex. 16 (Brigham Direct) at 55.

24. The sixth scenario is the equivalent of a DS3 point-to-point EEL (a DS3 loop connected to DS3 transport to an office where the CLEC has a collocation). For the St. Paul Market wire center, the TELRIC rate was formerly $1,036.11; the current TELRIC rate would be $711.22 ($605.96 for the DS3 loop, $87.97 for DS3 transport, and $17.29 for the DS3 ITP).[49] The interstate tariff rate is $2,162.27 ($1,092 for the DS3 loop, $1044.01 for DS3 transport, and $26.26 for the DS3 ITP); and the intrastate tariff rate is $3,475 ($1,282.50 for each of two DS3 loops and $910.10 for DS3 transport).[50] The intrastate tariff rate would be reduced to $2,218.86 if Qwest incorporated the proposed change for pricing the DS3 ITP.[51]

25. Integra argues that Qwest's intrastate private line rates cannot be considered just and reasonable because they are "wildly in excess" of economic cost as established by TELRIC rates.[52]

26. Integra argues that Qwest's interstate access rates cannot be considered just and reasonable because they are "significantly in excess" of TELRIC rates.[53] In addition, Integra points to successive increases in rates for DS1 and DS3 channel terminations and transport since the FCC granted Qwest pricing flexibility. These rate elements have increased in price from 40% to 108% over non price-flex rates.[54] In Integra's view, these price increases demonstrate that competition has not functioned to restrain Qwest's prices.

27. Integra also compared the rates at which Qwest offered the unbundled network element platform (UNE-P) with the prices of two different replacement products that doubled or tripled the price of the switch port.[55] Compared to the UNE-P price of $16.54, the Qwest Platform Plus (QPP) residential prices ranged from $19.83 to $20.19, depending on volume commitments; the Qwest Local Services Platform (QLSP) residential prices ranged from $19.62 to $21.19, depending on volume commitments. The increases for business customers were higher, ranging from $22.85 to $23.55 for the QPP and $20.02 to $23.55 for the QLSP.[56]

28. Integra seeks the establishment of an intrastate wholesale tariff for network elements with a price ceiling of 15% to 30% above TELRIC rates.[57] Integra also urges the Commission to preclude Qwest from charging for a loop as opposed to

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[49] Ex. 6 (Denney Direct) at 28; *Revised Ex. A* §§ 9.2.3.4.2, 9.6.3, and 9.1.3.
[50] Ex. 6 (Denney Direct) at 28.
[51] Ex. 16 (Brigham Direct) at 55.
[52] Ex. 6 (Denney Direct) at 28-30.
[53] Ex. 6 (Denney Direct) at 30.
[54] Ex. 6 (Denney Direct) at DD-2, DD-3.
[55] The UNE-P was a combination of the unbundled loop, shared/interoffice transport, and local switching. When the FCC eliminated local switching as an unbundled network element in the TRRO (¶ 199), Qwest developed commercial replacement products called the Qwest Platform Plus (QPP) and the Qwest Local Services Platform (QLSP).
[56] Ex. 6 (Denney Direct) at 41.
[57] Ex. 6 (Denney Direct) at 45.

an ITP on its intrastate access tariff and urges the Commission to apply its wholesale service quality standards to Qwest's wholesale intrastate products and services.[58]

29. The CLEC Coalition seeks the establishment of an intrastate wholesale tariff for network elements with a price ceiling of 5% to 20% above TELRIC rates.[59] The CLEC Coalition made this recommendation based on use of the pricing method the FCC used for payphone and access services (the New Services Test, or NST).[60] This method sets direct cost (which the CLEC Coalition considers to be the TELRIC price) as a price floor, then adds a reasonable amount of overhead (based on TSLRIC) to derive the overall price. Based on its analysis of Qwest overhead for comparable products, the CLEC Coalition recommends a range of 5% to 20% over TELRIC prices.[61] The CLEC Coalition points out that the FCC developed the NST as a means of assuring just and reasonable rates under 47 U.S.C. §§ 201 and 202 to address situations where price-cap regulated carriers were introducing new services.[62]

30. Qwest filed Automated Reporting Management Information System (ARMIS) data with the FCC reporting revenues of $254 million for Minnesota interstate private line services (excluding uncollectibles) for 2006, while intrastate special access revenues for the same period were reported to be $31 million. Based on its analysis of the ARMIS data, the CLEC Coalition maintains that Qwest earns an average rate of return of 35.01% across all of its interstate access services. For its interstate special access services, Qwest earns a return of 101.5%.[63] Because ARMIS data are not available for intrastate special access services, the CLEC Coalition is not able to perform a similar analysis. It estimates, however, that returns on intrastate access services would be even higher since Qwest's intrastate access prices are generally much higher than its interstate access prices.[64]

31. In response, Qwest contends that its overall average intrastate return on investment in 2006 was 5.63%, and its return on intrastate private line/special access service was even lower.[65]

32. The difficulty in using ARMIS data to estimate Qwest's returns is that federal rules are inconsistent with regard to the reporting of DSL-related service, which is classified as a private line service. While all revenues associated with DSL service are assigned to the interstate jurisdiction, DSL-related costs are assigned to both interstate and intrastate jurisdictions.[66] This has the effect of over-stating rates of return

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[58] *See In the Matter of Qwest's Wholesale Service Quality Standards, Docket No. P-421/AM-00-849, Order Adopting Wholesale Service Quality Standards* (July 3, 2003), *aff'd in part and rev'd in part*, 702 N.W.2d 246 (Minn. 2005).
[59] Ex. 1 (Starkey Direct) at 6-8.
[60] Ex. 1 (Starkey Direct) at 4-8; *see also* 47 C.F.R. § 61.49(g)(2).
[61] Ex. 1 (Starkey Direct) at 20-30; Ex. 2 (Starkey Direct Trade Secret) at 20-30 & Attachment MS-3.
[62] *See generally* Ex. 3 (Starkey Rebuttal).
[63] Ex. 11 (Ankum Direct) at 47-48.
[64] *Id*. at 48.
[65] Exs. 14 & 15 (Gude Rebuttal) at 7.
[66] Ex. 13 (Ankum Rebuttal) at 40-41.

on federal private line services and under-stating rates of return on state private line services.[67]

33. Interstate and intrastate access services are provided using essentially the same facilities. Qwest's estimate of its return on intrastate special access services is likely to be substantially understated as a result of the inconsistencies in the FCC's jurisdictional separations rules noted above.[68]

34. Qwest also argues that its intrastate private line rates in Minnesota are similar to its rates in other states and lower than rates charged by other ILECs in Illinois or Wisconsin.[69] That Qwest's rates are similar in other states does not establish that its rates in Minnesota are just and reasonable. Nor does the fact that other ILECs charge higher rates establish that Qwest's rates in Minnesota are just and reasonable.

35. Qwest contends further that its private line rates are comparable to the rates for similar services offered by the CLECs.[70] In making this comparison, Qwest is comparing its private line rates to the retail rates offered by CLECs to end user customers. The issue here is whether Qwest's wholesale rates, offered to competitors for local service, are reasonable.

36. The Department seeks the establishment of a wholesale tariff or price list for network elements. The Department advocates that, at minimum, Qwest should not be permitted to charge the higher intrastate tariff rates for any element with a lower interstate tariff rate; in addition, the price should never be greater than the corresponding intrastate or interstate tariffed rate.[71] Finally, the Department urges the Commission to require Qwest to file cost studies based on total service long-run incremental cost (TSLRIC) to determine the appropriate wholesale prices. TSLRIC methodology was introduced to evaluate cost for the entire output of a product, in order to restrict the ability of incumbent firms to use their economies of scale to under-price new entrants. Qwest has produced TSLRIC cost studies for its local and private line retail services for many years. The Department recommends that the Commission set a price ceiling for these elements of 20% over TSLRIC.[72]

37. The Administrative Law Judge concludes that comparing Qwest tariff prices to TELRIC rates does not establish that tariff prices are unreasonable or unjust. TELRIC prices are based on cost studies that assume Qwest's network is built using the least-cost, most efficient technology available. As applied to Qwest, this is essentially a hypothetical network. The FCC has indicated that special access pricing, which is based on historical cost and is regulated under the "just and reasonable" standard, "bears no necessary relation" to the cost-based standards of TELRIC methodology.[73]

[67] *Id*. at 40-41, 45.
[68] *Id*.
[69] Ex. 16 (Brigham Direct) at 44.
[70] Ex. 16 (Brigham Direct) at 45.
[71] Department Initial Brief at 54.
[72] Ex. 21 (Fagerlund Rebuttal) at 42-44.
[73] *TRRO* ¶ 51.

The recommendation by Integra and the CLEC Coalition to set wholesale prices based on a mark-up over TELRIC is not consistent with the guidance provided by the FCC to date on how these elements or services are to be priced.

38. The more valid comparison on the record in this case is between interstate access rates and intrastate access rates. Qwest has offered no reason why intrastate access rates are so much higher than the interstate access rates. The Administrative Law Judge concludes that Qwest's intrastate access tariff prices are unjust and unreasonable.

39. The Department's recommendation to require Qwest to file TSLRIC cost studies for the rate elements at issue and to set a price ceiling of 20% over TSLRIC appears to be inconsistent with the little guidance the FCC has given states with regard to pricing of elements that are no longer required to be provided under 47 U.S.C. § 251.

Qwest's AFOR Docket

40. State law permits a telephone company to petition for approval of an alternative form of regulation (AFOR) plan, in which the company must explain how ratepayers will benefit from the plan and justify the appropriateness of earnings levels and rates in light of the proposed plan.[74] Rates must exceed TSLRIC, in order to prevent a telephone company from pricing under cost to take advantage of economies of scale.[75] A company that has an approved AFOR plan under Minn. Stat. § 237.764 is not subject to rate-of-return regulation or earnings investigations during the term of the plan.[76] The purpose of an AFOR plan is to provide a telephone company's customers with service of a quality consistent with commission rules at affordable rates, to facilitate the development of telecommunication alternatives for customers, and to provide, where appropriate, a regulatory environment with greater flexibility than is available under traditional rate-of-return regulation.[77]

41. In Qwest's recent AFOR docket, Qwest argued, and the Commission agreed, that Qwest's AFOR filing did not involve wholesale rates. At the conclusion of that docket, the Commission approved Qwest's retail AFOR plan but recognized that a separate proceeding to investigate Qwest's wholesale rates was necessary.[78] The Commission thereafter opened this docket.

42. Qwest now argues that the Commission cannot examine the reasonableness of its wholesale rates, because as a carrier operating under an AFOR plan, it is exempt from rate of return regulation and earnings investigations. This argument is misplaced. The AFOR plan applies to Qwest's retail rates offered to end

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[74] Minn. Stat. § 237.764, subd. 1(c).
[75] Minn. Stat. § 237.771.
[76] Minn. Stat. § 237.763.
[77] Minn. Stat. § 237.76.
[78] Docket No. P-421/AR-05-1081, Order Approving Alternative Form of Regulation Plan as Modified (Dec. 29, 2005). In Qwest's AFOR, private line and special access services are defined as "retail services." *See* Appendix A, Schedule 3.

user customers, not to its wholesale rates for elements it is obligated to make available to local service competitors.[79] Qwest's decision to sell the facilities needed to provide local service through a tariff (either intrastate or interstate) does not alter its obligation to provide the facilities on a wholesale basis to competitors. Moreover, no party is advocating "rate of return regulation" of Qwest's wholesale rates. Qwest's returns are analyzed in this docket solely for the purpose of attempting to evaluate whether competition is functioning to drive wholesale prices toward cost.

Wholesale Service Quality Standards

43. Integra advocates that the Commission's Wholesale Service Quality Standards should be applied to Qwest's wholesale rates for elements that must be offered pursuant to Section 271.[80] In an AFOR docket pending in the state of Washington, Qwest agreed to include service quality standards for UNE substitutes provided to CLECs when UNEs are not available.[81] In this docket, Qwest contends that the Commission lacks authority to impose service quality requirements for Section 271 services. In addition, Qwest argues that there is no reason to apply a service quality plan to non-impaired wire centers because CLECs have other competitive options.[82]

44. In July 2003, the Commission developed and applied its Wholesale Service Quality Standards to Qwest's provision of section 251 UNEs.[83] Qwest appealed that decision, arguing that the 1996 Act pre-empts states from regulating local telecommunications competition. The Minnesota Supreme Court rejected this argument, reasoning that "[a]lthough the Act clearly moves Congress into the regulation of local telecommunications services and makes the federal government the dominant regulator, it is equally clear from the Act's provisions that Congress has not fully occupied the field to the exclusion of states."[84] The Court held that the Act does not by its express terms or by implication entirely preempt the states from regulating local telecommunications services. Rather, it concluded that the express provisions of the Act preserve a role for the states that includes ensuring adequate quality and fostering competition, if done within the parameters of the Act. Accordingly, the Court held that the wholesale service quality standards adopted by the Commission were not preempted by the Act.[85] If the Commission unquestionably has authority to apply service quality standards to § 251 UNEs, there would appear to be no reason why those same standards should not be applied to the exact same elements that must be provided to local service competitors under authority of § 271. The fact that a wire

[79] *Cf. In the Matter of Qwest's Wholesale Service Quality Standards*, 702 N.W.2d at 249 (Qwest's AFOR plan applies to its retail customers and specifically excludes issues related to wholesale service quality standards and remedies).
[80] Ex. 6 (Denney Direct) at 49.
[81] Ex. 16 (Brigham Direct) at 105.
[82] Ex. 16 (Brigham Direct) at 102, 104.
[83] *In the Matter of Qwest's Wholesale Service Quality Standards*, Docket No. P-421/AM-00-849, Order Adopting Wholesale Service Quality Standards (July 3, 2003).
[84] 702 N.W.2d at 251.
[85] *Id*. at 257.

center is deemed non-impaired does not mean that CLECs seeking to serve medium-sized business customers have a panoply of competitive options.

RECOMMENDATION

The Administrative Law Judges recommend that the Commission: (1) require Qwest to file a wholesale tariff or price list for network elements that it is obligated to provide to local service competitors or that it voluntarily provides; (2) cap the prices for those elements at Qwest's interstate access rates; and (3) require Qwest to implement its commitment to change the price of ITPs on its intrastate tariff to be consistent with the interstate access rates. The Administrative Law Judges also recommend that the Commission apply its wholesale service quality standards to the wholesale tariff.

Dated: October 14th, 2009

_s/ Steve M. Mihalchick_________
STEVE M. MIHALCHICK
Administrative Law Judge

_s/ Kathleen D. Sheehy_________
KATHLEEN D. SHEEHY
Administrative Law Judge

NOTICE

Notice is hereby given that, pursuant to Minn. Stat. § 14.61 and the Rules of Practice of the Minnesota Public Utilities Commission and the Office of Administrative Hearings, exceptions to this Report, if any, by any party adversely affected must be filed within 10 days of the mailing date hereof with the Executive Secretary, Minnesota Public Utilities Commission, Metro Square Building, Suite 350, 121 7th Place East, St. Paul, Minnesota 55101-2147. Exceptions must be specific and stated and numbered separately. Proposed Findings of Fact, Conclusions of Law and Order should be included, and copies thereof shall be served upon all parties. Oral argument before a majority of the Commission will be permitted to all parties adversely affected by the Administrative Law Judge's recommendation who request such argument with their filed exceptions or reply. Exceptions should be e-Filed with the Commission.

The Commission will make the final determination of the matter after the expiration of the period for filing exceptions as set forth above, or after oral argument, if such is requested and had in the matter.

Further notice is hereby given that the Commission may, at its own discretion, accept, reject, or modify the Administrative Law Judges' recommendations and that said recommendations have no legal effect unless expressly adopted by the Commission as its final order.

MEMORANDUM

Jurisdiction and Preemption

Section 152(b) of the Telecommunications Act of 1934 provides that, except as provided in certain sections, nothing in the chapter "shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service… ." The amendments adopted in the Telecommunications Act of 1996 contain several similar provisions that preserve the authority of states over various aspects of local service. In 47 U.S.C. § 253(b), the Act provides that "Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis . . . requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers." Section 261(b) preserves state regulations existing before the enactment of the Telecommunications Act of 1996, if the regulations are not inconsistent with the Act; and section 261(c) provides that "Nothing in this part precludes a State from imposing requirements on a telecommunications carrier for intrastate services that are necessary to further competition in the provision of telephone exchange service or exchange access, as long as the State's requirements are not inconsistent with this part" or the implementing regulations. Moreover, § 251(d)(3) explicitly provides that:

> [T]he [FCC] shall not preclude the enforcement of any regulation, order, or policy of a state commission that-
>
> (A) establishes access and interconnection obligations of local exchange carriers;
>
> (B) is consistent with the requirements of this section; and
>
> (C) does not substantially prevent implementation of requirements of this section and the purposes of this part.[86]

After passage of the Telecommunications Act of 1996, several state commissions and incumbent local exchange carriers (including Qwest's predecessor, U S West), challenged the FCC's authority to adopt the rules developed to implement the Act. They argued, among other things, that primary jurisdiction to implement the local competition provisions belonged to the States, rather than the FCC. Thus, they argued, the FCC's rules requiring TELRIC prices were invalid. The Eighth Circuit Court of Appeals agreed and vacated the pricing rules as being beyond the jurisdiction of the FCC. The Eighth Circuit held that the FCC's rulemaking authority extended only to interstate matters and that the FCC needed specific congressional authorization before implementing provisions of the Act that address intrastate telecommunications. The

[86] 47 U.S.C. § 251(d)(3).

Eighth Circuit relied on 47 U.S.C. § 152(b), which, it said, creates a presumption in favor of preserving state authority over intrastate communications. The Court of Appeals found no authority in the Act clear enough to overcome this presumption.[87]

The United States Supreme Court reversed, holding that the FCC had authority to design a pricing methodology through rulemaking, even though the 1996 amendments concerned the provision of intrastate service. The Court noted that, after the 1996 Act, § 152(b) may have less practical effect because, by extending the Communications Act into local competition, Congress removed a significant area from the States' *exclusive* control. The Court noted, however, that "[i]nsofar as Congress has remained silent, . . . § 152(b) continues to function."[88] The Court also rejected the argument that the FCC was precluded from requiring use of the TELRIC methodology by 47 U.S.C. § 252(c)(2), which entrusts the task of establishing rates to state commissions. The Court reasoned that the FCC's prescription, through rulemaking, of a requisite pricing methodology "no more prevents the States from establishing rates than do the statutory 'Pricing standards' set forth in § 252(d)."[89]

In a breathtaking and ironic change of advocacy, Qwest now argues that state commissions cannot "usurp the role of the FCC" by examining wholesale rates for elements that Qwest formerly was required to provide under § 251 at TELRIC rates, and which it now must make available to local service competitors under § 271 in order to retain its ability to provide long-distance service. Qwest asserts that the Act provides the FCC exclusive jurisdiction over all aspects of § 271, including pricing. This argument goes far beyond the text of § 271. It is clear that, over issues regarding an ILEC's long-distance authority, the FCC's role is exclusive. States have no authority to act under § 271 by determining which carriers may provide long-distance service, by setting prices for long-distance service, or by regulating the terms and conditions of long-distance service. But the items contained in the competitive checklist of § 271 have nothing to do with the provision of long-distance service; they collectively constitute the hammer held over the ILEC's head to facilitate competition in the provision of *local* service. Absent Section 271, ILECs could refuse to make those facilities available to competitors, unless state law required otherwise. The argument that states have *less* authority over pricing under state law than they did when those elements were governed by § 251 is inconsistent with the Act and with the Supreme Court's careful explanation of a state commission's role in *AT&T Corp. v. Iowa Utilities Board.* The appropriate question is not whether states are entirely preempted but whether a particular state action is consistent with the Act and the implementing regulations.

As noted above, there is nothing in the text of 47 U.S.C. § 271 that says anything about the pricing of the elements at issue in this case. Section 271 appears to assume that pricing of these elements will be controlled by §§ 251 and 252. It does not explicitly address the situation in which elements formerly required by §251 are now required

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[87] *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 795, 802, 805 (8th Cir. 1997).
[88] *AT&T Corp. v. Iowa Utilities Bd.*,525 U.S. 366, 381 n. 8 (1999).
[89] *Id*.,525 U.S. at 384-85.

only by § 271. Again, Section 271 authority is conditioned on an ILEC's compliance with §§ 251 and 252; on its obligation to provide, on an unbundled basis, the local loop, local transport, and local switching; and its obligation to provide access to a variety of other services. The only reference to price is with regard to the obligation to provide nondiscriminatory access to poles, ducts, conduits, and rights-of-way at "just and reasonable prices," as required by 47 U.S.C. § 224. After an ILEC has received § 271 authority, the FCC has indicated it intends to examine pricing, in the context of enforcing an ILEC's compliance with these conditions for elements no longer required by § 251, by referring to the ILEC's interstate access tariff or to the terms of a commercial agreement negotiated at arms-length. Although ILECs have been successful in obtaining relief from the courts when state commissions have asserted legal authority to act under § 271, or when they have required ILECs to include § 271 elements in the § 252 arbitration process, or when they have imposed broader unbundling requirements than has the FCC, this case presents the different issue of the extent to which a state may set prices under authority of state law for elements that Qwest is obligated to provide to local service competitors under § 271. The FCC has not said in any order issued to date that states lack authority under state law to set prices for elements an ILEC is required to provide to local service competitors under § 271, as a condition of providing long-distance service.

Despite Qwest's strenuous arguments to the contrary,[90] the Eighth Circuit's decision in *Southwestern Bell Telephone v. Missouri Public Service Commission*, 530 F.3d 676 (8th Cir. 2008)(*Southwestern Bell)* does not change this result. *Southwestern Bell* did not determine that an action by a state commission to determine whether rates were fair and reasonable under a Minnesota-like statute was be preempted under the Telecommunications Act, either expressly, or by implication as within the scope of the FCC's exclusive federal jurisdiction under the Telecommunications Act that the Eighth Circuit described in *Southwestern Bell*.

Consistent with the decisions of many other courts, *Southwestern Bell* held that the Missouri Public Service Commission exceeded its authority in attempting to require the ILEC (SBC) to provide certain elements to CLECs that the FCC had not required. *Southwestern Bell* emphasized the "exclusive jurisdiction" of the FCC to enforce § 271 requirements. But, the Commission here is not being asked to enforce § 271 requirements that are within the exclusive jurisdiction of the FCC. It is being asked to determine whether Qwest's rates for certain intrastate elements are fair and reasonable under state law. It has the jurisdiction to do so, subject to the standards imposed by the Telecommunications Act and FCC rules. That guidance is limited, but does not appear to allow for rates to be set as some multiple of costs determined under a TELRIC or TSLRIC methodology.

S.M.M./K.D.S.

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[90] See Qwest's June 27, 2008, Renewed Motion to Dismiss for Lack of Subject Matter Jurisdiction and for Certification to the Commission and its initial and reply briefs.