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**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

In the Matter of)
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**Qwest Communications
International Inc.**)
)

WC Docket No. 02-314

Consolidated Application for Authority)
to Provide In-Region, InterLATA Services in)
Colorado, Idaho, Iowa, Montana, Nebraska,)
North Dakota, Utah, Washington and)
Wyoming)
)

**DECLARATION OF DOUGLAS DENNEY
ON BEHALF OF AT&T CORP.**

1. My name is Douglas Denney. I am employed by AT&T as a Manager with Network Services, in the Local Services and Access Management group. My responsibilities include tracking, reviewing and analyzing local wholesale prices in Qwest's region; reviewing cost studies; and representing AT&T as a witness in state regulatory proceedings in the Qwest region relating to local wholesale price/cost issues.

2. I received a B.S. degree in Business Management in 1988. I spent three years doing graduate work at the University of Arizona in Economics, and then I transferred to Oregon State University where I have completed all the requirements for a Ph.D. except my dissertation. My field of study was Industrial Organization, and I focused on cost models and the measurement of market power. I taught a variety of economics courses at the University of Arizona and Oregon State University. I was hired by AT&T in December of 1996 and have spent most of my time with the Company analyzing cost models.

3. I have testified before most commissions in Qwest's 14-state territory on cost models – including the HAI Model, BCPM, GTE's ICM, U S WEST's UNE cost models, and the FCC's Synthesis Model. I have also testified about issues relating to the wholesale cost of local service – including universal service funding, unbundled network element pricing, geographic deaveraging, and competitive local exchange carrier access rates.

4. My testimony supplements the testimony of Dr. Mercer and Mr. Fassett, which shows that the unbundled network element (“UNE”) loop rates adopted by the Colorado Public Utilities Commission (“PUC”) are inflated by numerous clear TELRIC errors. The purpose of my testimony is to identify an additional clear TELRIC error in an input to the cost model used to develop Qwest's UNE loop rates. As explained elsewhere,¹ the Colorado PUC correctly recognized that the cost model advanced by AT&T – the HAI 5.2a cost model (“HAI Model”) – is capable of producing TELRIC-compliant UNE loop rates. Accordingly, the Colorado PUC stated that it would “look primarily to the HAI Model” to set Qwest's Colorado UNE loop rates.² However, a model is only as good as the input assumptions used – an appropriately designed forward-looking cost model will not produce forward-looking cost estimates if it is not populated with forward-looking inputs.³ Many of the key input values approved by the Colorado PUC, often with little or no explanation, were based upon Qwest proposals that violate fundamental TELRIC principles.

¹ See Mercer/Fassett Decl. (attached to Comments of AT&T).

² See Colorado Pricing Order at 38.

³ See, e.g., *Colorado Pricing Order* at 40 (recognizing that “input assumptions constitute the main difference in the results of the cost models”).

5. One of those key inputs to the HAI 5.2a cost model is a value called “Network Operations.” The Network Operations input estimates the forward-looking costs to manage a local telecommunications network that are not already accounted for on a plant-specific basis.

Network operations expenses include:

- Provisioning (ARMIS account 6512) – costs incurred in provisioning material and supplies, including office supplies;
- Power (6531) – the cost of electrical power used to operate the telecommunications network;
- Network Administration (6532) – the cost of activities such as controlling traffic flow, administering traffic measuring and monitoring devices, assigning equipment and load balancing, collecting and summarizing traffic data, administering trunking, and assigning interoffice facilities and circuit layout work;
- Testing (6533) – costs incurred in testing telecommunications facilities from a testing facility to determine the condition of plant;
- Plant Operations Administration (6534) – costs incurred in the general administration of plant operations; and
- Engineering (6535) – costs incurred in the general engineering of the telecommunications plant which are not directly chargeable to an undertaking or project.

6. To estimate the amount of Network Operations in a forward-looking network, the HAI model starts with the embedded total expenses from the Qwest ARMIS accounts described above and multiplies them by a forward-looking operations factor. The developers of the HAI Model have determined that an appropriate forward-looking factor is 50 percent,⁴ and that is the default factor used by the Model. The forward-looking expenses are then divided by the total lines in the network to develop a *per line* expense. This per line expense is allocated to the loop by adding it to the loop related portion of the total loop-specific direct expense estimate.

Notably, unlike other expenses in the HAI Model, the Network Operations expense is a dollar value (not a percent) and, therefore, the Network Operations expense does not vary with the level of investment or direct expenses.

7. As noted, the HAI Model computes forward-looking Network Operations expenses by applying a forward-looking factor of 50 percent to Qwest's embedded Network Operations expenses. The 50 percent factor is based on several considerations. As a preliminary matter, it is necessary to adjust Qwest's embedded Network Operations costs to account for efficiencies that arise on a forward-going basis. In fact, between 2000 and 2001 alone, Qwest's Total Network Operations expenses have fallen by 10.6 percent.⁵ Overall, between 1996 and 2001, Total Network Operations Expenses fell by 8.1 percent.⁶ (It should be noted that during this time period Qwest had significant line growth. Switched lines grew by 16.2 percent and total lines by 30.3 percent, which results in reductions on a per line basis of more than 20 percent.⁷)

⁴ Network Administration is allocated to traffic sensitive UNEs only.

⁵ The 10.6% reduction was calculated by taking the change in Network Operations (Account 6530) + Provisioning (Account 6512) from 2000 to 2001 divided by the year 2000 totals for these accounts $(114802 + 3722 - 129750 - 2875) / (129750 + 2875) = -.106$. Totals from these ARMIS accounts are in 1000s. See also AT&T (Qwest III), Mercer/Fassett Decl. ¶¶ 63-64 (explaining the various efficiency gains enjoyed by Qwest).

⁶ This value was calculated similarly to the previous value $(114802 + 3722 - 127385 - 1541) / (127385 + 1541) = -.081$.

⁷ According to ARMIS report 43-08, table III Qwest had 2,784,640 switched access lines in 2001 and 2,396,747 lines in 1996. According to the same report, Qwest's total access lines were 4,111,431 in 2001 and 3,155,240 in 1996. Per line reductions are calculated by taking the change in per line amounts from 1996 to 2001 divided by the 1996 amount $((114802 + 3722) / 2,784,640 - (127385 + 1541) / 2396747) / ((127385 + 1541) / 2396747) = -.209$. The reduction is even greater if total access lines are used.

8. It also is necessary to adjust Qwest's reported embedded Network Operations expenses downward to ensure that those costs reflect TELRIC principles. Qwest's Network Operations accounts include many items that are not TELRIC costs. First, some of the accounts in Qwest's reported network operations include costs that are specific to *retail* operations and would be performed by those who buy UNEs rather than the incumbent LEC that sells these UNEs. Those retail expenses include, for example, "testing" and "plant operations administration" accounts that are recovered in Qwest's retail rates. Second, many of the administrative and engineering functions included in the Network Operations accounts are already recovered by Qwest through non-recurring charges. For example, Qwest performs provisioning and testing for loops purchased by CLECs. Qwest's NRC for coordinated installation with cooperative testing recovers the cost of both of these functions. Third, many of the costs reported in Qwest's Network Operations accounts are already at least partially recovered in recurring rate elements. For example, Qwest's Network Operations accounts include power expenses that are explicitly recovered in the collocation model. Indeed, Qwest's SGAT UNEs already includes "maintenance factors," which include power and testing expense, and what Qwest calls the "network operations factor," which includes network administration, plant operations administration, and engineering.

9. Accordingly, the developers of the HAI Model determined that it is necessary to apply a 50 percent forward-looking factor to Qwest's embedded Network Operations accounts to develop an appropriate additive that properly recovers Qwest's forward-looking Network Operations accounts. The problem with the UNE loop rates adopted by the Colorado PUC is that, in developing those rates, the Colorado PUC erroneously applied a forward-looking factor of *96 percent* – almost double the forward-looking factor used by the Model's developers. Thus,

the UNE loop rates adopted by the Colorado PUC assume that the Qwest's forward-looking Network Operations expenses are equal 96% of Qwest's embedded Network Operations expenses. That *de minimis* reduction forward-looking adjustment is on its face far too high, and allows Qwest to recover embedded and non-TELRIC costs through its loop rates.

10. In fact, the Network Operations additive produced by the erroneous 96 percent factor results in a dollar additive that is nearly double the additive advocated by Qwest. Qwest's cost studies also include a "network operations factor" ("Qwest's factor"), which recovers costs contained in three of Qwest's Network Operations ARMIS accounts: (1) Network Administration (Account 6532); (2) Plant Operations Administration (Account 6534); and (3) Engineering (Account 6535). Qwest's advocacy in the cost case results in an additive to Qwest's proposed loop rates to recover the costs of these accounts equal to \$0.96.⁸ By contrast, the additive adopted by the CPUC (and advocated by Qwest) for the exact same accounts when using the HAI Model was \$1.85⁹ – nearly double the value used by Qwest in its cost studies. In addition Qwest's model recovers the costs associated with Power (Account 6531) and Testing (Account 6533) through their maintenance factors. The additive to Qwest's proposed loop rates to recover the cost of these accounts is \$0.46, while the additive adopted by the CPUC was \$0.70. Table I below, summarizes the network operations expenses for (1) Qwest's original cost model; (2) Qwest's original cost model adjusted to reflect Qwest's discounts that produced the

⁸ The \$0.96 was computed as follows: Qwest's cost model explicitly contains a loop additive of \$1.26. Based on that additive, Qwest's cost studies produced a loop rate of \$23.55. *See Rebuttal and Cross Answer Testimony of Robert Brigham*, p. 6, footnote 4, July 20, 2001. Qwest then supported the then current loop rate in the state of \$18.00, which is a 23.6 percent discount to its modeled loop rates. *See id.* p. 6, lines 9-13. Applying that 23.6 percent discount to Qwest's \$1.26 Network Operations additive results in an additive of \$0.96.

\$18.00 proposed loop rate; (3) the HAI model with inputs adopted by CPUC; and (4) the HAI model as advocated by AT&T.

Comparison of Network Operations					
Dollars per Loop per month Expenses and Factors Across Models					
	Accounts	Qwest's ICM	Qwest's ICM adjusted for \$18 Loop	HAI Model (as Ordered)	HAI Model (as filed)
		(1)	(2)	(3)	(4)
Forward Looking Network Operations Factor				96.0%	50.0%
Provisioning	6512	\$ -	\$ -	\$ 0.057	\$ 0.029
Power and Testing	6531, 6533	\$ 0.608	\$ 0.465	\$ 0.697	\$ 0.363
Network Admin., Plant Operations Admin. & Engineering	6532, 6534, 6535	\$ 1.258	\$ 0.961	\$ 1.850	\$ 0.964
Total		\$ 1.865	\$ 1.426	\$ 2.604	\$ 1.356
Derivation of Values		Exhibit A	(1) * 18/23.55	Exhibit B	Exhibit B

Exhibits A and B contain the cost studies from the case from where these values are derived.

11. There is no question therefore that Qwest's Colorado loop rates reflect a network operations cost that is nearly *two times* too high. Both Qwest and the proponents of the HAI Model have advocated the use of a \$0.96 additive for Network Administration, Plant Operations Administration and Engineering (which using the HAI Model would require a Network Operations Factor of approximately 50 percent). In addition Qwest advocated \$0.46 for Power and Testing compared to the \$0.70 adopted by the CPUC. To correct for this clear TELRIC error, Qwest's Colorado loop rates should be reduced by at least \$1.13 $((\$1.85 - \$0.96) + (\$0.70 - \$0.46))$.¹⁰

⁹ This value is equal to 96 percent of the values of the Qwest's accounts for (1) Network Administration (Account 6532); (2) Plant Operations Administration (Account 6534); and (3) Engineering (Account 6535).

¹⁰ Loop rates should be reduced by greater than \$1.13, since the additives associated by network operations have factors (corporate overhead and other tax factor) applied to them which raises these costs by approximately 14%.

12. It is unclear whether CPUC understood the implications of adopting 96% reduction to Qwest's embedded costs. In the 577T proceeding, Qwest argued that there should be no discount because although "Qwest's network operations expenses in Colorado declined between 1995 and 1997" those costs "have remained steady since then," and "[b]ecause the HAI Model starts with 2000 data it already accounts for cost reductions achieved since 1995." 577T Order at 62. As noted above, that argument is inconsistent with the Network Operations expenses used by Qwest in its own cost model (which is equivalent to nearly a 50% discount).¹¹ Moreover, as noted, Qwest's claims that those accounts will remain steady despite the historical evidence showing steady declines is false – as noted, between 2000 and 2001 alone, the value of those accounts fell by 10.6 percent.

13. The CPUC ultimately stated that "[t]he network operations expenses as used in the Qwest model are acceptable." 577T at 62. But rather than adopting the nearly 50 percent reduction to the network operations expenses used in Qwest's Model, CPUC adopted only a 4 percent discount (*i.e.*, a 96 percent factor) to Qwest's network operations expenses. Thus, it appears that CPUC was duped by Qwest – CPUC meant to adopt a discount similar to that in Qwest's model, but based on Qwest's erroneous arguments, CPUC adopted a much lower discount.

¹¹ In part this is due to adjustments Qwest makes to its network operations expense by removing expenses in these accounts that are associated with Collocation and Non-Recurring costs. See Qwest's Expense Factors Model, filed as part of the Collocation Model (though it includes the factors for all models) which was a CD-ROM attached to the testimony of Mr. Brigham.

CONCLUSION

14. For the foregoing reasons, Qwest's loop rates are inflated by a clear TELRIC error. To correct for that error, Qwest's loop rate should be reduced by \$1.13

VERIFICATION PAGE

I declare under penalty of perjury that the foregoing Declaration is true and correct.

/s/ Douglas Denney

Douglas Denney

Executed on: October 15, 2002

**EXHIBIT A
(REDACTED FOR PUBLIC INSPECTION)**

**EXHIBIT B
(REDACTED FOR PUBLIC INSPECTION)**