Qwest
1020 Nineteenth Street NW, Suite 700
Washington, DC 20036
Phone 202.429.3121
Fax 202.293.0561

Cronan O'Connell
Vice President-Federal Regulatory

October 28, 2002

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street SW, TW-A325
Washington, DC 20554

RE: CC Docket Nos. 01-338 and 96-98, 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

Dear Ms. Dortch:

The attached October 22, 2002 Ex Parte letter is being re-filed with an attached presentation, to correct the inadvertent exclusion of the presentation, when it was initially filed.

In accordance with FCC Rule 1.49(f), this *Ex Parte* letter is being filed electronically *via* the Electronic Comment Filing System for inclusion in the public record of the above-referenced dockets pursuant to FCC Rule 1.1206(b)(2).

Sincerely,
/s/ Cronan O'Connell

cc: Matthew Brill (mbrill@fcc.gov)

Attachment

Qwest
1020 Nineteenth Street NW, Suite 700
Washington, DC 20036
Phone 202.429.3121
Fax 202.293.0561

Cronan O'Connell
Vice President-Federal Regulatory

October 22, 2002

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street SW, TW-A325
Washington, DC 20554

RE: CC Docket Nos. 01-338 and 96-98, 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

Dear Ms. Dortch:

Today, Jerry Thompson and Cronan O'Connell of Qwest Communications International, Inc., accompanied by Jonathan Nuechterlein of Wilmer Cutler and Pickering met with Matthew Brill of Commissioner Kathleen Abernathy's office to discuss TELRIC. In particular, we addressed the current methodological errors of TELRIC in our region, the practical consequences from a rate perspective and what we recommend as the next steps in order for the Commission to rectify the inaccuracies in the current application of TELRIC, at the state level, as reflected in the attached presentation.

In accordance with FCC Rule 1.49(f), this *Ex Parte* letter is being filed electronically *via* the Electronic Comment Filing System for inclusion in the public record of the above-referenced dockets pursuant to FCC Rule 1.1206(b)(2).

Sincerely,

/s/ Cronan O'Connell

cc: Matthew Brill (mbrill@fcc.gov)

Attachment

Qwest®

Spirit of Service

TELRIC Presentation

October 21-22, 2002

Qwest TELRIC Presentation: Overview

- **What is the *purpose* of TELRIC?**
  - **The creation of economically rational price signals that encourage facilities investment where appropriate and that are *pro-competition* without being *pro-competitor***
- **How have many states *violated* TELRIC in their zeal to lower UNE rates? A non-exhaustive list of methodological errors:**
  - **cable placement costs**
  - **structure sharing**
  - **network routing shortcuts**
  - **fill factors**
  - **non-recurring costs**
- **What are the *practical consequences* of these TELRIC violations?**
  - **Disincentives for ILECs and CLECs alike to invest in socially beneficial new facilities.**

Qwest
Spirit of Service

TELRIC: Theory vs. Practice.

- **Six years ago, the Commission promised to "issue additional guidance" on TELRIC "[i]n the aftermath of the arbitrations and relying on the state experience." *Local Competition Order* ¶ 620. Now that the litigation concerning TELRIC has concluded, the time is ripe for the Commission to issue that guidance.**

- **In this presentation, Qwest does not seek fundamental *alterations* to TELRIC. Instead, it seeks *restoration* of TELRIC to its original purpose: the creation of economically appropriate price signals for CLECs as they choose between leasing facilities from ILECs and procuring their own.**

Qwest
Spirit of Service

TELRIC: Theory vs. Practice (cont'd)

- **In recent years, non-facilities-based CLECs and many states have treated TELRIC not as the economically objective replacement-cost methodology the Commission intended, but as a mandate to reduce rates in order to produce "the widest unbundling possible," an objective that the D.C. Circuit recently rejected as incompatible with the statutory design. *USTA v. FCC*, 290 F.3d 415, 424-25 (D.C. Cir. 2002).**

- **Proliferation of the UNE-platform for its own sake, however, was never the Commission's objective in adopting TELRIC. Instead, the Commission designed its cost methodology to be, as "Congress intended, *pro-competition*" rather than "*pro-competitor*." *Local Competition Order*, ¶ 618.**

Qwest
Spirit of Service

TELRIC's Purpose.

- **The "essential objective" of TELRIC "is to determine what it would cost, in *today's* market, to replace the functions of [a network] asset that make it useful," while simultaneously taking as given "the most basic geographical design of the existing network." FCC Br., *Verizon Communications Inc. v. FCC*, Nos. 00-511 *et al.*, at 6, 9 (filed April 2001) (emphasis added).**

- **Thus, the point of TELRIC is not to imagine that the *world itself* will be recreated from the void with an eye towards lowering UNE prices. Instead, TELRIC asks what facilities would be "currently available" to an efficient carrier seeking to replace the existing network, 47 C.F.R. § 51.505(b)(1), given the constraints of the rest of the world, outside the network, as they exist *today*.**

Qwest
Spirit of Service

TELRIC's Purpose (cont'd)

- **Taking such constraints into account is integral to the basic purpose of TELRIC, which is to "replicate[], to the extent possible, the conditions of a competitive market." *Local Competition Order*, ¶ 679. By replicating those conditions, TELRIC is meant to give CLECs appropriate price signals about when it would be efficient, and when inefficient, to build their own facilities rather than leasing the incumbents' existing capacity. *See id.* at ¶ 620, ¶¶ 683-85.**

- **TELRIC is meant to promote the ultimate objective of the 1996 Act: true facilities-based competition. This can be accomplished only if both CLECs and ILECs have adequate incentives to invest in new facilities of their own. No carrier would ever build facilities at today's costs, with the constraints of today's world, if it could instead lease facilities at rates reflecting the lower costs of yesterday or tomorrow.**

Qwest
Spirit of Service

TELRIC Loop Inputs

- The estimated forward-looking loop cost turns on basic TELRIC input questions.
  - Are streets paved or are they dirt?
  - How many utilities are constructing facilities simultaneously in the same locations?
  - Do obstacles like buildings, houses, and right-of-way restrictions exist?

Qwest
Spirit of Service

TELRIC Loop Inputs: Placement Methods

Basic Types:

- **Plowing (least costly, but available only where asphalt and concrete are not present).**
- **Directional boring: *I.e.*, tunneling under asphalt and concrete (more costly).**
- **"Cut and restore" asphalt and concrete (most costly).**

Qwest
Spirit of Service

TELRIC Errors: Placement Costs

- **The Arizona Corporation Commission found that "an appropriate cost model" should *not* assume that "the majority of placement activities would require that streets, sidewalks, and landscaping would need to be cut and restored or bored."**

- **The ACC thus accepted AT&T's claim that it is *wrong* to assume that "all physical structures are currently in places they are today" — and that it is right to assume instead that a replacement carrier could go *back in time* and place cable in the ground "before structures such as roads and landscaping are already in place."**

- **The Colorado PUC adopted a similar assumption.**

- ***This is not a forward-looking assumption.* Again, no carrier would ever build facilities at today's costs, with the constraints of today's world, if it could instead lease facilities at rates reflecting the lower costs of yesterday.**

Qwest
Spirit of Service

TELRIC Errors: Sharing

- **"Sharing" assumptions relate to the number of utilities that could be expected to construct distribution facilities in the same locations at the same time.**
- **The higher the sharing percentage, the lower the percentage of cable placement costs the efficient carrier could be deemed to incur on its own, and thus the lower the forward-looking loop cost.**

Qwest
Spirit of Service

TELRIC Errors: Sharing

- **The Colorado Commission found that**
  - **in the highest density areas, with the highest level of asphalt and concrete, the "efficient carrier" would be able to split placement costs with some other utility virtually every time it digs into the street, such that it would only incur 55% of those costs in the aggregate.**
- **The Arizona Commission found that**
  - **In all density areas, with aerial, buried and underground facilities, Qwest would be able to partner such that it would incur only 50% of that cost.**
- ***This is not a realistic replacement cost assumption.***
  - **"Sharing" opportunities are very limited in developed areas, because the utilities that might otherwise have an interest in finding such opportunities have already deployed most of their underground facilities there.**

Qwest
Spirit of Service

TELRIC Errors: Placement Costs/Sharing

- **In sum, in addressing both cable placement costs and sharing percentages, CLECs argue for, and some states endorse, an entirely different inquiry: what it *would have* cost a carrier to replace current network facilities *years ago*, back before business and residential development both made cable placement more costly and reduced savings from the sharing of trenching costs.**

- **TELRIC, however, is not a time machine. Although TELRIC entitles CLECs to many advantages an ILEC lacked when it built the network, it does not entitle CLECs to wish away present-day concrete and asphalt, just as it does not entitle them to pretend that labor is as cheap today as it was decades ago when much of the trenching for today's network was done.**

- **Indeed, if TELRIC permitted this retrospective analysis, a CLEC would never have any incentive to build its own facilities, because, through cheap access to UNEs, it could always take advantage of the lower costs incurred in past years.**

Qwest
Spirit of Service

TELRIC Errors: Network Routing Shortcuts

- **One important input used to determine the correct quantity of cable is its length.**
  - **The correct method that should be used would recognize that real world obstacles prevent lengths that are the shortest possible distances.**
  - **Construction of underground facilities requires that routes go around buildings along state-required rights-of-way.**

Qwest
Spirit of Service

TELRIC Errors: Network Routing Shortcuts

- **The HAI cost model, sponsored by CLECs and adopted by states inside and outside of Qwest's territory, represents the world in a simplified form that omits many of the features of the real world that make it costly to deploy a telecommunications network.**

- **An extreme example is Arizona's use of an optional new HAI network design algorithm ("minimum spanning tree") that purports to estimate the distance for connecting points or customers. The practical effect of using that algorithm is to assume that a given serving area has no obstructions such as houses, yards, office buildings, or right-of-way restrictions that could interfere with the cheap deployment of telephone lines.**

Qwest
Spirit of Service

TELRIC Errors: Fill Factors

- A "fill factor" reflects the percentage of a facility's capacity that, on average, is used when the facility is efficiently deployed. The higher the fill factor is, the lower the UNE rates are, because the costs of spare capacity that need to be allocated to individual working units are lower.

- States often adopt below-cost UNE rates by assuming unreasonably high fill factors. These states ignore the realities that (1) even the most efficient carriers build in room for growth and churn and (2) transmission capacity is "lumpy": *i.e.*, the equipment available on the market increases in capacity only in large increments.
  - For example, an efficient carrier needing capacity equivalent to 20 DS1 circuits would order one DS3 circuit rather than 20 DS1 circuits, even though the latter option would involve a higher fill factor.

Qwest
Spirit of Service

TELRIC Errors: Non-Recurring Costs

- **CLECs have advocated, and some states have adopted, trivial non-recurring charges for various labor-intensive activities. The premise underlying this denial of compensation for the use of skilled labor is the theory that such activities "will" be fully automated "in a forward-looking environment."**

- **This approach confuses *forward-looking* costs with *future* costs. AT&T's cost expert emphasized in Arizona that an efficient carrier's present capabilities using today's technology are, in effect, irrelevant because "*right now is not a forward-looking time*." AZ Hrg. Tr. 1566. Likewise, the Arizona commission accepted the AT&T NRC model -- for all but a handful of NRCs -- on the ground that it "recognizes the efficiencies that *will occur* in a forward-looking network." *Arizona Phase II Order* at 33 (emphasis added).**

- **But TELRIC bases forward-looking costs on the most efficient technology that is "currently available," not on technology that might exist someday in the future (if at all). 47 C.F.R. § 51.505(b)(1).**

Qwest
Spirit of Service

TELRIC Errors: NRCs (cont'd)

- **The full context of the AT&T NRC expert's testimony illustrates how far advocacy about TELRIC has strayed from TELRIC's original purpose. He answered "right now is not a forward-looking time" to justify *no compensation at all* for the human resource burden Qwest must bear in processing the 24% of UNE orders that CLECs choose today to submit by fax rather than through Qwest's automated systems. Specifically, he reasoned: "That is a real cost that they're [ILECs] incurring today on behalf of CLECs, but *in the future*, that cost should not be there if *we* [CLECs] have an appropriate GUI system installed." AZ Hrg. Tr. 1566-67.**

- **Of course, it would be inappropriate to penalize an *ILEC* for the inefficiencies of *CLECs* on the theory that someday *in the future* CLECs will be less inefficient. That such advocacy has found sympathetic ears at some state commissions is a disquieting reminder of the need for this Commission to give some basic guidance on how TELRIC should — and should not — be applied.**

Qwest
Spirit of Service

TELRIC Errors: Summary

- **In combination, these TELRIC violations simultaneously:**
  - **move *back* in time to pre-development days – when streets were dirt, digging was cheap, and other utilities supposedly shared the costs – while nonetheless ignoring other factors that produced higher costs in the past;**
  - **move *forward* in time to the unforeseeable future, when the technology is invented that allows CLECs and ILECs to solve complex network coordination problems with little or no human involvement, but without accounting for the costs of developing that technology; and**
  - **ignore facts outside the existing network that should be taken into account, such as homes, office buildings, and other inconvenient obstructions.**

Qwest
Spirit of Service

TELRIC Violations: Summary (cont'd)

- **The only common theme unifying these TELRIC violations is that the result in each case is a material reduction both in the ILEC's UNE rates and in the incentives of CLECs to invest in facilities of their own.**

- **These methodological lapses have enormous economic consequences. In Arizona, for example, the net result of such errors is an arbitrary reduction of more than four dollars (roughly 25%) in the statewide average recurring loop rate.**

- **When "Government set[s] wholesale local prices below real cost," as it is increasingly tempted to do, it "poison[s] prospects for economically sound facilities investment" and "contribute[s] to the destruction of companies, jobs, and shareholder wealth by discouraging economic investment and rewarding uneconomic investment."[1]**

- **[1] Scott C. Cleland, *Why De-Regulation Is Now The Dominant Telecom Trend/Theme*, Precursor Group Independent Research (Nov. 28, 2001).**

Qwest
Spirit of Service

Disincentive Effects of TELRIC Errors

Illustrative comparison of actual costs of adding new lines vs. UNE loop rate:

ILEC Current Cost	CATV Digital Upgrade	AT&T Loop Rate Advocacy	*Too Low* PUC Decision
$1,100	$700	$400	$600
Monthly cost:			
$22.00	$14.00	$8.00	$12.00
Loss over current cost:			
		$14.00	$ 10.00

Consequence: no incentive to invest

Qwest
Spirit of Service

Depreciation

- **Forward-looking depreciation (shorter) lives help, but do not offset TELRIC errors.**

Investment:	Current	AT&T	*Too Low*
	$1,100	$400	$600
Monthly Depreciation:			
20 years	$4.58	$1.67	$2.50
10 years	$9.17	$3.33	$5.00
Increase	$4.59	$1.67	$2.50

- **Offsets only a fraction of a *Too Low* Decision.**

Qwest
Spirit of Service

The Role of the Synthesis Model

- **AT&T and other CLECs have invoked SM input decisions – often with considerable success – as a basis for violating TELRIC with respect to all of the recurring cost inputs discussed above, including placement costs, structure sharing, and fill factors.**

- **The FCC has repeatedly stated, however, that the SM is not designed to produce TELRIC-based UNEs and should not be relied on for that purpose. Indeed, the Commission has already acknowledged several important respects in which the SM deviates from TELRIC. *E.g.*:**
  - **Per-line costs of switch growth additions. *Compare Inputs Order* (¶¶ 315-317) *with AT&T Corp. v. FCC*, 220 F.3d 607, 618 (D.C. Cir. 2000).**
  - **94% fill factor for switching. *Vermont 271 Order* ¶ 36. (The Commission has thus admonished that USF cost model "fill factors . . . should not be used for setting rates." *Id.*)**

Qwest
Spirit of Service

The Role of the Synthesis Model (cont'd)

- **Qwest and other ILECs have nonetheless met with limited success in trying to persuade state commissions that, in setting UNE rates, they should not rely on the decisions attributed to the FCC in the SM. *E.g.,* Arizona (placement costs, sharing percentages, MST).**
- **The Commission should make clear that, for UNE rate-setting purposes, the SM provides no evidentiary value of its own in supporting a particular input.**
- **This would not necessarily require the Commission to alter the model itself for universal service purposes. Any given error in that model may well have a relatively attenuated effect on the intended output of the model, the limited purpose of which is to identify *relative* cost differences among the states. But the same error, used within a different model designed to set *absolute* rate levels for individual UNEs, may have enormous consequences.**

Qwest
Spirit of Service

Conclusion

- **State commissions are tempted to depart from TELRIC principles to set low UNE rates that encourage wrong economic choices.**
- **The FCC can help prevent this by saying that UNE rates can be *too low* (an opportunity that 271 proceedings do not provide).**
- **More generally, the FCC should clarify the concrete respects in which states violate TELRIC by treating it as *pro-competitor* rather than *pro-competition*.**
- **The FCC should clarify that SM inputs should not be used for UNE rate-setting purposes.**
- **The Commission should issue these clarifications as part of its *Triennial Review* order. Alternatively, the Commission should adopt these clarifications as tentative conclusions in an FNPRM, to be finalized by mid- 2003.**

Qwest
Spirit of Service