Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Qwest Corporation	)	Transmittal No. 164
July 1, 2003	)	WCB/Pricing 03-15
Annual Access Charge Tariff Filing	)	

QWEST'S REPLY TO AT&T'S PETITION

Qwest Corporation ("Qwest"), through counsel and pursuant to Section 1.773 of the Federal Communications Commission's ("Commission") Rules,[1] and the Commission's tariff procedural *Order*,[2] respectfully submits its Reply to AT&T Corp.'s ("AT&T") Petition.[3]

I. INTRODUCTION

Qwest filed Transmittal No. 164 to revise its price cap indices and access charge rates beginning July 1, 2003. On June 23, 2003, AT&T filed a petition challenging Qwest's exogenous cost adjustment for Excess Deferred Taxes ("EDT") and urged the Commission to suspend and investigate Transmittal No. 164.[4] AT&T claims that Qwest has failed to demonstrate that there is a balance left in its EDT account.[5] AT&T also implies that the EDT

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[1] 47 C.F.R. § 1.773.

[2] *In the Matter of July 1, 2003 Annual Access Charge Tariff Filings*, WCB/Pricing 03-15, *Order*, rel. Apr. 18, 2003 ("*Tariff Order*").

[3] Petition of AT&T Corp. filed June 23, 2003, WCB/Pricing 03-15.

[4] To justify suspension of Transmittal No. 164, significant questions of unlawfulness must be raised and petitioners must demonstrate that immediate and serious harm is likely to occur if the tariff is not suspended. *See*, *e.g.*, *AT&T Communications Revisions to Tariff FCC Nos. 260, 266, 267, 268, 270, 273 and 274; Establishment of Rates and Regulations Applicable to ACCUNET Packet Service*, 56 Rad. Reg. (P&F) 2d 1503, 1508 ¶ 18 (1984); *ITT World Communications Inc.*, 73 FCC 2d 709, 719 ¶ 26 (1979); *A.T. & T.*, 46 FCC 2d 81, 85-86 ¶¶ 10-12 (1974); *see also generally Arrow Transportation Co. v. Southern Railway Co.*, 372 U.S. 658 (1963).

[5] AT&T Petition at 15.

exogenous cost adjustment should be at or near zero.[6] As Qwest demonstrates below, AT&T's claims are without merit.[7] Accordingly, Transmittal No. 164 should be allowed to take effect as filed.

II. QWEST'S EXOGENOUS COST ADJUSTMENT FOR EDT FULLY COMPLIES WITH THE COMMISSION'S PRICE CAP RULES

Qwest has included an exogenous cost adjustment for EDT since the inception of price cap regulation for local exchange carriers ("LEC") in 1991.[8] Twelve years later, AT&T claims that Qwest's cost support for this adjustment is inadequate. Qwest disagrees.

Deferred taxes arise because there is a difference between the amount of tax actually paid and the amount included for ratemaking purposes under rate of return regulation for any given "test" year.[9] EDTs arise when corporate tax rates are reduced -- as was the case in 1986 when the rate was reduced from 46 to 34 percent (later increased to 35 percent in 1993). Under rate of return regulation, deferred taxes are deducted from the regulated rate base[10] and added back in when they are paid. At the inception of price cap regulation, regulated rates were less than they

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[6] *Id.*

[7] In addition to lacking merit, AT&T's allegations should be dismissed as untimely. AT&T had the opportunity to address any issues that it might have had with Qwest's exogenous cost adjustments on May 13, 2003 when comments on LEC Tariff Review Plans were due. *See Tariff Order* ¶ 6. AT&T did not challenge Qwest's EDT adjustment at that time and should be precluded from doing so now. *See In the Matter of Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996*, *Report and Order*, 12 FCC Rcd. 2170, 2219 ¶ 101 (1997).

[8] The Commission found that Qwest (formerly U S WEST) flowed back EDT in a reasonable manner in its initial price cap tariff filing. *See In the Matter of Annual 1991 Access Tariff Filing*, Trans. No. 452, *Memorandum Opinion and Order*, 6 FCC Rcd. 3792, 3797 ¶ 43 (1991). Since that time Qwest's exogenous cost adjustments for EDT have taken effect as filed.

[9] This "difference" occurs due to differences between tax depreciation rates and the depreciation rates prescribed by the Commission (*i.e.*, "book" depreciation rates).

[10] In effect giving ratepayers the benefit of a "zero interest" loan.

would have been in the absence of deferred taxes. As a result, the Commission properly included an exogenous cost adjustment for EDT.

AT&T is correct that EDT (and the EDT exogenous cost adjustment) will eventually go to zero. However, as AT&T has acknowledged in its Petition, EDT will not disappear until all plant in existence in 1986 is fully depreciated.[11] AT&T is also well aware of the fact that book depreciation lives are very lengthy for a significant amount of Qwest's invested capital. As of January 1, 2003, almost half of Qwest's invested capital was recorded in accounts with depreciation lives of twenty years or longer. For example, Account 2441, conduit systems, represents approximately five percent of Qwest's capital and has book depreciation lives of 55 to 60 years in the different Qwest states. Therefore, it should not come as a surprise to either AT&T or the Commission that Qwest has numerous capital accounts that contain investments with vintages prior to 1986 that are not yet fully depreciated.[12] Moreover, Qwest expects that it will be including an EDT exogenous cost adjustment in its price cap tariff filing for the foreseeable future -- although the adjustment will continue to shrink in size.[13]

The foregoing comments demonstrate the AT&T's request that price cap LECs be required to prove that EDT is not zero is ludicrous and should be rejected. EDT will become zero when all plant that was in place in 1986 is fully depreciated -- and not before. In Qwest's

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[11] "As the depreciation lives of the assets underlying the EDT account expire, the underlying EDT exogenous costs will also decline, eventually reaching zero." AT&T Petition at 15.

[12] That is, Account 2121 – Buildings, Account 2122 – Furniture, Account 2411 – Pole Lines, Account 2421 – Aerial Cable Metallic, Account 2421 – Aerial Cable Non-Metallic, Account 2422 – Underground Cable, Account 2413 – Buried Cable, Account 2424 – Submarine Cable, Account 2426 – Intra-Building Cable, and Account 2441 – Conduit Systems. *See* Attachment A.

[13] For example, conduit investment placed in 1985 in a state with a 60 year service life for conduit will continue to have an impact on Qwest's EDT exogenous cost adjustment through 2045.

case this may be as long as 2045.[14] In order to remove any doubt concerning Qwest's exogenous cost adjustment for EDT in Transmittal No. 164, Qwest will provide a more detailed explanation of how this adjustment was calculated.

There are two possible ways of calculating the EDT adjustment for each year. One approach is the one that AT&T addresses in its Petition. Under this approach, a price cap LEC would have created an EDT account in 1986 (when the corporate tax rate was reduced) and amortized this account over the remaining life of plant in service in 1986.[15] The other approach -- which Qwest employs -- is to calculate EDT on an annual basis. A number of steps are involved in this calculation. Step 1, Qwest examines book depreciation and tax depreciation for each vintage account (*i.e.*, 1986 and earlier) to determine which accounts are "reversing" (*i.e.*, book depreciation exceeds tax depreciation) and the associated dollar amounts. Step 2, Qwest identifies the deferred taxes that were booked for each of these vintage accounts. Step 3, Qwest calculates the deferred taxes for the vintage accounts that are reversing applying a 35 percent tax rate to the reversing dollar amounts determined in Step 1. Step 4, EDT is calculated for each of the reversing vintage accounts by subtracting deferred taxes derived in Step 3 from booked deferred taxes in Step 2. This methodology results in an accurate and reasonable estimate of annual EDT for price cap purposes.

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[14] One of the primary variables in determining EDT is Commission prescribed depreciation rates (*i.e.*, book depreciation service lives). Needless to say, the EDT issue would disappear quickly if the Commission adopted more realistic depreciation lives (as Qwest has advocated many times in the past).

[15] Although Qwest has not previously calculated such an EDT balance, Qwest will do so and submit it to the Commission in order to resolve any questions that the Commission may have concerning Qwest's calculation of EDT on an annual basis. However, this effort will take some time given the historical nature of most of the data.

III. CONCLUSION

For the foregoing reasons, the Commission should reject AT&T's allegations and allow Transmittal No. 164 to take effect as filed.

Respectfully submitted,

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June 27, 2003

Attachment A

ACCOUNT	CATEGORY	TOTAL 1/1/2003 INVESTMENT (000,000s)	PROJECTION LIVES FOR MR PLANT AS OF Jun-03	TAX LIVES OF MR PLANT CLS Pre-1971	ADR 1971-1981	ACRS 1981-1986
2121	BUILDINGS	$2,685	22-53	45	36	15
2122	FURNITURE	$3	15-20	5	8	5
2411	POLE LINES	$253	18-28	35	28	15
2421	AERIAL CABLE MET	$1,248	18-24	35	28	15
2421	AERIAL CABLE NON MET	$36	25	35	28	15
2422	UNDGRD CABLE MET	$2,521	25	35	28	15
2422	UNDGRD CABLE NON MET	$787	25	35	28	15
2423	BURIED CABLE MET	$9,483	20-21	35	28	15
2423	BURIED CABLE NON MET	$670	25	35	28	15
2424	SUB CABLE MET	$7	20-25	35	28	15
2424	SUB CABLE NON MET	$5	25	35	28	15
2426	INTRA BLDG CA MET	$353	19-20	35	28	15
2426	INTRA BLDG NON MET	$20	25	35	28	15
2441	CONDUIT SYSTEMS	$2,150	55-60	35	28	15
	Total Plant w/ Lives > 17 years:	$20,221				

This attachment is subject to any future restatement of financial information by Qwest Communications International Inc., or any of its affiliates (the "Company"), as discussed in the Company's recent filings with the Securities and Exchange Commission, including its filings on Form 8-K on February 20, 2003, and May 29, 2003.

CERTIFICATE OF SERVICE

I, Richard Grozier, do hereby certify that I have caused the foregoing **QWEST'S REPLY TO AT&T'S PETITION** to be filed with the FCC via its Electronic Tariff Filing System, and served on the parties on the attached service list as indicated below, either via email or facsimile and First Class United States mail, postage prepaid.

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June 27, 2003

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Updated June 27, 2003