I. INTRODUCTION

At the May 11, 2000 hearing, the Hearing Officer permitted parties until May 19, 2000, at 4:00 p.m. to submit post-hearing briefs on the Phase I issues in this proceeding. Phase I was designed to comply on an expedited basis with the requirements of 47 C.F.R. Section 51.507(f), which became effective on May 1, 2000. Section 51.507(f) of the Federal Communications Commission’s (“FCC”) rules and regulations, requires State commissions to establish different rates for unbundled network elements (“UNEs”) in at least three defined geographic areas within the State to reflect geographic cost differences. The Arizona Corporation Commission (“Commission”) Staff submits the following Post-Hearing Brief which addresses the issue of wholesale cost zones for U S WEST UNE rates, as required by the FCC rules.

Geographic deaveraging proposals were submitted by three parties in Phase I, including U S WEST Communications, Inc. (“U S WEST”), AT&T Communications of the Mountain States, Inc. (“AT&T”), and the Commission Staff in response to the proposals of U S WEST and AT&T.

The Commission Staff proposed an interim plan utilizing three wholesale cost zones, the minimum number of zones required under the FCC rules, because the deaveraged rates are being developed on an expedited basis to comply with the FCC’s reinstated rule. The Staff’s proposal is based upon a neutral costing model developed by the FCC over the last several years for universal...
service costing purposes. Each of Staff’s proposed zones and the breakdown of wire centers contained therein was developed based upon costs. Overall, the Staff’s methodology results in approximately 20% of U S WEST’s access lines falling into Zone 1; 59% would fall into Zone 2; and the remaining 21% would fall into Zone 3. Staff’s proposal is reasonable when viewed against the Company’s existing retail rate structure. Staff’s proposal results in the following interim rates for Zones 1 through 3: $16.95, $19.97 and $32.41 respectively.

If the Commission uses the U S WEST proposal to deaverage UNE rates on an interim basis, it should utilize the Company’s existing BRA and Zones. The U S WEST proposal to utilize its expanded BRA proposal from its pending rate case achieves only token deaveraging with ninety-five percent (95%) of the Company’s access lines falling into the BRA. The U S WEST proposal for an expanded BRA has not and may not ultimately even be approved by the Commission and its expansion has no underlying cost basis, which makes it inappropriate even on an interim basis. Tr. (Million) p. 33.²

In that it seeks to expand the current BRA even further, the U S WEST proposal averages costs to an even greater degree than the existing retail rate structure. Currently 87.5% of the Company’s access lines are in the BRA. U S WEST Ex. 5.³ While there are underlying problems with utilizing the existing retail rate structure to deaverage UNE rates, this is only compounded to a much greater extent by using the expanded BRA and Zones proposed in the Company’s rate case which contain an even greater degree of averaging. Finally, because under its proposal 95% of the Company’s customers are located in the BRA, the U S WEST proposal results in extremely high wholesale rates in Zones 2 and 3, $40.65 and $63.70 respectively, which virtually ensures that consumers located in those zones will never be the beneficiaries of competition.

The AT&T deaveraging proposal⁴ is based upon the most updated HAI (5.0a) model. While Staff agrees with the approach taken by AT&T to disaggregate cost on wire center basis for purposes of interim rates, the current version of the HAI has not been subject to examination by the

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¹ This deadline was subsequently extended to May 26, 2000.
² All references to Transcript of May 11, 2000 Hearing.
³ All references to Exhibits are those admitted at the May 11, 2000 Hearing.
⁴ The AT&T deaveraging proposal is supported by NEXTLINK Arizona, Inc. through testimony filed by NEXTLINK Witness Rex Knowles. Upon information and belief, AT&T’s proposal is supported by other CLECs also.
Commission. Staff believes this should be done before the model is used in Arizona to deaverage UNE rates.

Staff utilized a neutral methodology which produces reasonable results in terms of wire center breakdowns and interim deaveraged loop rates. Staff’s proposal complies with both the spirit and intent of the FCC’s rules. Thus, the Commission should adopt it on an interim basis to set deaveraged UNE rates.

II. BACKGROUND

On August 8, 1996, the FCC adopted rules implementing Sections 251 and 252 of the Telecommunications Act of 1996 (‘‘1996 Act’’).§ 47 C.F.R. Section 51.507(f) requires State commissions to establish a minimum of three geographic rate zones for unbundled network elements and interconnection that reflect cost differences. The Eighth Circuit Court of Appeals subsequently stayed large portions of the FCC’s rules, including Section 51.507(f), and on July 18, 1997, it vacated the rules on jurisdictional grounds. On January 25, 1999, the United States Supreme Court reversed the Eighth Circuit’s jurisdictional holdings. As a result, the FCC rules that had been vacated on jurisdictional grounds, including Section 51.507(f), were subsequently reinstated.

On May 7, 1999, the FCC issued a sua sponte Order, FCC 99-86 (14 FCC Rcd. 8300) stay of the effectiveness of Section 51.507(f), ‘‘until six months after the Commission issues its order in CC Docket No. 96-45 finalizing and ordering implementation of high-cost universal service support for non-rural local exchange carriers (LECs) under section 254 of the Communications Act of 1934, as amended.’’ Id. at para. 3. On November 2, 1999, the FCC issued its Ninth Report and Order and Eighteenth Order on Reconsideration in the Universal Service Docket in which it expressly lifted the stay of the deaveraging requirement effective May 1, 2000. Id. at paras. 119-120.

On April 19, 2000, the Commission filed with the FCC a petition for expedited temporary waiver of 47 C.F.R. Section 51.507(f) until such time as the ACC is able to complete its

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§ Iowa Utilities Board v. FCC, 96 F.3d 1116 (8th Cir. 1996); Iowa Utilities Board v. FCC, 109 F.3d 418 (8th Cir. 1996) and Iowa Utilities Board v. FCC, 120 F.3d 753 (8th Cir. 1997).

§ See In the Matter of Federal-State Joint Board on Universal Service, Ninth Report and Order and Eighteenth Order on Reconsideration, CC Docket No. 96-45 (rel. November 2, 1999) (‘‘Universal Service Order’’).
proceedings establishing both interim and permanent deaveraged UNE rates. On April 26, 2000, the Commission filed a revised petition at the request of the FCC, seeking a waiver until June 29, 2000. On April 28, 2000, the FCC issued an order granting the ACC’s request for a waiver until June 29, 2000.

III. DISCUSSION

A. Staff Utilized a Neutral Model Which Produces Reasonable Results for Interim Geographic Deaveraged UNE Rates.

The Staff’s proposal produces a level of deaveraging that is reasonable on an interim basis and which complies with both the letter and spirit of the FCC rules. Staff also used a neutral model developed by the FCC for universal service funding purposes after several years of review and study, and inputs and repeated evaluations from numerous parties. Staff Ex. 1 p. 3; Tr. (Rowell) p. 122.

Staff’s three zone proposal is based upon individual U S WEST wire center costs, as determined by the FCC model. Zone 1 includes wire centers with average loop costs between $12.62 and $14.99. Zone 2 includes wire centers with average loop costs between $15.00 and $18.99. Zone 3 includes wire centers with average loop costs above $18.99. Since Staff’s proposal groups wire centers with similar average loop costs together, it is much more reflective of actual costs than the U S WEST proposal. The Staff’s proposal is also reasonable when compared to the Company’s existing retail rate structure. U S WEST charges the same retail rate to all residential consumers within the BRA, approximately 88% of U S WEST’s lines using the existing BRA. Under Staff’s proposal, approximately 80% of the access lines fall within Zones 1 and 2. For purposes of establishing interim deaveraged UNE rates, Staff’s proposal is, therefore, very reasonable.

While both U S WEST and AT&T have indicated that there are problems with the line counts contained in the FCC’s model for specific wire centers, Staff does not believe that this should have a material effect on the placement of individual wire centers within the three zones proposed by Staff. Tr. (Rowell) p. 122. Correcting the counts may lead to differences in individual

Staff has since notified the FCC that it will likely be requesting an extension of time on behalf of the Commission until July 20, 2000, due to internal Commission scheduling conflicts.
wire center costs, but in Staff’s opinion, it would not dramatically alter the rates for or the content of Staff’s proposed three zones. Tr. (Rowell) p. 122. Any inaccuracies that incorrect line counts create should be mitigated by the averaging of the loop costs within the three zones and also by the fact that Staff is scaling up the averages to conform with the current $21.98 rate. Tr. (Rowell) p. 122.

U S WEST also alleges that the breakpoints in Staff’s proposal are arbitrary. This is not correct. U S WEST’s proposal is more arbitrary than Staff’s because U S WEST uses an expanded BRA which has not yet been approved by the Commission, and, 95% of its customers would be located in the expanded BRA, with the costs of all high and low cost wire centers in the BRA averaged together to produce one statewide averaged UNE rate. Staff’s proposal attempts to at least group wire centers with similar costs together.

U S WEST finally argues that Staff’s wire center based proposal would be more difficult to implement from an administrative and billing standpoint. Actually, the opposite is true. The CLEC can easily determine what wire center a customer is in (and therefore the applicable UNE rate) based upon that customer’s telephone number, since the first three digits of a seven digit phone number are generally unique to a given wire center. Staff Ex. 1, p. 2. Carrier-to-carrier number portability which is in effect today should not affect a CLEC’s ability to identify customers by wire center.

Thus, Staff’s geographic deaveraging proposal is a reasonable interim approach, is based upon a neutral model which has been the subject of considerable scrutiny by another regulatory agency and would not be burdensome for for the CLECs from an administrative standpoint. Therefore, Staff recommends its adoption on an interim basis to deaverage UNE rates in Arizona.

B. U S WEST’s Proposal Is Based Upon An Expanded BRA That Has not Even Been Approved by the Commission and Thus is Inappropriate for Even Interim Rate Purposes.

U S WEST’s proposal is based upon its proposed retail rate structure in the pending rate case. As such it contains a high degree of rate averaging, rather than rate deaveraging. This is the fatal flaw in U S WEST’s proposal -- it not only attempts to utilize an already significantly
averaged statewide retail rate structure to drive deaveraging of the underlying wholesale rate structure, but uses an expanded BRA and Zone breakdown proposed by the Company in its pending rate case which has not even been approved by the Commission yet. This makes it completely unacceptable even to develop interim deaveraged UNE rates.

Using the proposed retail rate structure in the Company’s pending rate case to determine the underlying wholesale rates also produces “token” results, as is evidenced by the fact that almost 95% of the customers under U S WEST’s proposal would fall into the BRA. Costs have historically been averaged to a significant degree in the past to keep residential rates low. The whole purpose of deaveraging is to eliminate such artificial constraints on prices and allow the market to more appropriately dictate rates. U S WEST Witness Million conceded on cross examination that the enlargement to the BRA proposed in the rate case had no underlying cost basis. Tr. (Million) at p. 33.

U S WEST’s proposal is only cost-based to the extent it molds its underlying cost study to fit its proposed expanded retail rate structure. U S WEST’s LoopMod methodology groups wire centers into one of four classifications: 1) very small, 2) small, 3) medium, or 4) large. U S WEST Ex. 2. The Base Rate Area for each of these classifications is then defined in terms of distance and varies per wire center depending upon the wire center’s classification. U S WEST Ex. 2. There are then two concentric zones around each wire center’s Base Rate Area which also vary in size depending upon the classification of the wire center. U S WEST Ex. 2. All of the Base Rate Area costs are then aggregated into one statewide UNE rate and all Zone 1 and 2 rates are similarly aggregated into separate statewide UNE rates for Zones 1 and 2 respectively. Thus, the distinctive characteristics of each wire center including terrain, geography and other characteristics which vary considerably are not reflected at all in the Company’s proposal.

Use of the proposed BRA and Zone breakdown which has not yet been approved by the Commission, would also result in underlying wholesale rates in Zone 1 and Zone 2 being extremely high which means that these customers are unlikely to ever receive the benefits of a competitive marketplace. The underlying rates the Company is proposing for these two zones are $40.65 and 63.70 respectively.
U S WEST submitted USWC Ex. 5, at the request of Staff, which contains the
deaveraged UNE rates using the existing BRA and Zone breakdowns. The rate for the BRA would
be $18.96, Zone 1 would be $34.94, and Zone 2 would be $56.53 using the existing retail rate
structure. While these rates still suffer from the same underlying flaws associated with using the
existing averaged retail rate structure to establish deaveraged UNE rates, if the Commission adopts
U S WEST’s approach for interim rate purposes, it should utilize the existing retail zone breakdown
and the corresponding rates.

Staff does not dispute that retail rates should be deaveraged since they will be driven
in part by the underlying wholesale rate structure. However, the time to adjust retail rates is in the
rate case which is now pending. U S WEST Witness Million stated that U S WEST would have the
opportunity to seek retail rates that reflect the deaveraged UNE rates in their pending rate case.
U S WEST Ex. 1, p. 16. The wholesale rates established in this docket should be set on the basis
of costs, not a predetermined statewide averaged retail rate structure which has not even been
approved by the Commission yet.

C. AT&T’s Proposal Is Cost Based But The Version of the HAI Utilized by AT&T Should
be Subject to Review by the Commission Before it is Utilized to Deaverage UNE Rates.

AT&T proposes to deaverage wholesale UNE rates on a wire center basis using the
HAI model. AT&T Ex. 1, p. 9. AT&T provides two alternative options from which the
Commission may select including both a three zone and a five zone approach. AT&T Ex. 1 at pps.
12-13. Since the goal at this time is to comply with the FCC’s three cost zone requirement, Staff
believes that in the interim phase of this proceeding, the Commission should focus on selecting an
appropriate three zone approach.

Staff believes that while AT&T’s proposal to deaverage at the wire center level is
theoretically and technically sound, a concern arises because the version of the HAI (5.0a) relied
upon AT&T to deaverage rates has not been the subject of examination by the Commission. Staff
believes the Model should be subject to review before it is used to deaverage UNE rates in Arizona.
IV. CONCLUSION

For the foregoing reasons, Staff believes that the Commission should approve Staff’s three zone cost proposal to deaverage U S WEST’s UNE rates on an interim basis.

RESPECTFULLY submitted this 26th day of May, 2000.

[Signature]
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