IN THE MATTER OF INVESTIGATION
INTO U S WEST COMMUNICATIONS, INC.'S COMPLIANCE WITH CERTAIN
WHOLESALE PRICING REQUIREMENTS FOR UNBUNDLED NETWORK
ELEMENTS AND RESALE DISCOUNTS

DOCKET NO. T-00000A-00-0194

AT&T COMMUNICATIONS OF THE MOUNTAIN STATES, INC.'S NOTICE OF FILING REBUTTAL
TESTIMONY OF DOUGLAS DENNEY

AT&T Communications of the Mountain States, Inc. hereby files the Rebuttal
Testimony of Douglas Denney in the above-referenced matter. A copy of which is
attached to this notice.

Respectfully submitted this ___ day of May, 2000.

AT&T COMMUNICATIONS OF THE MOUNTAIN STATES, INC.

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CERTIFICATE OF SERVICE

I hereby certify that the original and 10 copies of the Rebuttal Testimony of Douglas Denney on behalf of AT&T Communications of the Mountain States, Inc., regarding Docket No. T-00000A-00-0194, were hand delivered on this 1st day of May, 2000, to:

Arizona Corporation Commission  
Docket Control - Utilities Division  
1200 West Washington Street  
Phoenix, AZ 85007

and a true and correct copy was sent via United States Mail, postage prepaid, on this 1st day of May, 2000, to:

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IN THE MATTER OF INVESTIGATION

INTO U S WEST COMMUNICATIONS, INC.'S COMPLIANCE WITH CERTAIN WHOLESALE PRICING REQUIREMENTS FOR UNBUNDLED NETWORK ELEMENTS AND RESALE DISCOUNTS

DOCKET NO. T-00000A-00-0194

REBUTTAL TESTIMONY OF

DOUGLAS DENNEY

ON BEHALF OF

AT&T COMMUNICATIONS

OF THE MOUNTAIN STATES, INC.

MAY 1, 2000
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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.
A. My name is Douglas Denney. I work at 1875 Lawrence Street, Denver, Colorado.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?
A. I am an economist for AT&T in its Local Services and Access Management Organization.

Q. ARE YOU THE SAME DOUGLAS DENNEY WHO FILED DIRECT TESTIMONY IN THIS DOCKET ON APRIL 24, 2000?
A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?
A. The purpose of this testimony is to compare U S WEST’s deaveraging proposal to AT&T’s proposal and rebut the April 24, 2000 direct testimony of U S WEST’s witness, Teresa K. Million filed in this docket.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.
A. Deaveraged loop rates that are based on costs will help to stimulate competition in the state of Arizona. The appropriate methodology for establishing cost-based rates is to create deaveraged wholesale rate zones that reflect significant cost differences that exist within the state. Only cost-based rates will send the
appropriate signals to the market and allow efficient competition to develop within the state.

U S WEST deaveraged loop proposal seeks to limit competition in the state by creating rates that are deaveraged as little as possible. U S WEST zones erroneously rely upon U S WEST’s current retail rate zone proposal, are not based on costs, and exhibit very little deaveraging.

In contrast, AT&T’s proposal is based on significant cost differences that exist between different geographic areas within the state. AT&T’s proposal will best promote efficient competition in the state of Arizona.

II. DEAVERAGED UNES

Q. PLEASE SUMMARIZE U S WEST’S PROPOSAL FOR DEAVERAGING UNES AND COMPARE IT TO AT&T’S PROPOSAL.

A. U S WEST proposes to deaverage the unbundled loop into “three cost-related” zones. U S WEST zones are based on their current retail rate un-deaveraging proposal and places 95% of the loops into zone one, which results in virtually no deaveraging at all.

1 Direct Testimony of Teresa K. Million, page 3, line 1.
AT&T’s proposal deaverages the unbundled loop into five cost based zones. The AT&T proposal calculates cost at the wire center level and then assigns customers to zones by grouping wire centers with similar costs together.

The table below, summarizes the results of US WEST’s and AT&T’s proposal:

<table>
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<th>Zone</th>
<th>AT&amp;T Proposal</th>
<th>US WEST proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loop Cost</td>
<td>% of Lines</td>
</tr>
<tr>
<td>1</td>
<td>$12.75</td>
<td>12.0%</td>
</tr>
<tr>
<td>2</td>
<td>$17.05</td>
<td>58.1%</td>
</tr>
<tr>
<td>3</td>
<td>$21.98</td>
<td>9.7%</td>
</tr>
<tr>
<td>4</td>
<td>$27.40</td>
<td>9.4%</td>
</tr>
<tr>
<td>5</td>
<td>$53.94</td>
<td>10.8%</td>
</tr>
<tr>
<td>average</td>
<td>$21.98</td>
<td></td>
</tr>
</tbody>
</table>

Q. WHAT ARE THE PROBLEMS WITH US WEST’S PROPOSAL?

A. There are three major problems with US WEST’s deaveraging proposal.

1) US WEST bases its wholesale deaveraging proposal on its current retail deaveraging proposal.

2) US WEST’s deaveraged zones are not cost based.

3) US WEST’s proposal results in virtually no deaveraging at all.

Q. WHY IS IT INAPPROPRIATE TO BASE WHOLESALE COSTS ON THE RETAIL COST STRUCTURE?

A. First, retail rates do not determine wholesale rates. In fact, the opposite relationship exists. Wholesale rates are one factor in influencing retail rates.
The purpose of the deaveraging requirement is to facilitate competition by sending the appropriate cost signals to the market place. Thus, the deaveraged loop rate should be based on cost, not on a retail rate structure.

U S WEST acknowledges this when they say, “wholesale rates drives the deaveraging of retail rates.”² Though U S WEST’s belief that wholesale and retail rates are “inextricably linked”³ is in error, they are correct in the causal relationship that wholesale rates influence retail rates.

The “inextricable link” between retail and wholesale rates is hardly a market reality. Retail rates tend to be driven as much or more by consumer wants, supply and demand, and marketing plans than geographic cost differences. Numerous examples can be seen in every day life. Long distance carriers tend to offer one rate across the country even though costs vary between and within states. Airlines often charge lower prices for a flight from Phoenix to New York than Phoenix to Denver, even though the costs of getting to Denver is undoubtedly cheaper. Fast food restaurants market national pricing of popular food items even though labor and rent vary across geographic territories.

Clearly, companies don’t plan on losing money, thus their pricing packages tend
to recover total costs. The recovery of total costs hardly leads to an "inextricable link" between wholesale and retail rates within distinct geographic areas.

Second, as I understand U S WEST’s current retail price deaveraging proposal, U S WEST is seeking to expand the base rate area, in effect, reducing the degree of retail rate deaveraging that currently exists in Arizona. U S WEST’s current retail rate plan is an averaging of the current rate structure, not a deaveraging. Thus, basing a wholesale deaveraging cost proposal on an averaging retail rate proposal is absolutely in conflict with the intent and purpose of the FCC’s rule to deaverage wholesale rates.

Q. WHY DO YOU SAY THAT U S WEST’S WHOLESALE DEAVERAGED ZONES ARE NOT COST BASED?

A. U S WEST deaveraging proposal is based upon their current retail deaveraging proposal. Based on the retail proposal, U S WEST calculates costs, using a cost model that is not designed to calculate cost differences within the state, and determines what they call, "cost related" zones. U S WEST calls the zones "cost related" because the cost for each zone is related to their cost model estimate of costs in that zone.

U S WEST cost’s are not, however, cost based. Cost-based zones mean that cost is the basis for creating zones. Since the purpose of establishing deaveraged rates is to facilitate competition by setting the prices of UNEs closer to the actual cost,
clearly cost should be the basis for establishing zones. U S WEST fails to use
cost as a determinant for establishing deaveraged loop prices and thus their
deaveraged proposal, though related to cost, is not very cost reflective.

The Commission should consider what proposal best relates prices to cost. Any
proposal is cost related, as long as a cost model is used to determine zone costs.
U S WEST has implied in a variety of proceedings that since all proposals include
some degree of averaging of costs all proposals are equal in their cost relatedness.
This is not true. Clearly a proposal that uses cost as the basis for establishing
zones, such as AT&T’s proposal does, is superior to a proposal that ignores costs,
such as U S WEST’s proposal.

Q. WHY DO YOU SAY THAT U S WEST’S PROPOSAL EXHIBITS
VIRTUALLY NO DEAVERAGING?

A. U S WEST deaveraging proposal places 95 percent of its Arizona customers in
the least-cost zone. This proposal fails to create deaveraged prices for 95 percent
of U S WEST customers in the state. Using U S WEST’s philosophy, placing one
customer in one zone and all other customers in another zone would satisfy the
FCC requirement of deaveraging. The purpose of deaveraging is to facilitate
competition by sending the appropriate cost signals to the marketplace.
Deaveraging methodologies that seek to mask costs do not comply with the spirit
of the deaveraging rule.
Q. **DO YOU HAVE ANY OTHER CONCERNS REGARDING U S WEST’S DEAVERAGING PROPOSAL?**

A. Yes. U S WEST calculated deaveraged costs after the sale of exchanges – its calculations show an increase in costs in the low-cost zone. This does not make sense. U S WEST is selling off their higher cost wire centers in the state. Logic dictates that when these high-cost wire centers are sold, the statewide average costs should fall. The wholesale costs in the low-cost zone should either remain unchanged (if nothing in zone one is being sold) or decrease. The fact that U S WEST calculations show an increase in the low-cost zone and a reduction in the high-cost zones, when high-cost wire centers are sold, should bring serious doubt upon U S WEST’s methodology and deaveraged cost calculations.

**III. CONCLUSION**

Q. **WHAT CONCLUSIONS CAN BE DRAWN FROM YOUR TESTIMONY?**

A. Both AT&T and U S WEST agree that the loop is the most important element to deaverage. AT&T and U S WEST disagree on the number of zones and the appropriate way to define zones within the state. AT&T proposes defining zones based on cost differences that exist within the state of Arizona. U S WEST proposes to define zones based on their current retail zone deaveraging proposal.
Methodologies other than grouping similar cost areas together, as proposed by AT&T, distort UNE prices and diminish the benefits that can be derived from deaveraging.

AT&T recommends the use of the deaveraged loop rates and zones identified in Attachment A to Mr. Denney’s direct testimony.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.