AT&T Communications of the Mountain States, Inc. ("AT&T") hereby files its brief on the establishment of interim geographically deaveraged rates for unbundled network elements ("UNEs") in the above captioned matter.

I. INTRODUCTION

The United States Supreme Court has confirmed that the Federal Communications Commission ("FCC") has legal authority to promulgate pricing rules. AT&T v. Iowa Utils Bd., 119 S.Ct. 721 (1999). The FCC subsequently confirmed that states must geographically deaverage rates for UNE's.

The Hearing Officer issued a Procedural Order on March 30, 2000, to establish a schedule for establishing interim geographically deaveraged rates for UNEs. The rates will be subject to true-up after permanent rates are set.

U S WEST Communications, Inc. ("U S WEST"), AT&T and the Staff of the Arizona Corporation Commission proposed different geographically deaveraged rates for the loop using different methodologies. The Commission must select one of the proposals and adopt rates until permanent deaveraged rates for UNEs are established.
II. ARGUMENTS

A. U S WEST’s Proposal

U S WEST proposes that, for interim purposes, only the loop be deaveraged. It also proposes using its current retail zone structure for purposes of deaveraging wholesale rates.1 U S WEST’s retail structure consists of a base rate area and two additional zones with zone increment charges. For wholesale purposes, the base rate area would be zone 1 and would have a loop rate of $20.12. Zone 2 would have a rate of $40.65, and zone 3 would have a rate of $63.70.

U S WEST argues that its proposal meets the requirements of the FCC’s rule.

U S WEST’s zone increment proposal meets the requirements of the FCC and makes sense for Arizona. First, it provides for three distance-based zones that are consistent with the retail zones that are currently proposed in Arizona. Second, the zones reflect a level of geographic deaveraging related to the cost of providing service in the proposed zones. The U S WEST proposal offers unbundled loops at a price lower than the statewide average in the low-cost base rates areas and at higher prices in the high-cost zones where loops are longer. Finally, because the zones are consistent with the existing retail structure in Arizona they will be easier to administer and more understandable to consumers.

Million Rebuttal (May 1, 2000) at 7. None of the reasons provided by U S WEST provide any basis to conclude that U S WEST’s rates meet the FCC’s requirements.

AT&T agrees with U S WEST that, for interim purposes, only the loop rates need to be deaveraged. AT&T agrees U S WEST has proposed a minimum of 3 zones. However, AT&T disagrees that the zones are necessarily distance-based, nor does the fact that the proposed zones are consistent with the existing retail zones provide any basis for suggesting U S WEST’s proposal meets the requirements of the FCC’s rule.

1 It is unclear whether U S WEST’s proposal to use the current retail zones is made for interim purposes only. U S WEST also uses the new boundaries proposed in its rate case that have not yet been adopted by the Commission.
U S WEST has provided no evidence that its retail zones are based on any cost studies. Nor has U S WEST provided any evidence that the retail zones will provide cost-based loop rates. "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 determine what they call, "cost related” zones.” Denney Rebuttal (May 1, 2000) at 5.

In essence, U S WEST argues the FCC’s rule only requires that the zones be “related” to cost, not cost-based. U S WEST starts with its retail zone structure and subsequently uses a cost model not designed to calculate cost differences within the state to justify use of its retail zones, and then argues this methodology creates “cost-related” zones that comply with the FCC’s rule. U S WEST is mistaken.

The FCC’s phrase “cost-related” is based on the FCC’s decision that rates for UNEs must be cost-based.

Geographic Deaveraging. The 1996 Act mandates that rates for interconnection and unbundled elements be “based on the cost...of providing the interconnection of network elements.” We agree with most parties that deaveraged rates more closely reflect the actual costs of providing interconnection and unbundled elements. Thus, we conclude that rates for interconnection and unbundled elements be geographically deaveraged.2

It is apparent that the FCC’s definition of cost-related and cost-based are intended to be synonymous. Since U S WEST’s methodology does not produce cost-based, geographically deaveraged rates, its proposal must be rejected.

U S WEST argues that its “proposal offers unbundled loops at a price lower than the statewide average in the low-cost base rate areas and at higher prices in the high-cost zones where loops are longer. Million Rebuttal at 7. This statement is highly misleading.

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What U S WEST's methodology does do is place 94.7% of the access lines in zone 1. Zone 1 is equivalent to its retail base rate area. 2% of the access lines are placed in zone 2, which corresponds to zone 1 of its retail rate structure. 3.3% of the access lines are placed in zone 3, which corresponds to zone 2 of its retail rate structure.

U S WEST's methodology derives a cost of $20.12 for zone 1. Therefore, $94.7% of the access lines would have unbundled loop rates of $20.12, which is $1.86 less than the statewide average of $21.98 set by the Commission. However, there no evidence that all base rate areas are necessarily low cost. In fact, U S WEST expanded the base-rate areas to include customers that are "further from the exchange central office" to be "fair and equitable." Teitzel Direct (Jan. 8, 1999), Docket No. T-01051B-99-0105, at 42. Mr. Teitzel does not even suggest in his testimony that the base rate area was expanded based on lower costs to serve the additional customers. In fact, by expanding the base rate area, customers previously paying a zone increment charge will get a rate decrease. Therefore, customers with longer loop lengths formerly in zone 1 will now be in the base rate area and will receive a rate decrease, not based on cost, but to be "fair and equitable."

U S WEST argues that there are higher wholesale rates than the statewide average in the high-cost zones where loops are longer. This is not accurate. It is apparent from reviewing the base rate areas and zones for the Camp Verde, Rim Rock and Cottonwood exchange areas that customers in the base-rate area can have loop lengths that exceed the length of a loop for customers in zone 1. The Cottonwood base rate area is over seven miles long. Depending on the location of the switch in the base rate area, a customer in the base rate area could have a longer loop length than a customer in zone 2, yet pay a lower retail rate. Loop length alone obviously was not the determinate for establishing boundaries for the base rate areas and zone 1.
Finally, U S WEST argues that “because the zones are consistent with the existing retail structure in Arizona they will be easier to administer and more understandable to consumers.” Million Rebuttal at 7. This assertion is simply incorrect. It also demonstrates that U S WEST refuses to acknowledge that competitive local exchange carriers (“CLECs”) are the “consumers” of U S WEST’s UNEs.

The rate structure will not be easier to administer and more understandable to customers. U S WEST has admitted that under its proposals CLECs would incur a operations supports system inquiry charge to determine which zone a customer is located in. Under AT&T’s proposal, and under Staff’s proposal, a CLEC need only know what wire center a prospective customer is located in. This is a very simple process, and does not require CLECs to incur a charge from U S WEST. U S WEST’s retail customers have nothing to do with the rates paid by CLECs to U S WEST for UNEs, and it is ridiculous to suggest such a connection.

Generally, the statewide average loop rate of $21.98 makes it hard for competitors to provide service to residential and small business customers by using U S WEST’s unbundled loops. U S WEST’s loop proposal effectively maintains the status quo and simply makes U S WEST’s argument that CLECs are only picking its high margin customers a self-fulfilling prophecy.

The retail rate is $13.18 for a residential customer. Mr. Denney testified that the loop makes up approximately 75% of the total cost a CLEC will face to provide local exchange service using unbundled network elements. Denney Direct at 4. Therefore, under U S WEST’s proposal it will be difficult, if not impossible, to provide services to some customers due to the high statewide average loop rate. However, AT&T’s proposal does
permit the benefits or geographic deaveraging to flow to some portion of consumers. U S WEST’s proposal does not.

There will simply be no competition for the vast majority of customers. What U S WEST has effectively done is use the retail zones because it serves its purpose of keeping deaveraged loop rates high. More importantly, it renders any true-up mechanism worthless because U S WEST’s proposal will preclude any meaningful competition until the Commission establishes a more realistic statewide average loop rate or the existing statewide average loop rate is appropriately deaveraged. It is apparent that U S WEST’s proposal is not what the FCC had in mind when it ordered deaveraged rates.

B. Staff’s Proposal

The Staff proposed using the FCC Hybrid Cost Proxy Model, version 2.6 (October 26, 1999). Rowell Rebuttal (May 1, 2000) at 3. Staff took the results by wire center off the FCC’s web site. Id. at 3 and 5. It did not independently run the model. Staff proposes three zones. Wire centers with loop costs less than $14.99 were placed in zone 1, wire centers with loop costs between $15.00 and $18.99 were placed in zone 2, and wire centers with loop costs of $19.00 and higher were placed in zone 3. Id. at 5-6. Staff determined a scaling factor of 1.21 to true-up the difference between the Arizona statewide average cost of $21.98 and the FCC model’s statewide average rate of $18.17. Id. at 6. A weighted average was determined for each zone, and the weighted average was multiplied by the factor. This resulted in a rate of $16.95 for zone 1, $19.97 for zone 2 and $32.41 for zone 3.
AT&T believes Staff’s methodology is appropriate. However, use of the FCC’s model raises several concerns. One, the FCC’s line counts are inaccurate. TR. 87-88. Two, the FCC model was not careful about calculating costs at the element level. TR. 88. “So when the FCC allocated expenses, when they calculated expenses, they calculated the right amount of expenses for total costs, but they didn’t care about how these expenses got assigned to different elements. Id. Consequently, the loop costs in the FCC model do not truly reflect UNE loop costs. Id.

Mr. Denney testified adjustments can be made and line counts corrected. However, this would cost a few thousand dollars, an expense neither AT&T or Staff has incurred. Consequently, the proper adjustments cannot be made. Id.

Finally, Staff’s proposal does not reflect sufficient deaveraging, generally making competition unlikely.

C. AT&T’s Proposal

Mr. Douglas Denney testified on behalf of AT&T. Mr. Denney used the HAI Model, version 5.0a, to determine the loop cost by wire center. Mr. Denney applied a scaling factor to maintain the Commission’s statewide average rate. Denney Direct Testimony at 11-12. The results were sorted numerically by wire center. Wire centers with similar costs were grouped together. Five zones were created: wire centers between $10 and $15 were placed in zone 1, $15 and $20 in zone 2, $20 and $25 in zone 3, $25 and $30 in zone 4, and all wire center loop costs over $30 were placed in zone 5. Id. at 12. This grouping produced the following results:

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3 AT&T does not necessarily agree with Staff’s zone breaks, because Staff’s proposal does not permit any meaningful competition.

4 Mr. Denney recommended 5 zones. However, Mr. Denney also produced results for 3 zones. Id. at 13.
<table>
<thead>
<tr>
<th>Zone</th>
<th>Loop Cost</th>
<th>Percent of Lines</th>
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</thead>
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<td>12.0</td>
</tr>
<tr>
<td>2</td>
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<td>58.1</td>
</tr>
<tr>
<td>3</td>
<td>$21.98</td>
<td>9.7</td>
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</tr>
<tr>
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<td>$53.94</td>
<td>10.8</td>
</tr>
</tbody>
</table>

Generally, AT&T’s proposal is easy to understand. It uses a cost model that is designed for establishing the cost of UNEs. The HAI Model contains the correct line counts.

U S WEST makes essentially two arguments against AT&T’s proposal: the zone break points are arbitrary and the differences between high-cost and low-cost wire centers are unreasonable. U S WEST’s argument that the zone break points are arbitrary is a red herring. First, it must be acknowledged that some method of determining zones must be used. Arguably, any method is arbitrary. U S WEST’s retail zone structure is arbitrary. However, AT&T starts with the loop costs of individual wire centers, U S WEST does not. Second, establishing the zones by loop costs does not allow for manipulation. Once break points are established, the wire centers fall into the respective zones. Third, similar cost wire centers are being grouped together. Under U S WEST’s proposal, all base rate areas are grouped together, without any idea of the underlying loop costs in each base rate area. Although Staff chose to use only 3 zones, it too used a similar method to break the zones. Finally, none of the zones AT&T proposes contain as many as 94.7% of the access lines, or as few as 2% of the access lines, as does U S WEST’s proposal. It is almost laughable that U S WEST argues that differences between the zones under AT&T’s proposal are unreasonable when 94.7% of the access lines are in zone 1 under its proposal.
III. CONCLUSION

U S WEST’s proposal should be rejected. It has no value whatsoever in attempting to establish deaveraged rates for UNEs. The Staff’s proposal, although methodologically sound, uses a model that contains some problems that cannot be corrected without additional investment and manipulation. AT&T’s five zone proposal is the best proposal for setting interim rates, and it should be adopted by the Commission.

Respectfully submitted this 26th day of May, 2000.

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