BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
DOCKETED
AUG 31 2001

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

POST-HEARING BRIEF
OF Z-TEL COMMUNICATIONS

INTRODUCTION

The evidence in this proceeding presented a range of rates for a variety of
unbundled network elements ("UNEs"). As a result, the Commission will need to go
beyond the mere "number-crunching" of the cost model and must instead provide a
reasoned basis, consistent with the purposes of the 1996 Act, for selecting a rate (or the
inputs and assumptions that produce that rate) from the range of rates generated by the
evidence. A two-part analytical framework should guide the choice of UNE rates from the
array provided by the parties. First, the Commission should limit its attention to rates that
are consistent with TELRIC rates. Second, rates should be chosen that will promote the
availability of traditional and innovative services in Arizona from new, competitive
entrants.

In discarding proposed UNE rates that are not compliant with TELRIC, the
Commission must consider that the FCC will review the rates adopted in this proceeding in
Qwest’s Arizona Section 271 application. In recent Section 271 orders, the FCC has explicitly laid out the manner in which it determines whether UNE rates are TELRIC compliant. The FCC’s decisions discuss how the FCC will establish the TELRIC “zone of reasonableness” for UNEs. Under the FCC’s “TELRIC test” for unbundled loops, unbundled local switching, unbundled tandem switching and unbundled shared transport, Qwest’s proposed rates for these UNEs are, without question, outside the TELRIC “zone of reasonableness.” Indeed, the rates for these UNEs are 30%-420% higher than the FCC’s analysis would permit and, consequently, will interfere with the success of a Qwest 271 application before the FCC. In contrast, the loop rates proposed by Mr. Dunkel, the witness for Commission Staff, pass the TELRIC test and should be adopted by the Commission. If TELRIC compliance, increased competition and a successful 271 application by Qwest are goals of this Commission, Mr. Dunkel’s proposed rates should be adopted.

Finally, with respect to Qwest’s line-sharing rate proposal, if a positive price is charged for the high-frequency portion of the loop, then the rate for the low-frequency portion of the loop rate must be reduced so that loop costs are not over-recovered. Line-sharing is “sharing.” Thus, if a positive price is charged for the high-frequency portion of the loop, then the rate for the low-frequency portion of the loop must be reduced to avoid the over-recovery of loop costs. When adjusting rates to account for a positive charge for line-sharing, the Commission should focus only on the unbundled loop rate, ignoring Qwest’s retail revenues.
ANALYSIS

A. An Analytical Framework for Determining UNE Rates

The Arizona Corporation Commission has a two-fold obligation in setting UNE rates: (i) UNE rates must comply with the TELRIC standard; and (ii) UNE rates should be set to achieve the overarching goal of the Telecommunications Act of 1996 – promoting competition in all markets. [See Z-Tel Ex. 1 (Ford Direct) at 8] Without dispute, any rate chosen by this Commission should, at a minimum, satisfy TELRIC principles. [Id.] That said, it is important to recognize that the TELRIC standard generally establishes a range of acceptable rates, not one particular rate. These rates define the TELRIC “zone of reasonableness.” Once the TELRIC “zone of reasonableness” is determined, the Commission must choose a specific rate from within that zone. Among a choice of TELRIC compliant rates, choosing from the lower TELRIC compliant values is more conducive to competitive entry. [Z-Tel Ex. 1 (Ford Direct) at 8-9] Conversely, because higher UNE rates increase the costs of potential entrants, choosing rates from the higher part of the range, while consistent with the first obligation of TELRIC compliance, demonstrates a preference for preserving the status quo of high market concentration at the expense of ensuring that consumers reap the benefits of competition. [Id.]

In order to satisfy the overarching goal of the Telecommunications Act of 1996, in picking a rate within the reasonable range the Commission should assess each input value, assumption or resultant cost estimate according to its effect on competition. Because higher UNE rates reduce competition and lower UNE rates increase competition, assumptions and/or input values that increase the cost estimates decrease competition and those that decrease cost estimates increase competition. The final input values and assumptions accepted by the Commission for the models generating cost estimates should
be chosen so that both obligations are met: a) rates and TELRIC compliant and b) competitive entry is viable. [See Z-Tel Ex. 1 (Ford Direct) at 10]

The reasonableness of this two-part analytical framework is apparent and the framework’s consistency with the primary goal of modern telecommunications policy to promote competition is unquestionable. Indeed, Qwest offers no valid rebuttal to the fundamental propositions set forth in the framework, choosing rather to distort Z-Tel’s arguments in an effort to obfuscate the important issues under consideration in this proceeding. Z-Tel’s proposal clearly requires UNE rates be set at levels consistent with what a TELRIC analysis would produce – nothing could be more clear in Z-Tel’s testimony. [See Z-Tel Ex. 2 (Ford Surrebuttal) at 3-4] Qwest’s arguments to the contrary are both disingenuous and wrong. [Id.] Moreover, a paragraph of the FCC Order cited by Qwest witness, Dr. Fitzsimmons, in rebuttal [Qwest Ex. 29 (Fitzsimmons Rebuttal) at 3 n.2] actually supports Z-Tel’s position:

One of the fundamental goals of the Telecommunications Act of 1996 (the 1996 Act) is to promote innovation and investment by multiple market participants in order to stimulate competition for all services, including broadband communications services. In this Report, we consider the deployment of broadband capability – what Congress has called "advanced telecommunications capability."

In the Matter of Inquiry Concerning Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, CC Docket No. 98-146, FCC No. 99-5 (Released Feb. 2, 1999), ¶ 1 (emphasis added). In this paragraph, the FCC claims that the promotion of “innovation and investment by multiple market participants” will “stimulate competition for all services.”
Clearly, the FCC considers the presence of multiple market participants and the stimulation of competition as important policy considerations – in direct conflict with the position of Qwest’s witnesses. The two-part framework for establishing UNE rates has clear implications for the realization of “multiple market participants,” and appears to be most consistent with the FCC’s position on regulatory policy in the telecommunications industry.

B. The FCC’s TELRIC Test

Undoubtedly, Qwest will use the rates established in this proceeding in support of its future 271 application for the State of Arizona. If the FCC determines that the UNE rates set in this proceeding are not TELRIC-compliant, then Qwest must “voluntarily” reduce those rates to TELRIC levels prior to approval. Such “voluntary” reductions in UNE rates were components of the Oklahoma, Kansas and Massachusetts 271 proceedings before the FCC.

In light of the inextricable link between this proceeding and Qwest’s future 271 application, the Commission should consider the boundaries for TELRIC compliance using methods developed and implemented by the FCC in previous 271 proceedings. The FCC has employed the TELRIC compliance test for the last three states receiving 271 approval, so the test’s relevance is indisputable.1 [Z-Tel Ex. 1 (Ford Direct) at 11-14] The possibility of establishing a rate outside the TELRIC “zone of reasonableness” and

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1 Although Qwest questions the validity of the application of the TELRIC test to Qwest—Arizona and the cross-company comparisons made in the TELRIC test, that criticism is without merit. The FCC specifically has rejected the relevance of company-specific information in the determination of forward-looking cost for an efficient provider. Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs, Tenth Report & Order, CC Docket Nos. 96-45, 07-160, FCC 99-304 (rel. Nov. 2, 1999). Furthermore, because no Qwest state has received 271 approval, extending the information on TELRIC compliance from past 271 proceedings to Qwest seems reasonable.
jeopardizing Qwest's future 271 application can be eliminated by adhering to the simple analysis set forth in the FCC's recent 271 Orders — an analysis duplicated in the testimony of Z-Tel's witness Dr. Ford.

The pricing prong of checklist item two of section 271 requires a BOC to demonstrate that it provides UNEs in accordance with section 252(d)(1) of the Act. For section 271 purposes, a BOC must show that its prices for interconnection and unbundled network elements are based on forward-looking, long-run incremental costs. In determining whether a BOC's UNE rates satisfy this standard, the FCC utilizes its Hybrid Cost Proxy Model ("HCPM" or "USF cost model") to compare UNE rates in 271-approved states with UNE rates in other states. The operating principle of the FCC's analysis is that relative UNE rates between states should be consistent with relative cost differences and that these relative cost differences are reasonably measured by the HCPM.

As the FCC indicated:

Our USF cost model provides a reasonable basis for comparing cost differences between states. We have previously noted that while the USF cost model should not be relied upon to set rates for UNEs, it accurately reflects the relative cost differences among states.

In other words, when evaluating Qwest's UNE rates within the context of a 271 application, the FCC likely will use its USF cost model to compare Qwest's UNE rates
with those in other states, as it has on other occasions. This comparison, which might be called the FCC’s “TELRIC Test,” will determine whether Qwest’s UNE rates satisfy the competitive checklist, a necessary precondition to 271 approval.

The FCC applied its “TELRIC Test” in the orders approving 271 applications in Oklahoma/Kansas and Massachusetts. In Oklahoma, the FCC evaluated the UNE loop rate, whereas in Massachusetts the loop and switching UNE rates were scrutinized with the TELRIC Test. For Oklahoma, the FCC expressed concern that the loop rate difference between Oklahoma and Texas was not cost justified:

In taking a weighted average of loop rates in Oklahoma and Texas, we find that Oklahoma’s rates are roughly one-third higher than those in Texas (ft. omitted).... Using a weighted average of wire-center loop costs, the USF cost model indicates that loop costs in SWBT’s Oklahoma study area are roughly 23 percent higher than loop costs in its Texas study area (ft. omitted). We therefore attribute this portion of the differential, roughly two-thirds of it, to differences in costs. The remainder of the differential, however, is not de minimus, and we cannot ignore its presence.6

However, during the 271 review process, SBC reduced its loop rates. With respect to the reduced loop rates, the FCC concluded:

The weighted average of the Oklahoma discounted loop rates is roughly 11 percent higher than the weighted average of the loop rates in Texas. This differential between Oklahoma promotional and Texas rates is well within the 23 percent differential suggested by the USF cost model, and so we conclude that the discounted rates meet the requirements of the Act.7

Similarly, Verizon reduced its switching rates during the Massachusetts 271 proceeding to a level consistent with that of New York. The FCC concluded that the New York

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6 FCC KS-OK 271 Order, ¶ 83-5.
7 FCC KS-OK 271 Order, ¶ 86.
switching rates were appropriate for Massachusetts because:

[a] weighted average of Verizon's voluntarily-discounted Massachusetts rates ... and corresponding rates in New York shows that rates in Massachusetts are roughly five percent lower than those in New York. A comparison based on the USF model of costs in Verizon's study area in Massachusetts and New York for these same elements indicates that the costs in Massachusetts are roughly the same as the costs in New York.8

Thus, as illustrated in the Oklahoma and Massachusetts 271 Orders, even UNE rates that are determined in an ad hoc fashion or adopted from another state can be TELRIC compliant so long as the UNE rates are consistent with cost differentials between states as determined by the FCC's HPCM. Accordingly, as long as rate differentials are supportable by cost differentials, UNE rates are TELRIC compliant. Therefore, the FCC's TELRIC Test is a reasonable tool by which to evaluate the compliance of Qwest's proposed UNE rates with TELRIC.

Based on the FCC's TELRIC test, the TELRIC compliant statewide average loop rate range for Arizona should be $12.17 to $13.70, with a point estimate of $13.30.9 [See Z-Tel Ex. 1 (Ford Direct) at 15] This average loop rate can then be deaveraged based on how the Commission decides to segregate wire centers for deaveraging. Z-Tel believes Staff's approach to that element of deaveraging is appropriate. It is also important to note that the Z-Tel test for a zone of reasonableness fits well with other, non-Qwest loop rates.

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9 Three reference states are used for the TELRIC test producing this range of values for the loop: Texas, Oklahoma and Kansas. If New York and Massachusetts are included, the range of TELRIC compliant loop rates is $12.17 to $15.46. For a number of reasons summarized in Dr. Ford's testimony and rebuttal [see Z-Tel Ex. 2 (Ford Rebuttal) at 12], New York and Massachusetts were not included in Z-Tel's TELRIC test for Arizona. In terms of teledensity and UNE costs, Texas is the closest comparable. [Id.]
proposals in this docket. Z-Tel’s proposed range for a statewide average loop rates is similar to the estimates of statewide average loop costs by Staff witness, Dunkel ($12.35/13.60) and by AT&T ($10.11). Notably, Qwest’s proposed statewide average loop rate of $25.95 is well outside the TELRIC “zone of reasonableness” as established by FCC guidelines (i.e., the TELRIC test), and that rate will no doubt interfere with the success of a Qwest-Arizona 271 application before the FCC.

C. Line-Sharing and Loop Rates

Z-Tel has provided a sound explanation of the economic theory of pricing under joint supply in competitive markets that should apply to line sharing rates. [See Z-Tel Ex. 1 (Ford Direct) at 15-18] For the provider of unbundled elements, only two services are sold: the low-frequency and high-frequency portions of the loop. If the average total cost (including overhead and reasonable profit) of the loop is determined to be, say, $13.00, then the revenue from that loop should be $13.00. If Qwest receives $13 per loop and also receives $5 for the high-frequency part of some loops (including those sold to itself), then Qwest has over-recovered the cost of the loop. Over-recovery violates the theory of joint-supply under competition, which states that the revenue from the loop (across all products provided by the loop) must equal the average (economic) cost of the loop. [See Z-Tel Ex. 1 (Ford Direct) at 17-18] To remedy this over-recovery, the UNE loop rates must be reduced to avoid excess recovery of loop costs. To calculate this reduction, Qwest’s loop cost need to be adjusted downward by an amount equal to the revenue received by Qwest for the high-frequency portion of the loop, including such charges that Qwest’s imputes to itself

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10 Based on a similar analysis, Z-Tel also urges the Commission to adopt a shared transport charge in the range of $0.00014 to $0.00056 per minute. [See Z-Tel Ex. 1 (Ford Direct) at 22-23]
when it provides DSL on a shared loop. [See Z-Tel Ex. 1 (Ford Direct) at 19] The line-sharing penetration implicit in Mr. Dunkel’s allocation of line-sharing OSS costs should be used in the computation.

CONCLUSION

The statewide average loop rate adopted by the Commission should not exceed the price range ($12.87 to $13.70) proposed by Z-Tel in this docket. The Shared Transport rate should not exceed $0.00014 to $0.00056 per minute.


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