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EXCEPTION

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IN THE MATTER OF INVESTIGATION)	DOCKET NO. T-00000A-00-0194
INTO U S WEST COMMUNICATIONS,)	
INC.'S COMPLIANCE WITH CERTAIN)	EXCEPTIONS TO THE
WHOLESALE PRICING REQUIREMENTS)	RECOMMENDED OPINION AND
FOR UNBUNDLED NETWORK)	ORDER
ELEMENTS AND RESALE DISCOUNTS)	

AT&T Communications of the Mountain States, Inc. ("AT&T") hereby takes exception to the Recommended Opinion and Order ("RO&O") filed by the Chief Administrative Law Judge ("ALJ") on July 5, 2000.

I. U S WEST's Methodology

The RO&O correctly concludes that "Staff and AT&T have presented plans that reflect actual costs better than the U S WEST proposal." RO&O at 5. The RO&O, however, adopts U S WEST's methodology. The only rationale provided in the RO&O is "that commission policy in setting retail rate needs to be taken into consideration in setting geographic deaveraged rates. To do otherwise, U S WEST could have retail rates which may not be cost-based but would have to compete with wholesale rates which would be cost-based." *Id.* The RO&O provides no other basis for selecting U S WEST's methodology.

The basis for selecting U S WEST methodology is unsound. U S WEST provided no evidence of the actual cost of its basic business and residential service rate zones. It

provided no cost studies showing the actual cost of deaveraged UNEs is related to the retail rate zones. U S WEST has argued that the Commission must deaverage retail and UNE rates at the same time; however, U S WEST has not proposed a cost-based method of deaveraging retail rates in its present rate case. U S WEST's argument boils down to this: if a truly cost-based deaveraging proposal is adopted, competition may emerge in areas where its retail rates exceed the Total Element Long Run Incremental Cost ("TELRIC") of the UNEs necessary to provide the service; accordingly, it will lose customers and revenues. To provide political cover, U S WEST argues that it receives implicit subsidies from the services priced above cost to cover the cost of services below cost. Million Direct at 17-18. However, the purpose of the Telecommunications Act of 1996 ("Act") is to promote competition in the local exchange market.

The basic residential rate is \$13.18. The RO&O sets the geographic deaveraged loop rates at \$18.96, \$34.94 and \$56.93 for the base rate area, zone 1 and zone 2, respectively. It is obvious that there will be no residential local exchange competition using unbundled network elements ("UNEs") under the proposal adopted by the ALJ. Therefore, U S WEST retail rates for residential service do not "have to compete with wholesale rates which would be cost-based." Even under AT&T's proposal, the lowest deaveraged rate for the loop is \$12.75. Mr. Douglas Denney testified that the loop represents approximately 75% of the cost of basic service. Denney Direct at 4. Simple math shows that the cost to a competitor to provide basic service using UNEs would be

uneconomic.¹ Once again, U S WEST would not have to compete against competitors using UNEs.

According to Ms. Teresa Million, the lowest basic business rate is \$32.78. Million Direct at 16. Under the proposal adopted in the RO&O, 87.5% of the access lines are priced at \$18.96. In other words, 87.5% of all access lines are below the business rate of \$32.78. Under AT&T's proposal, 89.2% are under the business rate of \$32.78. It becomes readily apparent that under the rates adopted in the RO&O, CLECs will make only marginally more money in the base rate area for business customers than it does under the present average UNE loop rate (\$21.98 average rate-\$18.96 = \$3.02). Under AT&T's cost-based proposal, the CLECs would obtain more revenues in zones 1 and zones 2 than under the proposal adopted in the RO&O.

The RO&O proposal simply reduces the amount of revenues CLECs would obtain by using UNE loops. By not adopting cost-based deaveraged UNE rates, more money is retained by U S WEST to implicitly subsidize retail services. However, the Federal Communications Commission ("FCC")² and federal courts³ have rejected arguments that UNE rates must support universal service and have held that UNE rates must be based on actual costs. The FCC has stated that "[s]tates may not, therefore, include universal service support funding in the rates for elements and services pursuant to sections 251

¹ Even if a competitive local exchange carrier ("CLEC") used its own switch and transport, the rate of \$12.75 for the loop may not promote viable retail competition, because a CLEC would incur its own costs in addition to the loop rate to provide the service.

² *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, FCC 96-325 (rel. Aug. 8, 1996) ("*Local Competition Order*"), ¶ 713; 47 C.F.R. § 51.505(d)(4).

³ *AT&T v. Pacific Bell*, 1998 WL 246652, *10 (N.D. Cal.); *Southwestern Bell v. AT&T*, 1998 WL 657717, *12 (W.D. Tex.) ("In addition, the Court rejects SWBT's attempts to raise 'universal service' issues as an end-run attack against the TELRIC methodology."); *Southwestern Bell v. FCC*, 153 F.3d 523, 539-540 (8th Cir. 1998)

and 252, nor may they implement mechanisms that have the same effect.”⁴ The methodology or mechanism adopted by the RO&O, by U S WEST’s own admission, is intended to recover implicit universal service subsidies. To the extent the Commission seeks to recover implicit universal service subsidies in UNE rates, the rates are contrary to FCC rules, federal court decisions and Section 252 of the Telecommunications Act of 1996.

II. U S WEST’s Rate Case

Apparently recognizing that the rates proposed by U S WEST in its rate case are less cost-based than current rates, the RO&O suggests that “it would be more appropriate to begin to gradually make the rate structure more cost-based.” RO&O at 6. However, the RO&O fails to *order* U S WEST to file cost-based retail rates, along with supporting cost studies, in its rate case. Nor does the RO&O provide any guidance what “gradually” means. Without some instructions to U S WEST to file a cost-based retail rate deaveraging proposal in the rate case, it is unlikely U S WEST will file such a proposal. This has been the history in other states. It is also the history in Arizona. U S WEST cited an Arizona Commission decision in its brief which states that the Commission shared U S WEST’s concerns that deaveraging of retail rates should to occur at the same time as wholesale rates. U S WEST Brief at 4. Although U S WEST knew at the time it filed its rate case that it had to deaverage wholesale rates, it made no effort to deaverage retail rates in its rate case.

It is unlikely U S WEST will be filing another rate case in the foreseeable future. If price caps are adopted, it is unlikely there will ever be another rate case. U S WEST

⁴ *Local Competition Order*, ¶713.

will continue to hide behind the argument that UNE rates should be deaveraged consistent with its retail rate structure. Arizona may never see cost-based UNE rates.⁵

III. The Federal Communications Commission's ("FCC") Synthesis Model

The RO&O adopts the Staff's methodology for establishing permanent UNE rates in Phase II of the Docket. However, the FCC model utilized by Staff does not generate UNE rates for *any* network elements. This "flaw" cannot be corrected by Staff. Furthermore, based on the limited review of the models used to deaverage the UNE loop rate, it makes no sense for the Commission to adopt any model for Phase II prior to receiving evidence on each of the models in Phase II of this proceeding.

IV. Refunds

The RO&O provides that the deaveraged loop rate is an interim rate and that it is subject to refund at the time permanent rates are established in Phase II of the proceeding. The problem inherent in a refund is that between the time that the interim rates are set and permanent rates are established, competition is precluded in many areas and for certain classes of customers. Therefore, a refund by itself is a necessary but inadequate solution.

V. Recommended Changes to RO&O

A. AT&T proposes that the Analysis on page 5 of the RO&O be stricken in its entirety and replaced with the following language.

⁵ AT&T also takes exception to Finding 22 in the RO&O that "[o]ne of the goals of the Act is to gradually have cost-based rates.

Staff and AT&T have presented a plan that reflects actual costs better than the U S WEST proposal. The Commission adopts AT&T's plan for establishing a deaveraged loop rate. AT&T pointed out a number of valid criticisms of Staff's proposal that could not be addressed by Staff.

U S WEST's plan fails to reflect actual costs of providing the UNE loop on a deaveraged basis. U S WEST's witness testified that the U S WEST plan is designed, in part, to recover implicit subsidies. The FCC's pricing methodology prohibits setting UNE rates that include universal service support. 47 C.F.R. § 51.505(d)(4). Therefore, U S WEST's proposal does not comply with Section 252 of the Act.

U S WEST has raised concerns in the past and in the present proceeding that retail rates and wholesale rates must be deaveraged at the same time. In Docket No. U-3021-96-448, et al., we shared U S WEST's concerns. However, U S WEST has not taken any action in its current rate case to propose a retail deaveraging proposal that would permit retail rates and wholesale rates to be deaveraged concurrently. Therefore, this Commission hereby orders U S WEST to file a proposal in its current rate case proceeding to deaverage retail rates that is based on the actual costs to serve a geographic area. Such proposal shall provide for a minimum of 3 zones. By requiring a minimum of 3 zones, the Commission does not prejudice whether more than 3 geographic zones for wholesale rates is appropriate.

B. AT&T recommends that the following language be stricken on page 3:

3) The purpose of deaveraging of UNE rates is to minimize implicit subsidies.

This sentence is ambiguous. AT&T cannot locate any reference to a statement by AT&T that supports this statement in the RO&O. UNE rates shall not include any implicit subsidies. Implicit subsidies in retail rates also are supposed to be removed and replaced with explicit subsidies. The third bullet in Finding 15 should be stricken for the same reason.

C. Findings 17 through 23, except 20 should be stricken. Paragraph 20 should be renumbered as paragraph 17. The following paragraphs should be inserted.

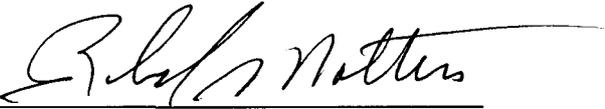
18. AT&T pointed out a number of valid criticisms of Staff's plan that could not be adequately addressed by Staff.
19. U S WEST's plan does not reflect actual costs.
20. U S WEST's plan recovers implicit subsidies in wholesale rates in violation of 47 C.F.R. § 51.505(d)(4).
21. AT&T's five zone geographic deaveraging would result in rates of \$12.75, \$17.05, \$21.98, \$27.40 and \$53.95 in zones 1 through 5, respectively.

Paragraph 4 in the Conclusions of Law should be stricken and replaced with the following:

It is reasonable to approve the AT&T methodology for establishing five geographic rates at this time and approve the interim rates set forth in Findings of Fact 21 subject to a true-up mechanism.

Respectfully submitted this 12th day of July, 2000.

**AT&T COMMUNICATIONS OF THE
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CERTIFICATE OF SERVICE

I hereby certify that the original and 10 copies of AT&T Communications of the Mountain States, Inc.'s Exceptions to the Recommended Opinion and Order in Docket No. T-00000A-00-0194 were sent by overnight delivery on this 12th day of July, 2000 to:

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