ISSUE DATE: July 10, 2000

DOCKET NO. P-999/CI-99-465

ORDER DEAVERAGING UNBUNDLED NETWORK ELEMENT RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott	Chair
Edward A. Garvey	Commissioner
Joel Jacobs	Commissioner
Marshall Johnson	Commissioner
LeRoy Koppendrayer	Commissioner

In the Matter of Implementing the Geographic Deaveraging Requirements of 47 C.F.R. § 51.507(f)

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PROCEDURAL HISTORY

On May 3, 1999, the Commission initiated the current docket "for the purpose of exploring geographic deaveraging and implementing 47 C.F.R. § 51.507(f)."[1] Federal Communications Commission (FCC) rule § 51.507(f) states:

> State commissions shall establish different rates for elements in at least three defined geographic areas within the state to reflect geographic cost differences.
> (1) To establish geographically-deaveraged rates, state commissions may use existing density-related zone pricing plans described in § 69.123 of this chapter, or other such cost-related zone plans established pursuant to state law.
> (2) In states not using such existing plans, state commissions must create a minimum of three cost-related zones.

On May 7, 1999, the FCC stayed the effect of § 51.507(f).[2]

On May 18, 1999, the Commission solicited comments on various issues related to geographic deaveraging. Parties filed comments by July 2, 1999, and reply comments by July 16.

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[1]In the Matter of a Generic Investigation of U S WEST Communications, Inc.'s Cost of Providing Interconnection and Unbundled Network Elements (USWC Generic Cost Docket), Docket No. P-442, 5321, 3167, 466, 421/96-1540 ORDER RESOLVING COST METHODOLOGY, REQUIRING COMPLIANCE FILING, AND INITIATING DEAVERAGING PROCEEDING.

[2]Common Carrier (CC) Docket No. 96-98, Stay Order (May 7, 1999).

On November 2, 1999, the FCC reinstated the applicability of rule § 51.507(f) effective May 1, 2000.[3]

On January 21, 2000, the Commission invited comments on a staff deaveraging proposal.

The matter came before the Commission on April 18. In response to Commission questions, parties filed additional comments on May 31, with supplemental comments on June 5. The matter again came before the Commission on June 8, 2000.

FINDINGS AND CONCLUSIONS

I. Background

On February 8, 1996, the Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56, became effective. The Act is designed to open the market for telecommunications services in three ways:

- by requiring incumbent local exchange carriers (LECs) to permit new entrants to purchase their services wholesale and resell them to customers,
- by requiring incumbent LECs to permit competing providers of local service to interconnect with their networks on competitive terms, and
- by requiring incumbent LECs to unbundle the elements of their networks and make them available to competitors on just, reasonable, and nondiscriminatory terms.[4]

A competitive local exchange carrier (CLEC) desiring to provide local exchange service can seek agreements with an incumbent LEC related to interconnection with the LEC's network, the purchase of finished services for resale, and the purchase of the LEC's unbundled network elements (UNEs). 47 U.S.C. §§ 251(c) and 252(a). If the LEC and the CLEC cannot reach an agreement within the time frame specified in the Act, either party may ask the state commission to arbitrate unresolved issues and to establish appropriate terms. 47 U.S.C. § 252(b). In particular, parties may ask the commission to determine the price for UNEs, interconnection, and methods of obtaining access to UNEs. 47 C.F.R. §§ 51.501, 51.505.

The cost of providing elements of telecommunications service may vary from place to place, especially between urban and rural places. Calculating the cost of an element without addressing cost differences between locations effectively produces a geographically-averaged price for that element. In contrast, calculating different prices for an element depending upon where the element is offered produces geographically-deaveraged prices.

The Act prescribes that rates for interconnection and unbundled network elements be "based on

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[3] In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, FCC 99-306 (November 2, 1999).

[4] 47 U.S.C. § 251(c).

the cost ... of providing the interconnection of network elements." 47 U.S.C. § 252(d)(1)(a)(i). The FCC concluded that geographically-deaveraged rates more closely reflect the actual cost of providing interconnection and unbundled elements than do averaged rates.[5] Therefore, the FCC directed state commissions to "establish different rates for elements in at least three defined geographic areas within the state to reflect cost differences." 47 C.F.R. § 51.507(f).

II. Harm of averaged rates[6]

Economic inefficiency results when people make decisions without bearing the full consequences – costs and benefits – of those decisions. Specifically, inefficiency can result when a CLEC buys a UNE from a LEC without bearing the full cost or acquiring the full benefit of that UNE. This situation can occur when the price of the UNE is not set on the basis of the economic cost to provide the UNE, but on the basis of the average cost to provide that type of UNE throughout the LEC's service area.

The cost to serve different customers varies, especially between customers in urban and rural areas. If a LEC offers uniform averaged UNE prices in urban and rural areas alike, then it is likely those prices exceed their costs in urban areas, and are less than their cost in rural areas.

Where the prices of UNEs exceed their cost, as is typical of urban areas, two consequences are foreseeable: First, CLECs that rely on UNEs may be discouraged from entering the market. Second, a CLEC that might have desired to lease facilities from a LEC at economic cost may be encouraged to build its own facilities instead. This would cause the CLEC to needlessly incur the cost of construction, and the LEC to needlessly forego the profitable opportunity to lease its facilities.

Conversely, where UNEs are priced below their cost, as is typical in rural areas, two corresponding consequences are foreseeable: First, the low UNE price may inspire CLECs to enter the market and bid customers away from the LEC, even if the CLEC's economic costs are higher than the LEC's. Second, some CLECs may be discouraged from building their own facilities, knowing that they could not compete against other CLECs that operated using the below-cost UNEs.

Deaveraging represents an attempt to reduce the inefficiencies noted above.

III. Analysis

While the FCC rule resolves the question of whether to deaverage UNE rates, it leaves many more issues unresolved. Specifically, in implementing this FCC mandate, the Commission must address the following issues:

A. Where to deaverage,

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[5] In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, 11 FCC Rcd 15499 (August 8, 1996) (First Report & Order) ¶¶ 764-65.

[6] First Report and Order, ¶¶ 758-765.

B. Elements to be deaveraged,
C. Geographic units of analysis,
D. Zone definition, and
E. When to deaverage.

A. Where to deaverage

The FCC directs each state commission to establish different rates for elements in at least three defined geographic areas *within the state*. This Commission refrained from deaveraging wholesale rates in the context of the USWC Generic Cost Docket in part to accommodate parties that argued that the Commission should consider data from other LECs before developing a state-wide deaveraging plan.[7] For purposes of the current docket, however, no party proposes that the Commission deaverage UNE rates in any LEC's service area other than USWC's.

Three reasons favor implementing the FCC's rule by first deaveraging USWC' s UNE rates. First, USWC serves the great majority of the state in term of access lines or customers. Moreover, USWC serves the most densely-populated parts of the state. By any measure, deaveraging USWC's service area would have the greatest impact on competition in Minnesota.

Second, the Commission sees no demand to deaverage UNE prices in other parts of the state. No party has asked the Commission to establish UNE prices, averaged or deaveraged, for any LEC other than USWC.[8] And no party to the current proceeding recommends that the Commission order the deaveraging of UNE prices for any other LEC.

Third, because no party has asked the Commission to establish UNE rates for any other LEC's service area, the Commission currently lacks the data to permit the establishment of UNE prices for other LECs. Thus, before the Commission could establish deaveraged UNE rates throughout the rest of the state, the Commission would first have to conduct a proceeding comparable to the USWC's Generic Cost Docket, develop a cost model and inputs appropriate to those LECs, and then incorporate the issues raised in this deaveraging docket, for each of the approximately 90 remaining LECs in the state. This would be an expensive and time-consuming process.

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[7]USWC Generic Cost Docket, ORDER RESOLVING COST METHODOLOGY, REQUIRING COMPLIANCE FILING, AND INITIATING DEAVERAGING PROCEEDING (May 3, 1999).

[8]See, for example, In the Matter of the Investigation of GTE-Minnesota's Cost of Providing Interconnection and Unbundled Network Elements, Docket No. P-442, 407, 5321, 466/CI-96-1541 ORDER TERMINATING INVESTIGATION, DISMISSING PROCEEDING AND CLOSING DOCKET (April 28, 1999) (docket closed due to "declining perceived need for setting permanent UNE rates for GTE and virtually no desire/ability to participate in this proceeding....")

Given the magnitude of the burden to deaverage rates beyond USWC's service area, and the dearth of demand, the Commission could not justify the expense and delay necessary to deaverage UNE rates for all LECs simultaneously. For the foregoing reasons, the Commission finds it reasonable to comply with FCC rule § 51.507(f) by establishing deaveraged UNE rates for USWC's service area first. The Commission can address deaveraging in other parts of the state as it receives requests to establish UNE rates in those regions.

A. Elements to be deaveraged

While the FCC resolved that state commissions should establish deaveraged rates for elements, it did not resolve the question of which elements to deaverage.

In the course of the USWC Generic Cost Docket, the Commission has established rates for a wide variety of UNEs.[9] In the course of the current proceeding, however, no party has asked the Commission to deaverage the rate for any element other than the local loop.

Deaveraging the local loop rate represents a reasonable means of complying with the FCC's rule. The cost of the local loop represents the greatest cost to providing local service. Moreover, the Commission's cost model reveals that the cost of the local loop varies greatly throughout USWC's service area. For the foregoing reasons, the Commission elects to implement the FCC's rule by deaveraging local loop rates.

A. Geographic units of analysis

The Commission established USWC's current loop prices on the basis of the average long-run incremental cost to provide loops throughout Minnesota. But, as noted above, the FCC now directs the Commission to adopt "geographically-deaveraged rates", based on differences in cost.

It is important to establish what the term "geographically-deaveraged rates" does *not* mean. Conceptually, USWC might incur a different cost to provide each loop, warranting a different loop price for each line. But the burden of administering such a pricing system would outweigh its benefits. No party has proposed that the Commission deaverage to such an extent, and even the FCC acknowledges the practical necessity of establishing deaveraged prices on the basis of zones. So for practical purposes, "deaveraged" merely means less averaged. If an averaged rate is calculated on the basis of the average cost to provide a loop in USWC's Minnesota service areas, a deaveraged rate will be calculated on the basis of the average cost to provide a loop in some zone within USWC's Minnesota service area.

While no party asked the Commission to establish rates on a loop-by-loop basis, some parties did advocate disaggregating data below the wire-center level of aggregation. Specifically, they argued that rates should reflect the difference between the cost of "in-town" loops and "out-of-town" loops. At the Commission's June 8, 2000 hearing, however, every party advocated a position that did not involve this type of sub-wire-center split. Some rural CLECs, however, continued to recommend an in-town/out-of-town split as a second-best alternative.

USWC collects data on the basis of wire centers rather than on the basis of, say, census tracts,

[9] USWC Generic Cost Docket, Compliance Filing of USWC (June 13, 2000).

square miles, municipal boundaries, metropolitan statistical areas or other communities of interest. As a result, analyses on the basis of wire centers hold the greatest promise for accuracy for the least administrative burden. In the USWC Generic Cost Docket, the Commission adopted the Report of the Administrative Law Judge. That report stated that, while the HAI cost model could calculate averaged UNE costs for a given wire center, it could not accurately calculate averaged costs for a subpart of a wire center.[10]

Based on the information and arguments in the record, the Commission finds it reasonable to deaverage loop rates on the basis of wire center data, and will refrain from ordering more than one price for loops within a wire center.

D. Zone definition

USWC has more than 150 wire centers. No party has proposed that the Commission establish this many UNE pricing zones. Indeed, in the trade-off between the desire to enhance the accuracy of price signals and the desire to maintain administrative simplicity, no party proposes that the Commission establish more than four zones. Specifically, at the Commission's June 8 hearing each party supported either the Eschelon 4 Zone Plan, or the three-zone Plan J1. On the basis of the record, the Commission finds that deaveraging USWC's loop prices into three or four zones would constitute a reasonable means to implement the FCC's deaveraging rule.

The Commission will now address the relative merits of the Eschelon 4 Zone Plan and Plan J1.

1. The Eschelon 4 Zone Plan

As the name suggests, the Eschelon 4 Zone Plan is a plan proposed by Eschelon Telecom, Inc. (Eschelon) to set the rate for USWC's local loops on the basis of the average loop costs in four zones. The plan has the support of AT&T Communications of the Midwest, Inc., Eschelon and WorldCom, Inc.

The plan assigns wire centers to each of four zones based on the wire center's average loop costs. Zone 1 would contain those wire centers for which the HAI Model estimated average loop costs in the first (lowest) quartile of the range of loop costs. Zone 2 would contain wire centers within the second quartile, and so on. However, the plan would not split wire centers between zones; whenever the cost of a wire center's loops places it on the boundary between two quartiles, the plan would assign the wire center to one quartile or the other so as to best achieve a system with an equal number of loops in each zone. Then the price of a loop in each zone would reflect the average cost of the loops in that zone. According to Eschelon's calculations,

- Zone 1 would have an average loop cost of $11.84.
- Zone 2 would have an average loop cost of $14.83.
- Zone 3 would have an average loop cost of $16.91.
- Zone 4 would have an average loop cost of $27.96.

The advocates of the Eschelon 4 Zone Plan assert that their plan would have the following benefits:

[10] USWC Generic Cost Docket, ORDER RESOLVING COST METHODOLOGY, REQUIRING COMPLIANCE FILING, AND INITIATING DEAVERAGING PROCEEDING (May 3, 1999).

First, the plan would fulfill the requirements of the FCC's rule: It would establish at least three cost-based zones in which to deaverage rates.

Second, by having four zones rather than three, the Eschelon 4 Zone Plan would tend to minimize the difference between a loop's economic cost and the rate charged for the loop. In other words, the plan would send more accurate price signals than a three-zone plan. As a consequence, a CLEC would have less incentive to build a loop when leasing would be cheaper, or to lease a loop where overbuilding would be cheaper.

Third, the plan is conceptually simple. It is based on cost, and only cost. It does not attempt to address any policy issue other than sending appropriate price signals.

2. Plan J1

Plan J1 represents a compromise position among various parties: Crystal Communications, the Minnesota Department of Commerce, the Minnesota Office of Attorney General, US West Communications, Inc., and a consortium of rural competitive local exchange carriers affiliated with incumbent LECs, including Hutchinson Telecommunications, Inc.; Integra Telcom of Minnesota, Inc.; Onvoy Communications; NorthStar Access, LLC; Otter Tail Telcom, LLC; Paul Bunyan Rural Telephone Cooperative; Tekstar Communications, Inc.; U.S. Link, Inc.; Val-Ed Joint Venture, LLP; and WETEC LLC.

These parties fashioned a plan designed to maintain the status quo to a great extent, at least until the Commission could resolve related issues. These issues include the development of a state fund to subsidize high-cost local telephone service (universal service fund) and the deaveraging of retail local telephone rates.

- Zone 1 would consist of twelve wire centers in downtown Minneapolis and St. Paul. These wire centers serve a disproportionate number of lines, and consequently have a low average line cost. The average loop cost would be $11.97.
- Zone 2 would consist of seven wire centers surrounding Zone 1. These wire centers also serve a disproportionate number of lines, but generally not as many as the Zone 1 wire centers. The average loop cost would be $13.34.
- Zone 3 would consist of the rest of USWC' service area, and would have an average loop cost of $20.46.

The advocates of Plan J1 assert that their plan would have the following benefits:

First, the plan would fulfill the requirement of the FCC's rule: It would establish three cost-based zones in which to deaveraged rates.

Second, it would permit competition in each zone in USWC's service area. Competitors in Zones 1 and 2 would be able to lease the same loops they are leasing today, but for less money. Competitors in Zone 3 would pay more to lease local loops. But at only $20.46, advocates allege that rural CLECs could incur the loop cost, add on the other costs of providing local telephone service (such as switching, advertising, billing and collections, bad debts, and personnel) and still produce a retail service that could compete with USWC's outstate business rate of $34.61. The Eschelon 4 Zone Plan, in contrast, would cause loop rates in some areas to reach $27.96, which

would provide a much narrower margin. According to the rural CLECs, this margin would virtually foreclose UNE-based competition, upon which rural CLECs depend.
Third, Plan J1 would minimize the harm that might result from deaveraging wholesale rates before a state subsidy for high-cost areas became operational, and before retail rates had been deaveraged. As noted above, the effect of deaveraging wholesale loop rates in Zone 3 would be to increase wholesale rates relative to USWC's retail rate, which harms a CLEC's ability to compete via UNEs in these areas. A high-cost support fund or deaveraged retail rates would ameliorate this effect. By subsidizing high-cost service, such a fund would permit CLECs to better afford the higher loop rates. And deaveraging retail rates would presumably result in USWC charging higher rates in rural areas (offset to some extent by the high-cost subsidy), which would make it easier for CLECs to compete with USWC. But deaveraging wholesale rates before establishing the fund or deaveraging retail rates might cause CLECs to abandon the Zone 3 market. While the CLECs might return after a fund was established and retail rates were deaveraged, this off-again/on-again dynamic would be costly to CLECs and inconvenient to customers.

Fourth, by keeping loop rates lower in Zone 3, Plan J1 would discourage CLECs from overbuilding in rural areas. A CLEC has the choice of leasing a loop from USWC or building its own loop; if the price of leasing remains attractive, CLECs would be less inclined to build. That would keep CLECs from incurring the cost of overbuilding, while permitting USWC to continue to make use of the plant it already has in place.

Finally, Plan J1 would be simpler for consumers to understand. The zones are mostly contiguous, and do not result in a patchwork of different loop rates around the state.

3. Commission analysis

The Commission favors the Eschelon 4 Zone Plan. The FCC directs this Commission to establish zones on the basis of cost; the Eschelon 4 Zone Plan is based only on cost. The simplicity of its formula – put an equal number of loops into each zone, with all the lowest-cost loops put into the first zone, etc. – guards against the formula being skewed to favor one group over another. In contrast, Plan J1 is not based solely on cost.

	Eschelon 4 Zone Plan		**Plan J1**	
	Loop Cost Range	Average	Loop Cost Range	Average
Zone 1	$ 8.90- 14.09	$11.84	$ 8.90- 14.42	$11.97
Zone 2	$14.19- 16.04	$14.83	$10.84- 14.83	$13.34
Zone 3	$16.06- 18.25	$16.91	$12.38-100.56*	$20.46
Zone 4	$18.28-100.56*	$27.96		

*Excluding Sabin Wire Center data, which is discussed further below.

As the preceding table shows, the Eschelon 4 Zone Plan would assign a wire center with, for example, a $14 average loop cost to Zone 1, resulting in a loop price of $11.84. Plan J1 might assign that wire center to any zone, resulting in a loop price anywhere from $11.97 to $20.46. Clearly, cost does not determine price in Plan J1.

Additionally, the Eschelon 4 Zone Plan does a better job than Plan J1 at reducing the difference between the average cost of a wire center's loops and the price for those loops. First, the Eschelon 4 Zone Plan has four zones rather than three. Second, the ranges of loop costs within Eschelon zones do not overlap, whereas the Plan J1 ranges do. Thus, for example, within Eschelon's Zone 1 the difference between a wire center's average loop cost (consider the most extreme example of $8.90) and the proposed loop price ($11.84) is never more than $2.94. Within Plan J1's Zone 1, the difference between a loop cost ($8.90) and the loop price ($11.97) can be as high as $3.07. In short, the Eschelon 4 Zone Plan generates prices that are closer to the costs they are intended to represent, which is the goal of this docket.

While Plan J1 advocates stress the merits of creating a plan that facilitates UNE-based competition throughout USWC's service area, the Commission is not persuaded. First, to the extent that the argument depends upon a factual analysis of a CLEC's costs and revenues, the record does not support it. The record reflects the cost of loops, and USWC's retail price for services. It does not reflect a CLEC's cost of converting a loop into a retail service, nor the revenues that a CLEC could expect to recover for its services. Significantly, a CLEC receives revenues by charging access rates to other carriers when originating or terminating calls using its own plant (or UNEs leased from the incumbent). The amount that a CLEC charges for access is not constrained, practically or legally, by the level of the incumbent's access rates. Without greater information about costs and revenues, the Commission cannot evaluate the strength of the CLEC's arguments about the relative competitive consequences of Plan J1 or the Eschelon 4 Zone Plan.

Second, the Commission is not persuaded of the merit of promoting UNE-based competition over other forms of competition. This docket was not intended to contrive a specific outcome, and the Commission is not endeavoring to pick winners and losers. Rather, this docket is merely one more step on the road to that elusive "level playing field" between incumbents and competitors, where winners and losers will be determined by customers. Specifically, in setting UNE rates the Commission seeks to present to CLECs the same costs and benefits that LECs face. As the Commission cannot lessen the costs that a LEC must bear to build and operate a loop to a customer, the Commission will not attempt to manipulate those costs for the benefit of any particular CLEC.

It may well be true that a plan that contrived to keep loop rates low in certain areas would discourage overbuilding in those areas. But such a plan would necessarily also keep loop rates high in other areas, unduly stimulating overbuilding. The Commission will decline to make itself the arbiter of what form of competition is warranted in each area. The Commission will establish cost-based rates. And, having done so, the Commission will leave to CLECs the choice of where and when to compete, and the business plan the CLEC will employ.

Finally, the Commission is not persuaded that the Plan J1 is superior because it would be simpler for consumers to understand. In this docket the Commission is establishing *wholesale* rates. The average customer will have no more need to understand UNE pricing than he has to understand how much a grocer pays for apples or an auto manufacturer pays for steel. Rather, it is the CLEC that must understand and acclimate to the way loop costs vary throughout USWC's service area – just as USWC must do.

E. When to deaverage

Some advocates of Plan J1 asked the commission to adopt, but not implement, a deaveraging plan. They argue that implementation should be coordinated with implementation of a state-wide universal service fund for subsidizing high-cost areas, as well as retail deaveraging.

The Commission is mindful of its obligations to maintain universal service. But it is also mindful of its obligation to promote competition. The Commission reconciles these obligations as best it can. But as the FCC noted,

> It is important, however, that the Commission not permit itself to be gridlocked into inactivity by endeavoring to find precise solutions to each component of this complex set of problems. It is preferable and more reasonable to take several steps in the right direction, even if incomplete, than to remain frozen with indecision because a perfect, ultimate solution remains outside our grasp.[11]

Uncertainty impairs competition. Businesses must make plans based on forecasts. If the Commission were to signal that it planned to change rates, but did not indicate when the change would occur, this could have a destabilizing effect on business. In contrast, if the Commission can establish rates that will take effect on a foreseeable date, and will remain in effect for the foreseeable future, businesses will be better able to plan, and therefore to act. Ever since Congress passed the Telecommunications Act of 1996, parties have expected that USWC's wholesale loop rates would move toward cost; the only question was when. The Commission will now lay that question to rest.

IV. Compliance filing and data anomaly

The Commission will direct parties to calculate a new local loop price for each zone on the basis of the average loop price within each zone.

This calculation could be affected, however, if the Commission's cost model produces inaccurate prices for any wire centers. Apropos to that, the Commission notes that its cost model provides a cost for local loops in the Sabin Wire Center that is more than ten times higher than the cost for loops in any other USWC wire center in the state. The record provides no explanation for this anomaly.

The Commission invites parties to review the data underlying the calculation of the Sabin Wire Center loop costs in conjunction with their compliance filings. If any party concludes that the Sabin Wire Center data has some bearing on the current docket, that party should feel free to share its views with the Commission at that time.

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[11] In the Matter of Access Charge Reform, CC Docket No. 96-262, SIXTH REPORT AND ORDER, FCC 00-193 (rel. May 31, 2000), ¶ 27.

ORDER

1. Within 90 days of this order's effective date, USWC shall deaverage the wholesale rate for its unbundled loops according to the Eschelon 4 Zone Plan, discussed above. The average loop cost shall be determined on the basis of the HAI Model and inputs authorized in In the Matter of a Generic Investigation of U S WEST Communications, Inc.'s Cost of Providing Interconnection and Unbundled Network Elements, Docket No. P-442, 5321, 3167, 466, 421/96-1540, ORDER GRANTING RECONSIDERATION, SETTING PRICES AND ORDERING COMPLIANCE FILING (March 15, 2000).

2. Within 30 days of this order's effective date, parties shall submit a compliance filing setting forth any details for implementing Ordering Paragraph 1, and discussing why the Commission's cost model indicates that local loops in the Sabin exchange cost ten times as much as loops in any other exchange.

3. Parties may file, within 30 days of this order's effective date, comments on whether the Commission should modify its decision as a result of the Sabin exchange anomaly.

4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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Statement of Commissioner Edward Garvey
Concurring in Part, Dissenting in Part
In the Matter of Implementing UNE Geographic Deaveraging Requirements
Docket #P-999/CI-99-465

The Commission's wholesale deaveraging decision is an important step in the right direction. It is good that the Commission started the process for geographically deaveraging the rates for unbundled network elements (UNEs). It is also good that the Commission concluded that it could start this process independent of the related matters of retail rate deaveraging and universal service fund issues. Unfortunately, it started the deaveraging process in a way that places CLECs currently serving higher-cost rural areas in a potentially untenable price squeeze. A smaller, more incremental step could have achieved the same result without that harm. This is why I prefer the J-1 proposal over Eschelon-4.

Many Small Steps; Not One Leap. Deaveraging is a complicated process. At its core is the wise public policy of promoting cost-based prices. However, achieving such cost-based prices requires not only wholesale deaveraging, but the deaveraging of retail prices, the creation of a universal service fund (USF), the relaxation of tariff pricing in general, and the development of true competitors. These cannot occur overnight. This is a journey with many steps. In such a journey, wholesale deaveraging is not only one step among many, but should, itself, consist of many steps. Accordingly, the Commission should pursue a series of evolutionary steps, instead of a revolutionary leap. Such steps allow the Commission to calibrate the decision in a way that carefully minimizes adverse consequences, while maximizing the gain. Revolutionary leaps, which may lead to positive results but often with unnecessary costs, do not allow such calibration.

In the context of our decision options, J-1 could have been an important evolutionary step that started the deaveraging process with limited costs. Eschelon-4 is a revolutionary leap towards true cost-based pricing. This is an admirable goal and may have long-term positive results. Yet, such results are likely to come at the expense of rural CLECs. While J-1 may not have achieved the same amount of competitive entry as Eschelon-4, it does not have the potential adverse consequences to CLECs. J-1 is, therefore, a better balance of the costs and benefits.

Impacts of Wholesale Deaveraging But Not Retail Deaveraging. Deaveraging explicitly means that some prices will fall and others rise. Up until now the prices that US West charges consumers have reflected an average of the costs over a large area. This averaging was explicitly done to promote universal service through more affordable rates by having low-cost urban consumers subsidize higher-cost rural consumers. As a result, when we talk about deaveraging there are two connected components:

- The rates US West can charge its wholesale customers, called wholesale deaveraging. This is the issue the Commission tackled with today's decision.
- The rates end-use consumers pay. This is called retail deaveraging. The Commission did not deal with this issue. US West is still constrained by its retail tariffs.

Wholesale deaveraging such as the Commission did, without retail deaveraging, means that in some areas of the state CLECs will pay US West significantly less than what US West may charge consumers for the same loop. This becomes an attractive windfall to the CLECs, who will likely shadow-price US West's retail prices. Such windfalls are not necessarily bad, as they may be needed to attract competitors into the marketplace.

Just as wholesale deaveraging without retail deaveraging may benefit some CLECs in some exchanges, the opposite can and will happen, too. CLECs can be harmed by deaveraging. In fact, there will be large geographic areas of US West's service area where the wholesale cost of the loop will be above US West's retail tariffs. No competitor can effectively compete in such an environment.

Role of Universal Service. Universal service is another key element in the deaveraging effort. As I mentioned, averaging of rates was done to promote universal service by making the high-cost loops more affordable by subsidizing them with low-cost loops. Deaveraging, especially retail deaveraging, ends the cross subsidies, meaning that the retail prices of a number of loops will become much higher than they are today. No policy-maker is excited about raising prices. That is why we are creating a specific fund (USF) to offset the adverse consequences of retail deaveraging. The USF will make explicit subsidies to encourage phone companies to serve high cost customers without unduly increasing retail rates and jeopardizing continued universal telephone service. The creation of this fund and decisions on who gets the subsidies, who pays into the fund and how much subsidy is given out are many months away. As a result the Commission is wisely not rushing to retail deaveraging.

The Need to Wholesale Deaverage. Nonetheless, averaging must end as we replace regulated monopolies with a competitive marketplace. Implicit subsidies should be driven out and prices set according to actual costs. Deaveraging must be done in order to create a consumer-driven telecommunications marketplace. This decision dealing with wholesale deaveraging is an important step on this journey. However, it is only one of many steps involved. Retail deaveraging and the USF issues are not addressed. The question becomes, why take a step at this time.

Fortunately, or unfortunately, depending on one's perspective (and I see both sides), the FCC told states to start wholesale deaveraging immediately. It said that Minnesota and other states could not wait the many months it will take for the USF to be created before deaveraging wholesale rates for UNEs. I agree with the FCC. It is in the public interest to begin deaveraging at the wholesale level before retail deaveraging and the USF are in place. However, in taking this step the Commission should be mindful that taking this independent action is not without peril. There may be "winner" CLECs and "loser" CLECs. This need not be. At a minimum, the potential downsides should be tempered.

Comparing J-1 to Eschelon-4. The J-1 proposal was supported by the state's policy and consumer advocates (the Department of Commerce and the Office of Attorney General's Residential Utilities Division) as well as U S WEST, the rural CLEC group and Crystal. It created a low-cost urban core and a small, slightly more expensive suburban zone, while keeping enough lower-cost exchanges in zone three to prevent a dramatic increase in the high-cost areas. For its part, Eschelon-4 was put forward by Eschelon and subsequently supported by AT&T and MCI. Unlike J-1, Eschelon-4 is strictly cost based: four zones were lumped together strictly on the basis of their costs. There is no geographic connection to the zones and the exchanges. The rates that fall out of the Eschelon-4 plan clearly reflect costs and place wire centers with similar costs in the same zone. So, none of the exchange costs overlap.
Some argue that a weakness of J-1 is that it is not purely cost-based like Eschelon-4. This appears true. J-1 appears to be designed to limit the adverse effects of wholesale-only deaveraging on rural CLECs. As I have already stated, wholesale deaveraging independent of retail deaveraging places those CLECs that serve the higher-cost areas in a very difficult if not impossible position. AT&T, MCI and Eschelon benefit from J-1, they just do not benefit as much as they would in Eschelon-4. Thus, although Eschelon-4 moves the state closer and more directly to costs, it does so in a way that harms actual competition in rural Minnesota.

More Retail Deaveraging Requests Likely. Any step to deaverage wholesale rates makes it likely that the Commission will be required to consider more requests for retail deaveraging. The Commission has only dealt with a few such request up until now. With more requests, the Commission may face the Hobson's choice of granting retail deaveraging and allowing prices to increase in high cost areas even though the USF is not ready or facing the newsworthy stories of rural CLECs closing up shop because of the differential between high deaveraged wholesale prices and lower tariffed retail prices. This is not in the public interest. Eschelon-4 makes this unpleasant outcome more likely than J-1.

Instead, the Commission should recognize that deaveraging must be done in steps. J-1 is a powerful step that benefits those CLECs that wish to penetrate the urban areas, like Eschelon, AT&T and MCI, without hurting the CLECs that are already competing in the rural areas, like Crystal. The drive to cost-based pricing must be tempered by thoughtful public policy and not come at the expense of rural competitors. Once we retail-deaverage and develop a USF, we can take another wholesale deaveraging step, a step like Eschelon-4. Then, after a short while we can take another step and adopt Eschelon-152, i.e., deaverage down to the individual exchange.

Comments on the Process. Before I close, let me editorialize on the process. Commission staff did an outstanding job of analyzing the policy considerations from both a long-term and a short-term perspective. They may have also polarized the debate by recommending Eschelon-4. However, when faced with either the "establish, but don't implement"J-1 proposal or implementing something, the obvious better choice is to do something. And, Eschelon's pure cost-based proposals were superior to the other options presented, at least from a philosophical perspective. Plus, there was uncertainty whether options, say U S WEST's community of interest proposal, were still on the table.
Thus, I wish some of the parties had spent their time figuring out how best to implement

deaveraging, instead of developing creative legal wordsmith arguments on how to frustrate or delay the inevitable. While there is no guarantee that the diverse views of the opposing CLECs could have been reconciled, it is possible that a true consensus could have been developed if the “establish, but don’t implement” concept had been taken off the table sooner than the June 8th hearing. Such a consensus is still possible, and ideally should occur, but the Commission’s decision makes that much harder and more unlikely.

There are many difficult decisions that this Commission will need to make on the rest of our journey. We will also need to make these decisions rapidly if they are to have meaning. When faced with these difficult choices, it seems less than ideal to limit the Commission’s exploration of the issues. We place a lot of faith in our advocates to present well developed proposals and in our staff to analyze the options presented and offer additional alternatives. More options and more flexibility allows the Commission to forge compromise or at least find middle ground.

To conclude, while I am apprehensive about the size of the step we have taken, I am pleased that the Commission has taken the wholesale deaveraging step. We know where we want to go--to create a consumer-driven telecommunications marketplace offering quality, value, fairness and choice--and wholesale deaveraging is an important step towards that destination.