ISSUE DATE: October 5, 2000

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

ORDER ON RECONSIDERATION

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 [wholesale unbundled network] 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 July 10, 2000, in the current docket, the Commission issued its ORDER DEAVERAGING UNBUNDLED NETWORK ELEMENT RATES.

[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.

By July 31, 2000, the Commission had received petitions for reconsideration from the Department of Commerce (the Department), HickoryTech (formerly Crystal Communications), Integra Telecom and the Rural CLEC[2] Consortium consisting of HomeTown Solutions, LLC; Hutchinson Telecommunications, Inc.; NorthStar Access LLC; Onvoy; Otter Tail Telecom, LLC; Paul Bunyan Telephone Cooperative; Tekstar Communications, Inc.; U.S. Link, Inc.; Val-Ed Joint Venture, LLP; and WETEC LLC.

By August 10, 2000, the Commission had received comments from AT&T Communications of the Midwest, Inc. (AT&T), Eschelon Telecom, Inc. (Eschelon), the Office of the Attorney General's Residential and Small business Utilities Division (OAG-RUD), Qwest (formerly U S WEST Communications, Inc.) (USWC), the Rural CLEC Consortium, and the Suburban Rate Authority (SRA), representing 36 suburban cities.

On September 5, 2000, the Commission met to consider the matter.

FINDINGS AND CONCLUSIONS

I. Background

On February 8, 1996, the Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56 (the Federal Act), became effective. The Act is designed to give a CLEC three different ways to serve each customer:

- A CLEC may buy a LEC's services at wholesale rates and resell them to customers.
- A CLEC may serve customers entirely through the CLEC's own facilities, and only interconnect with the LEC to hand off and pick up calls between their networks.
- A CLEC may rent the LEC's UNEs and combinations of UNEs, and combine them (including the option of combining them with some of its own facilities) to offer services to customers.[3]

A 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). Either party may ask the state utility commission to arbitrate and establish appropriate terms, including the price of UNEs. 47 U.S.C. § 252(b), 47 C.F.R. §§ 51.501, 51.505.

Various circumstances influence which method of competition is most attractive to a CLEC.

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[2]CLEC stands for "competitive local exchange carrier": generally, a local telecommunications carrier that is not an incumbent local telephone company.

[3]47 U.S.C. § 251(c).

Resale has the advantage of requiring the least technical sophistication, and a CLEC can begin serving a customer most quickly via resale. On the other hand, resale offers CLECs the fewest options. A CLEC cannot offer services that the LEC does not offer, and must rely on the LEC to install or repair any plant. Additionally, the opportunity for profit is constrained by 1) the legal obligation to pay the Commission-approved wholesale rate for services, and 2) the competitive need to keep retail prices competitive with the LEC's Commission-approved retail rate for the same services.

Facilities-based competition gives the CLEC the greatest discretion in the choice of facilities and the pace of implementation. It also requires the greatest initial investment, creating business risk. While no regulation limits how low a CLEC can drive its costs, a CLEC will face competitive pressures to keep its prices no higher than the LEC's prices for comparable services.

UNE-based competition has similarities to both resale competition and facilities-based competition. Similar to resale, UNE-based competition permits a CLEC to avoid the large initial cost of building its own facilities. Yet similar to facilities-based competition, UNE-based competition gives a CLEC the discretion to incorporate the use of its own facilities (such as its own switch providing advanced services), so that the CLEC is not constrained to provide only the services offered by the LEC. The CLEC's costs – that is, the UNE prices – are set forth in the interconnection agreement, and may be set by Commission order. But, as with the other methods of competition, a CLEC will face competitive pressures to keep its prices no higher than the LEC's prices for comparable services.

The cost of providing UNEs 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 Commission has established geographically averaged rates for USWC's UNEs.[4] But the FCC directs 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).

The Commission has elected to implement this policy by establishing deaveraged rates for USWC's local loops. For a further discussion, see the July 10 Order.

II. The July 10 Order

In its July 10 Order, the Commission selected the Eschelon 4 Zone Plan from among the plans

[4] 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).

recommended by the parties for deaveraging UNE rates. That plan assigns each wire center to one of four zones based on the wire center's average loop costs. Generally, 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. The price of a loop in each zone would reflect the average cost of the loops in that zone.

The Commission favored this plan over Plan J1 because the Eschelon 4 Zone Plan–

- was "cost-based" – that is, the cost of a loop determined its price,
- minimized the difference between the loop's price and the loop's cost, and
- established zones without regard to considerations other than price – that is, without taking account of the consequences in any specific area or for any specific company.

The third principle was especially important to the Commission's decision. The FCC has directed state utility commissions to calculate cost-based UNE rates for at least three zones. In implementing this mandate, the Commission must change UNE rates in various parts of the state, having the likely effect of promoting the interest of some CLECs and harming the interest of others. Different plans would affect different CLECs to different degrees. The Commission favored a principle-based method for calculating deaveraged rates. In this way the Commission could act in an even-handed manner, even if it could not produce even results.

III. Requests for Reconsideration

A. Positions of the Parties

Various parties ask the Commission to reconsider its decision. One asks the Commission to refrain from deaveraging rates, and another asks the Commission to adopt the previously-rejected Plan J1. But most petitioners propose new plans. The petitioners argue that these plans are also cost-based, also produce a small difference between a loop's price and its cost, and yet have other benefits as well. And, most significantly, they all challenge the idea that the Commission should select a method of deaveraging UNE rates without considering its consequences.

The Department's Request for Reconsideration is illustrative. The Department criticizes the Eschelon 4 Zone Plan as inconsistent with the Commission's own stated objectives. If the Commission really wants to adopt a plan that is cost-based, minimizes the difference between a loop's price and its cost, and only considers price, then it should reject the Eschelon 4 Zone Plan and establish a separate loop rate for each wire center. But the Department does not recommend this option. Rather, the Department argues that the Commission *ought* to consider the consequences of the plan it selects. If it would do so, according to the Department, then the Commission would reject the Eschelon 4 Zone Plan because of its harmful effects.
The parties' general critique of the July 10 Order is as follows: The Commission noted that geographically-deaveraged wholesale rates would set prices close to cost, prompting economic efficiency. But the Commission's analysis fails to acknowledge the relationship between wholesale and retail markets. Admittedly, it may be efficient to have the supply of a wholesale UNE based on cost. But the demand for the wholesale UNE derives from the demand for the

resulting *retail* services. And in that retail market, USWC serves the vast majority of lines at prices *not* based on geographically deaveraged costs. This degree of distortion in the retail market undercuts the merits of pursuing economic purity in the wholesale market.

These distortions may be alleviated in the future, with the advent of a sufficient fund to subsidize retail local telephone rates in a competitively-neutral manner,[5] or the advent of retail rate deaveraging, or both. In the meantime, parties argue, the Commission needs to consider current circumstances as it deaverages rates.

The Commission had expressed reluctance to develop a phased-in approach to setting deaveraged UNE rates, noting that CLEC businesses would benefit from certainty regarding costs. Yet the petitioners argue that businesses are not solely focused on costs; they are concerned with the difference between their costs and their revenues. USWC's retail rates, which are legally constrained from reflecting geographic variations in cost, artificially constrains the revenues that a CLEC can hope to earn on each loop. And, where regulation creates a problem, it is appropriate for the Commission to intervene and create a regulatory solution.

AT&T and Eschelon oppose the motions for reconsideration. They argue that the petitioner's objections had been considered and rejected in the July 10 Order, and that any new evidence was now untimely.

A. Commission Action

The Commission concedes the merit of the petitioners' argument. USWC's retail prices affect the wholesale market for USWC's UNEs. Regulation causes USWC to maintain relatively uniform retail rates throughout its service area.[6] This regulatory dynamic is not neutral in its effect on different regions and different CLECs; it favors CLECs operating in low-cost areas over CLECs operating in high-cost areas. Thus, the Commission need not be neutral in its deaveraging decision.

The Commission concludes that it is appropriate to consider the effects of retail regulation when it establishes a method for deaveraging wholesale rates. If and when retail regulation changes, the

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[5]Minn. Stat. § 237.16, subd. 9 provides for the creation of a state "universal service fund" for this purpose; see Docket No. P-999/R-97-609 In the Matter of the Planned Promulgation of Rules Governing the Competitive Provision of Local Telephone Service, Including Issues Related to Universal Service, Regulatory Treatment of Competitive Local Exchange Carriers (CLECs), Service Quality, and Emergency Service (911).

[6] Minn. Stat. §§ 237.09, subd. 1; 237.121; 237.60, subd. 3. USWC is also constrained by the terms of its Alternative Form of Regulation Plan. See In the Matter of the Petition of U S WEST Communications, Inc. for Approval of its Alternative Form of Regulation Plan, Docket No. P-421/AR-97-1544 Modified Alternative Form of Regulation Plan for the State of Minnesota (January 11, 1999).

Commission may need to revisit this issue. In sum, today's decision must be a step in a journey to deaveraging, not the final destination.

For the foregoing reasons, the Commission will grant the parties' requests for reconsideration of the Commission's July 10, 2000 Order. The Commission will now consider how to structure deaveraging to ameliorate the competitive harms resulting from USWC's relatively uniform retail rates.

IV. Parties' Proposals on Reconsideration

On reconsideration, parties offer a range of suggestions, including a proposal not to deaverage, a proposal to fully deaverage down to the individual wire center level, and a variety of proposals in-between.

A. Maintaining Averaged Rates

HickoryTech urges the Commission to refrain from implementing deaveraged rates currently. HickoryTech empathizes the need to implement retail rate deaveraging in concert with wholesale rate deaveraging.

B. Setting Loop Prices on the Basis of Individual Wire Center Data

In contrast to the preceding proposal to not deaverage rates, the Department suggests deaveraging rates down to the wire center level.

As noted above, the Department argues that if the Commission truly wishes to set UNE prices that 1) are "cost-based," 2) minimize the difference between the loop's price and the loop's cost, and 3) establish zones without regard to considerations other than price, then the Commission should set loop prices on the basis of each individual wire center's costs. This policy would be the most cost-based, in that it would reduce the difference between a loop's cost and its price to zero. Moreover, it would eliminate the contentious issue of how to aggregate wire centers into zones: each of USWC's more than 150 wire centers would become its own zone for purposes of setting loop prices.

C. Setting Loop Prices on the Basis of Groups of Wire Centers

1. AT&T's and Eschelon's Proposal

AT&T and Eschelon ask the Commission to reaffirm its selection of the Eschelon 4 Zone Plan, described above. That would create four zones, each containing roughly 25% of USWC's loops.

- Zone 1 would contain wire centers with average loop cost of $8.82[7] to $14.09, resulting in a loop price of roughly $ 11.84,
- Zone 2 would contain wire centers with average loop cost of $14.19 to $16.04, resulting in a loop price of roughly $ 14.83,
- Zone 3 would contain wire centers with average loop cost of $16.06 to $18.25, resulting in a loop price of roughly $ 16.91, and
- Zone 4 would contain wire centers with average loop cost of $18.28 to $158.14, resulting in a loop price of roughly $ 27.96.

In the alternative, they propose that the Commission could increase the number of zones, while continuing the Eschelon policy of placing a uniform number of loops into each zone, ranked in order of cost.

2. Rural CLEC Consortium Proposal

Other parties, sharing a concern that high UNE rates may impede competition, propose new deaveraging methods for the Commission's consideration.

The Rural CLEC Consortium also asks the Commission to reaffirm the Eschelon 4 Zone Plan with the following modification: shift the 56 lowest-cost wire centers from Zone 4 to Zone 3. This would have the effect of reducing the loop price in those 56 wire centers by roughly $8, increasing the price in the rest of Zone 3 by roughly $3, and increasing the price in the rest of Zone 4 by roughly $21 (relative to the original Eschelon 4 Zone Plan).

- Zone 1 would contain wire centers with average loop cost of $8.82 to $14.09, resulting in a loop price of roughly $ 11.84,
- Zone 2 would contain wire centers with average loop cost of $14.19 to $16.04, resulting in a loop price of roughly $ 14.83,
- Zone 3 would contain wire centers with average loop cost of $16.06 to $34.92, resulting in a loop price of roughly $ 19.97, and
- Zone 4 would contain wire centers with average loop cost of $35.81 to $158.14, resulting in a loop price of roughly $ 48.41.

According to the Rural CLEC Consortium, this plan would have the following advantages: First, it would make UNE-based competition viable in those 56 wire centers which would not have been

[7] All financial numbers in this Order are approximate, pending the selection of a final deaveraging method, and a final compliance filing by the parties; see below.

viable otherwise. Second, it would not harm the viability of UNE-based competition in any of the rest of Zones 1, 2 or 3. Third, it would not harm the viability of UNE-based competition in the remainder of Zone 4, because UNE-based competition would not be viable there under the Eschelon 4 Zone Plan either. Finally, it would leave most of the Eschelon 4 Zone Plan unchanged.

The SRA also supports this proposal. At least five wire centers that serve SRA cities fall within the high-cost Zone 4 of the Eschelon 4 Zone Plan. The SRA opposes plans that set loop rates by averaging the cost of (relatively low cost) suburban wire centers with (relatively higher cost) rural wire centers. While such averaging may have the effect of reducing UNE prices in rural areas, it also has the effect of increasing UNE prices in suburban areas.

3. HickoryTech Proposal

HickoryTech also supports the Rural CLEC Consortium proposal. Alternatively, HickoryTech supports Plan J1. Plan J1 was 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, with loop costs ranging from \$8.90 to \$14.42. These wire centers serve a disproportionate number of lines, and consequently have a low average line cost. The average loop cost would be approximately \$11.97.
- Zone 2 would consist of seven wire centers surrounding Zone 1, with loop costs ranging from \$10.84 to \$13.34. 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 approximately \$13.34.
- Zone 3 would consist of the rest of USWC's service area, with loop costs ranging from \$12.38 to \$150.14. The zone would have an average loop cost of approximately \$20.46.

4. Department Proposal

The Department agrees with the supporters of the Rural CLEC Consortium proposal on many points: First, excessive UNE rates can preclude UNE-based competition. Second, the Commission should deaverage UNE rates in a manner that does not preclude UNE-based competition. Third, under the Rural CLEC Consortium proposal, UNE prices in Zone 4 would preclude UNE-based competition.

But, while the Rural CLEC Consortium accepts that deaveraging may end UNE-based competition in some high-cost areas, the Department rejects this outcome. Instead, the Department designs its proposal to keep UNE rates moderate throughout USWC's service area. It accomplishes this goal by placing more than half of USWC's loops into one zone, and dividing the remaining low-cost loops among three other zones. While the Department offered many variations of it plan, the option it favors is as follows:

- Zone 1 would contain the lowest-cost wire center, resulting in a loop price of approximately $8.82.
- Zone 2 would contain the next 13 lowest-cost wire centers, with an average loop price of approximately $12.39.
- Zone 3 would contain the next 15 lowest-cost wire centers, with an average loop price of approximately $14.69.
- Zone 4 would contain the remaining 123 wire centers, with an average loop price of approximately $21.94.

By averaging together enough loops, the Department keeps all UNE loop rates below $22, which the Department deems reasonable.

5. OAG-RUD Proposal

The OAG-RUD supports the Department's plan, but would modify it to combine the first two zones of the plan:

- Zone 1-2 would contain the 14 lowest-cost wire centers, resulting in a loop price of approximately $12.03.
- Zone 3 would contain the next 15 lowest-cost wire centers, with an average loop price of approximately $14.69.
- Zone 4 would contain the remaining 123 wire centers, with an average loop price of approximately $21.94.

6. Integra Proposal

Integra supports the Rural CLEC Consortium proposal for the reasons articulated by the Rural CLEC Consortium.

But more generally, Integra asks that the Commission disaggregate the Duluth Melrose exchange. That exchange consists of multiple wire centers. Five of these centers[8] have relatively high-cost loops, but one has relatively low-cost loops. The effect of aggregating these loop prices is to unduly impede UNE-based competition in the low-cost Duluth Melrose wire center. Integra asks that the Commission disaggregate these wire centers for purposes of assigning loop prices.

V. Commission Action

A. Maintaining Averaged Rates

Whatever the merits of maintaining averaged wholesale rates may be, the issue is preempted by

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[8] Duluth Kenwood, CLLI Code DLTHMNCSRS7; Duluth Hunter's Park, CLLI Code DLTHMNWARF7; Duluth Calumet, CLLI Code DLTHMNCBRS6; Duluth Endion, CLLI Code DLTHMNFSRS7; and Duluth Hemlock, CLLI Code DLTHMNAFRS7.

the Federal Act and the FCC's rules interpreting it. For the reasons set forth in the Commission's July 10 Order, the Commission will deny the motion to refrain from deaveraging wholesale rates.

B. Setting Loop Prices on the Basis of Individual Wire Center Data

The Commission finds merit in the idea of deaveraging loop rates to the wire center level at some advanced stage of local telephone competition. But currently no party actually advocates this position.

The Department joins the OAG-RUD and rural CLECs in encouraging the Commission to take into account the consequences of USWC's fixed retail rates when it sets wholesale prices. Rural CLECs note that deaveraging to the wire center level is only marginally better than the Eschelon 4 Zone Plan at reducing wholesale loop rates in rural areas where CLECs operate. And urban CLECs, who would be expected to derive the greatest benefit from such a plan, express concerns that it would complicate billing, and unduly delay the implementation of deaveraging. This last concern is echoed by USWC, the company that must implement whatever deaveraging method the Commission selects. The administrative burdens of having more than 150 loop prices would delay implementation, according to USWC. Significantly, while USWC expresses no preference among the other plans, it expresses strong reservations about this one.

For the reasons advanced by the various parties, the Commission will decline to set a separate loop price for each wire center at this stage of competition. The Commission will instead consider setting loop costs on the basis of aggregated wire center data.

C. Setting Loop Prices on the Basis of Aggregated Wire Center Data

The Commission has concluded that it may consider the consequences of the plan it selects for deaveraging UNE rates, and select the plan that best promotes the public interest.

The Commission will decline to adopt Plan J1 for the reasons it articulated in the July 10 Order. No party has articulated a persuasive reason for assigning wire centers to zones on the basis of geography rather than cost.

In selecting among the remaining proposals – the Department Plan, the Eschelon 4 Zone Plan, the Rural CLEC Consortium Plan – the Commission gives great weight to the expertise of the state agencies charged with the duty of representing the public interest in Commission proceedings. The Department is charged with promoting the broad public interest. The OAG-RUD is charged with protecting residential and small business utility ratepayers. And, significantly, neither entity has a financial interest in the outcome.

Both agencies caution against adopting a deaveraging plan that would result in UNE rates as high as the Zone 4 rates, $ 27.96, in the Eschelon 4 Zone Plan. Clearly this militates against reaffirming the Eschelon Plan. It also militates against any variation of the Eschelon plan that increased the number of zones. More zones would exacerbate the problem, result in higher prices in the high-cost zones. Finally, the agencies' concerns militate against the Rural CLEC Consortium Plan, which would set a price of $ 48.41 in Zone 4.

The Commission will decline to adopt the OAG-RUD's proposed modification of the Department's plan, combining Zones 1 and 2. This policy would eliminate the lowest-cost loop price. Parties argue for the need to moderate the highest UNE prices, even where high prices might more accurately reflect cost; but no party has argued for the need to moderate the lowest UNE prices, where the low price would more accurately reflect cost. Therefore, the Commission will adopt the Department's proposal without the proposed modification.

Some parties argue that Department's rate for Zone 4 ($21.94), while less than the Zone 4 rate in either the Eschelon 4 Zone Plan ($27.96) or the Rural CLEC Consortium Plan ($48.41), is still too high. The Commission, however, must balance the purpose of the docket – moving toward cost-based wholesale rates – and the desire to mitigate harm to existing UNE-based competitors. The Department and the OAG-RUD largely agree on where that balance is to be struck. The Commission will affirm that judgment.

No party opposed Integra's proposal to disaggregate the Duluth Melrose exchange into wire centers, and AT&T acknowledged the merit of Integra's request. The Commission will therefore grant the request, and order that the Duluth Melrose exchange be disaggregated, with its wire centers incorporated into the Department Proposal on the basis of their costs.

For the foregoing reasons, the Commission will order that USWC's UNE loops be priced according to the Department's recommended formula, with the proviso that the Duluth Melrose exchange first be disaggregated into its individual wire centers for the purpose of setting loop rates.

ORDER

1. The petitions to reconsider the Commission's ORDER DEAVERAGING UNBUNDLED NETWORK ELEMENT RATES (July 10, 2000) are granted.

2. Parties shall disaggregate the Duluth Melrose exchange data into its component wire centers, and calculate an average loop rate for each wire center.

3. Parties shall set deaveraged unbundled network element rates according to the proposal advocated by the Department of Commerce, as 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).

4. Qwest shall begin offering local loops at the resulting rates by November 1, 2000.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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