

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Order Instituting Investigation on the Commission's Own Motion into the Deaveraging of Unbundled Network Element Rates within at Least Three Geographic Regions of the State Of California Pursuant to Federal Communications Commission Rule 47 C.F.R. § 51. 507(f).

FILED  
PUBLIC UTILITIES COMMISSION  
MARCH 2, 2000  
INVESTIGATION 00-03-002

**ORDER INSTITUTING INVESTIGATION****I. Summary**

We institute this formal investigation as a procedural vehicle to accomplish the goal of complying with the Federal Communications Commission's (FCC) rule<sup>1</sup> that requires the deaveraging of unbundled network element (UNE) rates within at least three geographic regions of the state by May 1, 2000.

**II. Procedural Background**

In August 1996, the FCC promulgated a number of rules in its Local Competition proceeding<sup>2</sup> to implement the interconnection provisions of the 1996 Telecommunications Act (TA 96). One of these rules was § 51.507(f), which required each state commission to: "establish different rates for [network] elements in at least three defined geographic areas within the state to reflect

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<sup>1</sup> 47 Code of Federal Regulations (C.F.R.) § 51. 507(f).

<sup>2</sup> *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket 96-98, First Report and Order

geographic cost differences.”<sup>3</sup> This rule, known as the geographic deaveraging rule, was vacated by the Eighth Circuit but later reinstated by the U.S. Supreme Court in AT&T v. Iowa Utilities Board, 119 S.Ct. 721 (1999).

On March 1, 1999, the coordinating commissioner for telecommunications, on behalf of the Commission, wrote to the FCC asking the FCC to defer reinstating the geographic deaveraging rule for unbundled network elements for one year, or until March 1, 2000. A number of other states also sought a stay of the FCC’s rule. On May 7, 1999, the FCC agreed to stay its rule until six months after the issuance of its order finalizing and ordering implementation of high-cost universal service support for nonrural LECs. On November 2, 1999, the FCC issued such an order, and stated that the stay of the geographic deaveraging rule would be lifted on May 1, 2000. The FCC specified that “[b]y that date, states are required to establish different rates for interconnection and UNEs in at least three geographic areas pursuant to section 51.507(f) of the [FCC’s] rules.”

### **III. Commission Overview**

In late 1996, the Commission evaluated the merits of the Total Element Long-Run Incremental Cost (TELRIC) methodology as the basis for determining the costs of UNEs in the Open Access and Network Architecture Development proceeding (OANAD).<sup>4</sup> During the course of that phase of OANAD, we directed Pacific Bell (Pacific) and GTE California Incorporated (GTEC) to submit TELRIC costs that could be used to set geographically-deaveraged UNE prices. In compliance with the directive, Pacific submitted studies that presented

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<sup>3</sup> The FCC rule requires deaveraging of wholesale rates for UNEs in at least three geographic regions of a state.

<sup>4</sup> Rulemaking (R.) 93-04-003/Investigation (I.) 94-04-002.

geographically deaveraged costs for network elements based upon a “revenue zone” approach, as well as statewide average costs. Urging the rejection of Pacific’s approach as not being cost-based, AT&T Communications of California, Inc. (AT&T) and MCI WorldCom<sup>5</sup> proposed that the Commission use Version 2.2.2 of the Hatfield Model to calculate geographically deaveraged loop costs.

Comparing the two proposals in Decision (D.) 98-02-106, the Commission rejected Pacific’s revenue zone approach to geographic deaveraging because it failed the TA 96 test that requires prices for UNEs to be based on the costs of the incumbent local exchange carrier (ILEC). We also rejected AT&T’s and MCI WorldCom’s Hatfield Model on the ground that it produced “unreasonably high loop costs for rural areas,”<sup>6</sup> and because its geographic deaveraging methodology appeared likely to aggravate difficulties caused by the model’s internal assumptions about rural areas.

Most recently, in D.99-11-050, our interim decision setting final prices for the UNEs to be offered by Pacific, we declined new proposals by both Pacific and AT&T/MCI WorldCom that “would have introduced incomplete, *ad hoc* forms of geographic deaveraging into UNE prices.” (*Id.* at 17.) However, we also recognize that both proposals were attempts to remedy a dilemma that we had acknowledged in our 1996 Universal Service case, D.96-10-066. That dilemma is how to divide the Universal Service subsidy between an ILEC and a competitive local exchange carrier (CLEC) when the latter offers service in a high-cost area through a combination of its own facilities and UNEs purchased from the ILEC.

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<sup>5</sup> At the time, filing as MCI Telecommunications Corporation.

<sup>6</sup> D.98-02-106 at 93.

As described in D.99-11-050, AT&T and MCI WorldCom proposed applying a surcredit of \$2.64 on residential loops financed through the Universal Service fund on which Pacific is entitled to draw. In response, Pacific suggested its own formula for an “equitable division” of the pertinent Universal Service fund between a CLEC that provides residential service<sup>7</sup> and the ILEC that provides the loop. We rejected both proposals for proffering solutions inconsistent with the intentions of the Universal Service fund. (D.99-11-050, *mimeo.* at 91-99.) Consequently, we established only statewide-average prices for Pacific in D.99-11-050.

Prior to the issuance of D.99-11-050, AT&T and MCI WorldCom presented another geographic deaveraging proposal in their comments on the proposed order. Central to that proposal was the assertion that the existing OANAD record contains the essential elements for immediate geographic deaveraging. AT&T and MCI WorldCom maintained that:

”[t]he OANAD record provides all of the information that the Commission would need to adopt valid geographically deaveraged loop prices now. Attachment A to these comments contains a detailed roadmap, referencing specific cost data files and identifying the computational steps necessary to transform the data within those files into geographically deaveraged costs and prices. Appendix C to Attachment A offers a specific example of a possible three-zone grouping with a breakpoint for the highest cost zone set at a level [ \$ ]<sup>8</sup> that will maximize in that group the number of loops that fall within the price category that is eligible for universal service

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<sup>7</sup> Specifically, a CLEC that provides such service through a combination of its own facilities and UNEs purchased from the ILEC, and assumes carrier of last resort obligations.

<sup>8</sup> Quoted dollar amount omitted.

support (assuming that revenues from basic service cover all of the forward-looking costs of the remaining components of universal service). Close coordination of unbundled loop pricing and universal service support is desirable both to avoid the kinds of discriminatory outcomes embodied in the draft decision and to ensure that there is no necessity to adopt *retail* price deaveraging.” (AT&T/ MCI WorldCom Opening Comments on the Draft Interim Decision at 9.)

For several reasons, the Commission chose not to consider the geographic deaveraging approach set forth in the attachment to the AT&T/MCI WorldCom comments. A fundamental reason was that the submission constituted new testimony, and none of the other parties had had an opportunity to comment on it or cross-examine the witnesses who advocated it. However, in refusing to consider AT&T’s and MCI’s approach on these procedural grounds, we also declined to render any opinion on its merit. (D.99-11-050, *mimeo.*, at 92, n. 85.)

#### **IV. Discussion**

While we institute this proceeding today much of the groundwork for it was, as stated above, laid some time ago. In a number of earlier proceedings, we have been confronted with the importance of geographic deaveraging to the realization of local exchange competition. Given the substantial amounts of data submitted in the OANAD record, the question repeatedly has arisen whether any measure of that data, properly updated, could be appropriately used to generate geographically deaveraged prices.

In their opening comments on the UNE pricing proposed decision, AT&T and MCI WorldCom asserted that the OANAD record contains data and methodologies that could be utilized to develop valid geographically deaveraged loop prices. They contended that the adopted statewide-average loop cost reflects an aggregation of underlying wire-center-by-wire-center costs. Moreover, they maintained that the same wire-center-by-wire-center data has essentially

already been used to develop the highly deaveraged costs that determine the size of the universal service California High Cost Fund-B (CHCF-B).

According to AT&T and MCI WorldCom, the OANAD record contains a description of a process for using Pacific's study inputs to produce valid wire-center-specific costs. AT&T and MCI WorldCom propose that with wire-center-specific costs, geographically deaveraged costs and prices can be produced by simply grouping wire centers in any desired configuration.

While the Commission has been mindful of the task of developing geographically deaveraged prices in accordance with the FCC's orders, we have delayed initiating the geographic deaveraging proceeding because of the necessity of completing other proceedings, such as the pricing of UNEs, the non-recurring cost phase of OANAD and the myriad numbering issues. The untested AT&T/MCI WorldCom proposal intrigues us in terms of the potential it offers for a focused and efficient proceeding. Therefore, we would like the parties to evaluate fully and address the AT&T/MCI WorldCom geographic deaveraging proposal and its underlying documentation. At the same time, we invite parties to present other proposals for how geographic deaveraging might be achieved. We will not, however, entertain the two geographic deaveraging proposals that we have previously seen and rejected, i.e., Pacific's "revenue zone" approach or zones based on any version of the Hatfield Model.

AT&T and MCI WorldCom have designated their latest proposal as proprietary in deference to the Pacific Bell cost data included. Therefore, we direct AT&T, MCI WorldCom and Pacific to work together promptly to develop whatever additional confidentiality agreements are necessary so that within the next ten days, any interested party may obtain a copy of the geographic deaveraging proposal that was appended to the June 4, 1999 AT&T/MCI

WorldCom joint comments to the draft interim decision in  
R.93-04-003/I.93-04-002.<sup>9</sup>

## **V. Category Determination and Preliminary Scoping Memo**

This investigation will be conducted in accordance with Article 2.5 of the Commission's Rules of Practice and Procedure (Rules). As required by Rule 6(c)(1), this order includes a category determination and a preliminary scoping memo.<sup>10</sup>

The scope of this investigation is to develop deaveraged UNE rates for Pacific Bell. Pacific's UNE rates will be deaveraged into three geographic zones.

Pursuant to Rule 6(c)(1), we determine the category of this investigation proceeding to be "ratesetting" as the term is defined in Rule 5(c).<sup>11</sup> We anticipate holding evidentiary hearings to examine disputed issues of fact.

The timetable for this proceeding is set forth in Appendix A. As a first step, interested parties shall file responses to this Order Instituting Investigation (OII) within 40 days of its issuance. As required by Rule 6(c)(1), any party filing a response to this OII shall state in the response any objections the party has regarding the need for hearings, the issues to be considered, or the schedule, as set forth in the order.

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<sup>9</sup> We assume that for most parties, the nondisclosure agreements they have already entered into in the OANAD proceeding are sufficiently broad to allow them such access.

<sup>10</sup> Rule 5(m) defines "scoping memo" as an order or ruling describing the issues to be considered in a proceeding and a timetable for resolving the proceeding.

<sup>11</sup> Pursuant to Rule 6(c)(1), the category the Commission assigns in an Order Instituting Investigation is appealable under the procedures in Rule 6.4.

Following review of the responses, the assigned ALJ will convene a Prehearing Conference (PHC) to discuss the issues, scope and schedule of this proceeding. After the PHC, the assigned Commissioner will issue a scoping memo that finalizes the schedule of this proceeding and the issues to be addressed. (Rules 6(c)(1) and 6.3).

Commissioner Carl Wood shall be the assigned Commissioner, and Burton Mattson shall be the assigned ALJ.

#### **VI. Service of this Order and Service List for Proceeding**

The OANAD docket has been used to develop TELRIC costs and prices for Pacific. Therefore, so that potentially interested parties are notified of this investigation to geographically deaverage those TELRIC-based rates, we will serve this order on the OANAD service list, R.93-04-003/I.93-04-002.

The Universal Service docket utilized the wire-center-by-wire-center data, put forth in the instant geographic deaveraging proposal, to develop the deaveraged costs that determine the size of the CHCF-B. Thus, so that we maximize the number of potentially interested parties that we inform, we will also serve this order on the service list of the Universal Service proceeding, R.95-01-020/I.95-01-021. Anyone wishing to be placed on the service list to this proceeding should notify the Process Office within 20 days after the issuance of this order. The assigned ALJ will issue a ruling establishing the service list for this proceeding and may revise and update the service list during the pendency of this proceeding, pursuant to Rule 2.3(f).

#### **IT IS ORDERED** that:

1. An investigation on the Commission's own motion into geographically deaveraging unbundled network element rates of Pacific Bell's (Pacific) is hereby instituted. Pacific is named a respondent to this investigation.

2. We direct all interested parties who wish to be included on the service list for this proceeding to send a letter within 20 days after the issuance of this order to the Commission's Process Office. Thereafter, the assigned Administrative Law Judge (ALJ) shall issue a ruling establishing a service list for this investigation.

3. AT&T Communications of California, Inc. (AT&T), MCI WorldCom and Pacific are directed to work together promptly to develop whatever confidentiality agreements are necessary so that within the next ten days, any interested party may obtain a copy of the geographic deaveraging proposal appended to AT&T's and MCI WorldCom's June 4, 1999 joint comments on the draft interim decision in Rulemaking (R.) 93-04-003/Investigation (I.) 93-04-002.

4. Pacific and interested parties shall file and serve their responses to this Order Instituting Investigation within 40 days from the date of issuance, in accordance with the Commission's rules for filing and serving documents.

5. As required by Rule 6(c)(1) of the Commission's Rules of Practice and Procedure, any party filing a response to this order shall state in the response any objections to (a) the determination of the need for an evidentiary hearing, and/or (b) the preliminary scope and timetable for this proceeding.

6. The assigned ALJ shall issue a Ruling setting a Prehearing Conference to discuss issues and the proposed schedule in the preliminary scoping memo. Following the PHC, the Assigned Commissioner will rule on the scoping memo, and make changes as appropriate.

7. The Executive Director shall serve this order on the respondent, Pacific Bell, and on the service lists for the Open Access and Network Architecture Development docket: R.93-04-003/I.93-04-002 and the Universal Service docket: R.95-01-020/I.95-01-021.

This order is effective today.

Dated March 2, 2000, at San Francisco, California.

RICHARD A. BILAS  
President  
HENRY M. DUQUE  
JOSIAH L. NEEPER  
CARL W. WOOD  
LORETTA M. LYNCH  
Commissioners

**APPENDIX A: PROPOSED SCHEDULE**

Day 1	Prehearing Conference
Day 20	Assigned Commissioner rules on preliminary scoping memo
Day 60	Discovery ends
Day 90	Concurrent Opening Testimony
Day 110	Concurrent Reply Testimony
Day 125-Day 133	Evidentiary Hearings
Day 173	Concurrent Opening Briefs
Day 187	Concurrent Reply Briefs
Day 267	ALJ issues draft decision

(END OF APPENDIX A)