BELLSOUTH

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May 24, 2002

VIA HAND DELIVERY

Mr. David Waddell, Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

Re: *Generic Docket to Consider Technology Advances and Geographic Deaveraging*
Docket No. 01-00339

Dear Mr. Waddell:

Enclosed please find the original and thirteen copies of BellSouth's Comments on Methodology for Geographic Deaveraging. A copy of the enclosed is being provided to counsel of record.

Very truly yours,

Guy M. Hicks

GMH/jej

Enclosure

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE: *Generic Docket to Consider Geographic Deaveraging*

Docket No. 01-00339

COMMENTS OF BELLSOUTH TELECOMMUNICATIONS, INC.
ON METHODOLOGY FOR GEOGRAPHIC DEAVERAGING

In accordance with the "Notice of Filing and Status Conference" issued by the Pre-Hearing Officer on April 24, 2002, BellSouth Telecommunications, Inc. ("BellSouth") respectfully proposes the continued use of the deaveraging methodology that BellSouth proposed in Docket No. 97-01262 on April 14, 2000. As more fully explained below, this deaveraging methodology has been in effect for some eighteen months, and competition has flourished under this methodology. BellSouth, therefore, respectfully submits that the Tennessee Regulatory Authority ("TRA") should adopt this methodology on a permanent basis in this docket.

A. The Deaveraging Methodology Being Used Today has Been in Effect for Eighteen Months, and Competition has Flourished Under this Methodology.

BellSouth filed a Deaveraging Proposal in Docket No. 97-01262 on April 14, 2000.[1] BellSouth's proposed methodology provided, in pertinent part, that:

> The recurring cost of the local loop is the only network element that should be deaveraged;[2] (Proposal at 2);
>
> Existing local exchange rate groups should be mapped into Zone 1 consisting of Rate Groups 4 and 5, Zone 2 consisting of Rate Group 3, and Zone 3 consisting of Rate Groups 1 and 2 (Proposal at 4);

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[1] *See* BellSouth Telecommunications, Inc.'s Deaveraging Proposal, *In Re: Petition of BellSouth Telecom. Inc. to Convene a Contested Case to Establish "Permanent Prices" for Interconnection and Unbundled Network Elements*, Docket No. 97-01262 ("Proposal") (April 14, 2000). Attachment A to these Comments is a copy of this Proposal.

[2] BellSouth also uses this methodology to deaverage rates for unbundled loops and local channels below the DS3 level (including sub-loops and combinations involving these elements) in Tennessee.

The following ratios of the average monthly cost per loop in each zone to the state average should be adopted: 88.42% for Zone 1; 115.48% for Zone 2; and 151.00% for Zone 3 (Proposal at 5); and

These ratios should be applied to the proxy loop price approved by the Authority in Dockets No. 96-01152 and 96-01271 to determine the deaveraged proxy prices. (Proposal at 5).

By Order dated November 22, 2000, the TRA ruled that "BellSouth's proposed deaveraged UNE proxy prices for three (3) geographic zones should be adopted until such time as the Authority adopts deaveraged rates for the permanent UNE loop prices," and the TRA adopted proxy rates for the UNE loop of "$15.92 for zone 1, $20.79 for zone two, and $27.18 for zone three."[3] Subsequently, the TRA ordered BellSouth "to continue using the interim methodology to deaverage loop rates . . . ."[4]

BellSouth's deaveraging methodology, therefore, has been in effect for at least eighteen months. During that time, competition has flourished. As the TRA informed the General Assembly, "[o]n June 30, 2001, new market entrants had invested $489 million in equipment and facilities in Tennessee since the passage of [the state Telecommunications Act of 1995 and the federal Telecommunications Act of 1996]." *See* Annual Report of the Tennessee Regulatory Authority for the Period July 1, 2000 to June 30, 2001 at page 36. In that same report, the TRA informed the General Assembly that "28 competitors serve 335,598 lines in Tennessee, primarily business customers in the State's four (4) largest metropolitan areas." *Id.* This represents "10%

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[3] *See* Second Interim Order Re: Revised Cost Studies and Geographic Deaveraging, *In Re: Petition of BellSouth Telecom. Inc. to Convene a Contested Case to Establish "Permanent Prices" for Interconnection and Unbundled Network Elements*, Docket No. 97-01262 at 10 (November 22, 2000). These proxy rates for the UNE loop that were adopted in this Order are the same rates that BellSouth proposed in its Deaveraging Proposal. *See* Proposal at 5.

[4] *See* Third Interim Order Re: BellSouth's Revised Cost Studies, In Re: Petition of BellSouth Telecom. Inc. to Convene a Contested Case to Establish "Permanent Prices" for Interconnection and Unbundled Network Elements, Docket No. 97-01262 at 7 (January 4, 2001).

of Tennessee's *total* lines open to competition and *28% of the business lines subject to competition.*" *Id.* (emphasis added). As the TRA's Report correctly notes, "Tennesseans are seeing significant competitive activity in the business segments of the local telecommunications markets . . . ." *Id.*

The deaveraging methodology that is being used today clearly provides CLECs a meaningful opportunity to compete, and there is no reason for the TRA to discard this tried and true methodology for a new and unproven one.

B. The Deaveraging Methodology Being Used Today Complies with the FCC's Rules.

The FCC's rules require state commissions to establish different rates for unbundled network elements in at least three cost-related rate zones within the state to reflect geographic cost differences. 47 C.F.R. § 51.507(f). The rules, however, give state commissions considerable latitude in determining how deaveraging should be accomplished. FCC Rule 51.507(f)(1), for example, specifically grants state commissions the ability to establish geographically deaveraged prices using "existing density-related zone pricing plans described in § 69.123 [Special Access and Switched Transport] of this chapter, or *other such cost-related zone plans established pursuant to state law.*" (emphasis added). Clearly, the FCC agreed that geographic zones that exist for retail services (such as the five rate groups in Tennessee) are a proper basis for establishing deaveraged unbundled network element rates. Alternatively, the state commission must create a minimum of three "cost-related rate zones." 47 C.F.R. § 51.507(f)(2).

Moreover, contrary to arguments CLECs have raised in proceedings before other state commissions, the fact that retail rates were established using a rate group structure does not create non-cost based deaveraged UNE rates in violation of FCC Rule 51.505(d). BellSouth

used its existing rate groups to establish the zones to which the deaveraged unbundled network element rates apply. BellSouth's deaveraging methodology, however, does *not* include any costs associated with offering retail telecommunications services, nor are BellSouth's retail service rates or revenues included in any of the cost development to establish deaveraged prices.

C. The Deaveraging Methodology Being Used Today Appropriately Deaverages Only the Recurring Rates for Unbundled Loops and Local Channels Below the DS3 Level.

The existing methodology deaverages only the recurring rates for unbundled loops and local channels below the DS3 level (including sub-loops and combinations involving these elements), and these are the only unbundled network elements for which rates should be geographically deaveraged. Costs for loops and local channels at the level of a DS3 or higher are developed on a per mile basis and, therefore, rates for these elements do not require further deaveraging. Other UNEs either do not display the same level of cost variation by geographic location or have price structures that already account for geographic cost differences.

Switching, for example, does not vary significantly by geographic location, and none of the factors that make the loop cost vary are present with respect to switching cost calculations. The physical characteristics of a loop and the placement costs associated with that loop vary by geographic location due to cable type (aerial, buried or underground) and distance (length). These types of factors, however, do not impact switching costs. Another influence on loop costs, customer density, also has little impact on switching costs because the modularity of digital switching equipment allows BellSouth to grow switches as demand dictates. Also, remote switching entities can be deployed to serve pockets of customers.

Additionally, switching cannot be viewed in the same manner as local loops because logically one cannot isolate one switch from the network. The switch is a part of a total

integrated network designed to handle a call from the originating switch entity to the terminating switch entity. To segment individual switches based on individual cost differences ignores the interdependencies between switch entities. This is clearly a problem for remote switches that are dependent on a host switch for interoffice call processing. The variation in switching costs between wire centers does not warrant the geographic deaveraging of switch-based elements.

The other costs of unbundled network elements may vary by geographic location, but these cost differences are reflected in the rate structure, thus eliminating the need for deaveraging. For example, the rate structure for interoffice transport is on a per mile basis and, therefore, already accounts for geographic variation. Thus, there is no reason to include interoffice transport in the deaveraging scheme. Of course, some of the physical attributes of the interoffice route will impact the costs just as they do in the loop (e.g. the type of placement). Because the cost is expressed on a per unit (mile) basis, however, these differences are negligible.

D. The Deaveraging Methodology Being Used Today Appropriately Creates Three Zones.

In proceedings before public service commissions in other states, CLECs have argued that anywhere from five to ten zones should be used for deaveraging purposes. The TRA should reject any such arguments that may be proffered in this docket and continue to use three zones for deaveraging purposes. The more zones that are used, the higher the deaveraged UNE rates in the highest-cost, most rural zones become. Deaveraging based upon more than three zones, therefore, would only decrease the likelihood that customers in high cost zones will enjoy competitive alternatives, and it would provide a windfall to CLECs serving customers in the lowest cost zones, which explains the impetus for CLEC proposals for up to ten zones in other states.

E. The TRA Should Reject Any Proposal to Create Zones on the Basis of Wire Centers Rather than Rate Groups or to Create More than Three Zones.

As explained above, the deaveraging methodology that has been in place in Tennessee for the last eighteen months deaverages rates in three geographic areas utilizing existing BellSouth rate groups. The TRA should reject any proposal to discard this methodology for one that creates zones utilizing wire centers. Under the existing deaveraging methodology, customers that are located in the same geographic area and that have similar calling areas would be in the same deaveraged zone for unbundled network element pricing. Utilizing existing rate groups as the basis for establishing the three cost-related rate zones, therefore, results in consistent prices for customers within the same geographic markets.

Moreover, defining three geographic zones by rate groups provides consistency between the structure of BellSouth's retail services, resale and unbundled network element prices. The need for such consistency should be obvious, because CLECs use unbundled network elements to compete with services offered at retail by BellSouth. Unlike prices for unbundled network elements, BellSouth's rates for basic service were established in an inverse relationship to cost in order to ensure affordable local service for all urban and rural customers. As a result, deaveraging of unbundled network elements will result in rates that vary in the opposite direction from the prices for BellSouth's retail services. Although rebalancing retail rates in a manner that results in retail rates that vary in the same direction as rates for UNEs is the most logical and effective means of addressing this problem, deaveraging utilizing existing rate groups would ameliorate this problem to some extent.

Deaveraging by rate groups clearly is preferable to the deaveraging methodology that CLECs have proposed in several other states, by which the cost of a UNE within a geographically defined area should not vary by more than twenty percent, plus or minus, of the

average price of the UNE in that area. For one thing, the methodology that has been proposed by the CLECs has resulted in up to ten zones in a given state. Such a cumbersome methodology clearly would be difficult to administer. Moreover, such a methodology easily could result in a CLEC having to pay different loop rates in order to serve customers that live across the street from one another simply because the customers are served from different wire centers. Such inconsistency is significantly less likely to occur when deaveraged pricing zones are established based on rate groups.

Additionally, as noted above, the more zones that are used in a deaveraging methodology, the higher the deaveraged UNE rates in the highest-cost, most rural zones become and the lower the deaveraged UNE rates in the lowest-cost, most urban zones become. Reducing prices for unbundled network elements in the lowest-cost zones, however, does not translate into increased competition or lower consumer prices in those areas. The UNE rates that have resulted from the deaveraging methodology that is in place today already have allowed CLECs to successfully target business customers in the lowest-cost zones. Increasing the number of zones used in a deaveraging methodology will only provide additional margin for CLECs in the lowest cost zones.

At the same time, increasing the number of zones used in a deaveraging methodology would increase the rates for unbundled network elements in the highest-cost zones (where CLECs have chosen to compete only sparingly). That certainly will do nothing to promote competition in those areas. If a CLEC is not currently competing in the highest-cost areas by purchasing unbundled network elements at rates resulting from a three-zone deaveraging methodology, why would that CLEC choose to begin competing in those areas by purchasing unbundled network elements at the higher rates that would result from a five-zone or ten-zone

deaveraging methodology? Clearly, adopting a deaveraging methodology that uses more than three zones will do nothing to increase competition in either the low-cost areas of the state or in the high-cost areas of the state.

CONCLUSION

In short, the deaveraging methodology that is being used today is consistent with the FCC's rules and promotes local competition, given the existing retail rate structure and levels. The TRA, therefore, should adopt the methodology that is being used today on a permanent basis in this docket.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 24, 2002, a copy of the foregoing document was served on the parties of record, via the method indicated:

[ ] Hand
[X] Mail
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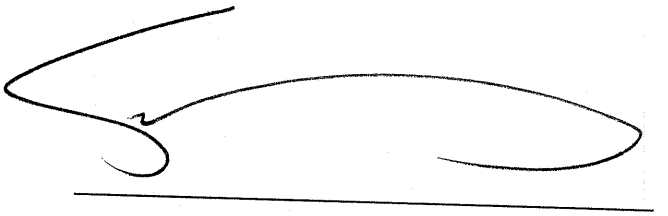

ATTACHMENT "A"

BEFORE THE TENNESSEE REGULATORY AUTHORITY
Nashville, Tennessee

In Re: ***Contested Cost Proceeding to Establish Final Cost Based Rates for Interconnection and Unbundled Network Elements***

Docket No. 97-01262

BELLSOUTH TELECOMMUNICATIONS, INC.'S DEAVERAGING PROPOSAL

I. INTRODUCTION

Pursuant to the April 10, 2000 Notice of the Tennessee Regulatory Authority ("Authority"), BellSouth Telecommunications, Inc. ("BellSouth") respectfully submits its proposal for geographic deaveraging of the proxy prices adopted by the Authority in Dockets No. 96-01152 and 96-01271. As outlined in greater detail below, BellSouth proposes that the Authority deaverage the proxy prices for the local loop based upon established rate groups.

II. DISCUSSION

A. Which Network Elements Should Be Deaveraged?

Federal Communication Commission ("FCC") Rule 51.507(f) requires state commissions to establish different prices for unbundled network elements in at least three cost-related zones within the state to reflect geographic cost differences. 47 C.F.R. § 51.507(f). The FCC stayed the effectiveness of this rule until six months after the FCC implemented high-cost universal service support for non-rural local exchange carriers ("LECs"). With the November 2, 1999 release of the FCC's order in CC Docket No. 96-46, the stay of Rule 51.507(f) will be lifted effective May 1, 2000. As such, state commissions are required to deaverage prices for unbundled network elements to the extent they exhibit geographic cost differences.

There is no dispute that the recurring cost of an unbundled loop varies by geographic location. However, other unbundled network elements either do not display the same level of cost variation by geographic location or have price structures that already account for geographic cost differences. Thus, BellSouth believes that the recurring cost of the local loop is the only network element that should be deaveraged in this proceeding.

For example, switching does not vary significantly by geographic location. None of the factors that make the loop cost vary are present with respect to switching cost calculations. The physical characteristics of the loop and the placement costs associated with that loop vary by geographic location due to weather, terrain, and distance. However, these factors do not impact switching costs to any great degree. Another factor -- customer density -- also has little impact on switching costs since the modularity of digital switching equipment allows LECs to grow switches as demand dictates. Also, remote switch entities can be deployed to serve pockets of customers. There is one factor that does contribute to the variation in switching costs – namely, the vendor, since the two dominant switch vendors, Lucent and Nortel, have different switch architectures. The result is that the distribution between traffic-sensitive ($/Minute of Use) and non-traffic-sensitive (port) costs differs purely because of this difference in vendor architecture, not due to any geographic difference.

Additionally, switching cannot be viewed in the same manner as local loops because logically one cannot isolate one switch from the network. The switch is a part of a total integrated network. To segment individual switches based on individual cost differences ignores the interdependencies between switch entities. This is clearly a problem for remote switches that are dependent on a host switch for a number of functions including interoffice call processing, access to 911, operator functions, and features such as Caller ID.

The cost of other unbundled network elements may vary by geographic location, but these cost differences are reflected in existing rate structures without the need for deaveraging. An example is interoffice transport. The rate structure for interoffice transport is on per mile basis. Unlike the recurring cost of an unbundled loop, which does vary by geographic location, the rate structure for interoffice transport already accounts for geographic differences by eliminating length from the equation. Thus, there is no reason to include interoffice transport in the deaveraging scheme. Of course, some of the physical attributes of the interoffice route will impact the costs just as they do in the loop, e.g., the type of placement. However, because the cost is expressed on a per unit (mile) basis, these differences are negligible.

Every state commission in BellSouth's region that to date has established deaveraged rates for unbundled network elements has done so only with respect to loops (and certain combinations involving the loop). *See, e.g.,* Order Adopting Joint Stipulation for Deaveraged UNE Rates, *In re: Review of Cost Studies, Methodologies, and Cost-Based Rates for Interconnection and Unbundling of BellSouth Telecommunications Services,* Docket No. 7061-U (Ga. Public Service Comm'n April 4, 2000) (approving stipulation to deaverage recurring rates for unbundled loops and certain UNE combinations involving the loop); Order, *In re: An Inquiry Into the Development of Deaveraged Rates For Unbundled Network Elements*, Administrative Case No. 382 (Ky. Public Service Comm'n March 24, 2000) (same).

B. How Should Prices Be Deaveraged?

BellSouth proposes that the appropriate basis for deaveraging loop prices is the market conditions which exist within each of the designated geographic areas. The concept is that prices should vary when there are significant cost or market variations. While statewide averaged loop prices currently exist in Tennessee, the purpose of deaveraging is to better reflect differences that exist among the geographic areas.

Geographic differences and end-user markets should be used as the criteria to assign the existing local exchange rate groups into zones. Rate group costs tend to follow the zoning methodology. Typically, on a loop cost basis, Zone 1 rate groups have costs less than 100% of the statewide average cost, Zone 2 costs are between 100% and 150% of the average and Zone 3 represents costs greater than 150% of the statewide average. BellSouth proposes that the existing local exchange rate groups be mapped into the following three zones:

Primary Metropolitan Areas – (e.g., Nashville, Knoxville)

Rate Groups Four and Five (4, 5) = Zone 1

Secondary Metropolitan Areas – (e.g., Clarksville, Jackson)

Rate Group Three (3) = Zone 2

Non-metropolitan Areas – (e.g., Columbia, Cumberland City)

Rate Groups One and Two (1, 2) = Zone 3

Once the existing rate groups are mapped to each of the three zones, it is necessary to determine the ratio of the average monthly cost per loop in each zone to the state average. This process can be accomplished by using the FCC's Hybrid Cost Proxy Model ("HCPM") and the national inputs as proposed by the FCC for this analysis. In its Ninth Report and Order; Forward-Looking Mechanism for High Cost Support for Non-Rural Carriers (Dockets 96-45 and 97-160), the FCC selected the HCPM as the "model of choice" for use in determining high cost universal service support. In its Tenth Report and order in those same dockets, the FCC further defined input values for use in the HCPM.[1]

[1] Use of the HCPM should not be construed as BellSouth's endorsement of the model, its output results, or the input values, particularly with respect to determining the cost of unbundled network elements. However, use of the HCPM with FCC-ordered input values should be the least contentious method of deaveraging statewide loop rates in Tennessee and thus, should expedite the process, particularly since deaveraged rates must be in place by May 1, 2000.

By using HCPM, BellSouth determined the following ratios:

Zone 1 (Rate Groups 4, 5)	88.42% of statewide average
Zone 2 (Rate Group 3)	115.48% of statewide average
Zone 3 (Rate Groups 1, 2)	151.00% of statewide average

These ratios are then applied to the proxy loop price ($18.00) approved by the Authority in Dockets No. 96-01152 and 96-01271, which results in the following deaveraged proxy prices:

	Proxy* Statewide Rate	Zone 1	Zone 2	Zone 3
Unbundled Loop (Recurring Rates)		88.42%	115.48%	151.00%
2-wire analog voice grade loop -	**$ 18.00**	$ 15.92	$ 20.79	$ 27.18
4-wire analog voice grade loop	**$ 18.00**	$ 15.92	$ 20.79	$ 27.18
2-wire ISDN digital grade loop	**$ 18.00**	$ 15.92	$ 20.79	$ 27.18
Zone Make-up				
Zone 1 (RG4-5) = Nashville, Knoxville				
Zone 2 (RG3) = Clarksville, Jackson				
Zone 3 (RG1-2) = Columbia, Cumberland City				
***Statewide rates from orders in Dockets No. 96-01152 and 96-01271. (AT&T and MCI Arbitrations)**				

The FCC's geographic deaveraging rule gives the Authority discretion in defining geographic areas within the State of Tennessee to reflect geographic cost differences. *See* 47 CFR § 51.507(f)(1) (in establishing geographically-deaveraged rates, state commissions "may use existing density-related zone pricing plans" or "other such cost-related zone plans established pursuant to state law"). In exercising its discretion under the Telecommunications Act of 1996, the Authority must always "remain focused on the long term interests" of the citizens of Tennessee. *See MCI Telecommunications Corp. v. BellSouth Telecommunications, Inc.*, 40 F. Supp. 2d 416, 424 (E.D. Ky. 1999) (affirming Kentucky Commission's refusal to establish geographically deaveraged rates prior to Rule 51.507(f) taking effect, holding that the Kentucky Commission's "effort to prevent new entrants from seeking the lowest possible overhead to serve the most lucrative customers" was lawful).

BellSouth's proposal that rates be geographically deaveraged based upon established rate groups is consistent with this public interest approach. Deaveraging based upon rate groups would provide more competitive choices to a greater number of customers, including those in rural areas, by recognizing the relationship between retail telephone rates in Tennessee and the cost of unbundled network elements. At least one federal district court has recognized such a relationship when it upheld the Kentucky Commission's decision to defer the consideration of deaveraged costs to subsequent universal service proceedings. *See Id.* Other state commissions have as well in establishing deaveraged loop rates based upon existing rate groups. *See, e.g., in re: Sprint Communications Companies, L.P.'s Petition for Arbitration of Interconnection Rates, Terms, Conditions and Related Arrangements With GTE Midwest, Inc.*, 176 P.U.R. 4th 285 (MO Pub. Service Comm'n, Jan. 15, 1997) (finding it appropriate "to set geographically deaveraged interim rates for unbundled loops, with the rates deaveraged into four zones based upon GTE's existing rate groups").

The Authority should decline any invitation to deaverage loop rates based upon wire centers, which will only ensure lower loop rates in the metropolitan areas at the expense of competition in rural areas. Deaveraging based upon wire centers poses other difficulties as well. For example, it could result in a competing local exchange carrier ("CLEC") having to pay different loop rates in order to serve customers that live across the street from one another simply because the customers are served from different wire centers. This could result in the dissimilar treatment of customers who are similarly situated in all respects (except for the location of their serving wire center).

CLECs understandably desire to obtain as low a loop rate as possible in those areas where they are competing, which, for the overwhelming part, has been the metropolitan areas in Tennessee. However, this desire does not outweigh the Authority's obligation to "promote

competition" and "secure lower prices and higher quality services" for all Tennessee telecommunications consumers, including those who live in rural areas in the State. H. Rep. No. 104-204, 1 (July 24, 1995). Deaveraging rates for unbundled network elements by rate groups is consistent with that obligation, which cannot be said about deaveraging based upon wire centers.

III. CONCLUSION

Utilizing local exchange rate groups to deaverage loop prices meets the requirements set forth by the FCC and provides consistency between the structure of BellSouth's retail, resale and prices for unbundled network elements. As such, end-users with similar calling areas and located in the same geographic region will be in the same deaveraged zone for loop pricing purposes. Furthermore, using existing rate groups as the basis for establishing pricing zones results in a more balanced pricing structure for unbundled network elements. Accordingly, the Authority should adopt BellSouth's proposal to deaverage the proxy price for the local loop based upon established rate groups.

Respectfully submitted this 14th day of April, 2000.

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