BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

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| In the Matter of the Nebraska Public Service Commission, on its own motion to make adjustments to the universal service fund mechanism established in NUSF-26. | Application No. NUSF-50<br>Progression Order No. 3 |
| In the Matter of the Nebraska Public Service Commission, on its own motion, seeking to investigate whether the zones established in Docket C-2516 are appropriate in light of NUSF-26 findings and conclusions. | Application No. C-3554/PI-112<br><br>ORDER<br><br>Entered: October 10, 2007 |

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BY THE COMMISSION:

O P I N I O N   A N D   F I N D I N G S

On February 28, 2006, the Nebraska Public Service Commission (Commission) opened the above-captioned proceedings to investigate whether the zones established in Docket C-2516 are appropriate in light of the NUSF-26 findings and conclusions and to make adjustments to the universal service fund mechanism established in NUSF-26 relative to the porting of Nebraska universal service fund support. Notice of the application was published in the Daily Record, Omaha, Nebraska, on March 2, 2006. Written comments were filed by Embarq Corporation (Embarq), the Rural Independent Companies (RIC), and Windstream Communications (Windstream) on April 17, 2007. Testimony was filed by Qwest Corporation (Qwest), Nebraska Telecommunications and Technology, Inc. (NT&T), Allo Communications, LLC (Allo), and the Commission Staff (Staff). A hearing was held in Lincoln, Nebraska, on May 1, 2007, with appearances shown above.

## I. Background

In 2002, the Commission established rates for unbundled network elements in Docket C-2516/PI-49.[1] Consistent with federal law, the Commission's rates were based on total element long-run incremental costs (TELRIC). Three economic cost models were used by the Commission for the development of the TELRIC compliant rates: Hatfield (HAI), the Hybrid Cost Proxy Model (HCPM) and the Benchmark Cost Proxy Model (BCPM).[2] The Commission then grouped wire centers with similar cost characteristics into three zones.[3] The zones were created in order to fulfill the federal requirement for all state commissions to geographically deaverage rates into at least three cost based zones.[4] The parties specifically agreed in Docket C-2516/PI-49 that the

[1] *See* Docket C-2516/PI-49, *In the Matter of the Commission, on its own Motion, to Investigate Cost Studies to Establish Qwest Corporation's Rates for Interconnection, Unbundled Network Elements, Transport and Termination and Resale*, Findings and Conclusions (April 23, 2002)("C-2516").
[2] *See id.*
[3] *See id.*
[4] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 F.C.C.R. 15,499, 15,882, ¶ 764 (1996)("Local Competition Order") *rev'd in part and vac'd in part on other grounds see Verizon v. FCC*, 535 US 476, 122 S.Ct. 1646 (2002); *see also* 47 C.F.R. § 51.507(f).

Commission should deaverage only loop rates as the UNE loop was the most significant cost driver of the TELRIC based network.[5] The Commission used statistical clustering analysis to group wire centers into the three zones.[6] The Commission took an average of all the wire centers that were clustered into a zone, resulting in zone UNE loop rates.[7] The three zones were developed for Qwest, then US West, wire centers only.

After the Commission adopted UNE rates in Docket C-2516/PI-49, Qwest Corporation filed a request to voluntarily reduce UNE rates.[8] At that time, Qwest Corporation was seeking Federal Communications Commission (FCC) approval to provide in-region long distance telecommunications service via the section 271 mechanism in the Telecommunications Act of 1996 (the Act). The Commission subsequently made those reduced rates effective. No party challenged the Commission's findings in Docket C-2516/PI-49 or the rates that subsequently were made effective.[9]

As a result of the deaveraging process in C-2516, competitive carriers leasing UNE loops from Qwest pay three different rates depending on whether the customer is located in zone 1, 2, or 3. In zone 3, competitive local exchange carriers (CLECs) are charged sixty-two dollars and forty-nine cents ($62.49) for a UNE loop regardless of whether the customer was in a town or city, close to a central office, or in a sparsely populated unincorporated area.

In 2004, the Commission established a long-term universal service funding mechanism for high-cost support.[10] The high-cost support mechanism targets funding to those areas where support is needed most. Those areas, the Commission concluded are rural, out-of-town areas of Nebraska. Accordingly, the Commission combined loop density and cost information from a TELRIC compliant cost model with household census data to target support to the out-of-town residential areas.[11] No party challenged the Commission's findings in NUSF-26.

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[5] *See C-2516.*
[6] *See id.*
[7] *See id.*
[8] *See* Docket C-2516/PI-49, In the Matter of the Commission, on its own Motion, to Investigate Cost Studies to Establish Qwest Corporation's Rates for Interconnection, Unbundled Network Elements, Transport and Termination and Resale, Compliance Filing Approved In Part And Denied In Part & Other Rates Declared Effective (June 5, 2002).
[9] *See id.*
[10] *See* Docket NUSF-26, *In the Matter of the Commission, on its own motion, Seeking to Establish a Long-term Universal Service Funding Mechanism, Findings and Conclusions* (November 3, 2004)("NUSF-26 Findings and Conclusions Order").
[11] *See id.*

In that proceeding, the Commission also addressed how the porting of support from an ILEC to a CLEC should be structured. Specifically, the Commission found,

> Therefore, the rates used to calculate the monies to be ported from ILEC to CNETC during the post NUSF-26 transition period will be as follows: Zone One residential: $0.57, Zone Two residential: $20.35, Zone Three residential $69.59. Support should continue to be ported based upon the total support amount from the ILEC to the providing CNETC on a dollar-for-dollar basis.[12]

In addition, the Commission found as a general matter, it would no longer port support for business lines. The Commission adopted a hold harmless provision during the 5-year post NUSF-26 transition period.[13]

As a consequence of Docket C-2516 (and the rate that became effective) and the NUSF-26 Findings and Conclusions Order, CLECs are charged $62.49 by Qwest for an in-town UNE loop designated as a zone 3 area, and no longer receive an offset of high-cost state universal service fund support. Meanwhile Qwest charged single line residential customers $18.15.[14] Certain CLECs requested the Commission modify its findings relative to porting support for business lines and requested the Commission re-evaluate the UNE loop rates in the three zones in light of the Commission's findings relative to high-cost lines in the NUSF-26 Findings and Conclusions Order.[15]

In Docket C-3554, the Staff released a methodology to further deaverage the three zones into six zones. Comments were filed May 3, 2006 and reply comments were filed on May 26, 2006. In NUSF-50, the Staff released a porting proposal. The Staff's porting proposal was released for comment on February 28, 2006 and comments were received on May 25, 2006. Then, on February 13, 2007, the Staff released its deaveraging and porting proposal in a combined document for comment. As an alternative, the Staff also proposed deaveraging the three zones into four zones.

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[12] NUSF-26 Findings and Conclusions Order ¶ 27.
[13] *See id.,* ¶ 29.
[14] *See* Qwest Exchange Tariff section 5.2.4 (Effective date 1-1-2005).
[15] *See* C-3448/NUSF-46 *In the Matter of the Joint Petition of Allo Communications, Imperial, L.L.C., Mobius Communications Company, Hemingford, and Pinpoint Communications, Inc., Cambridge, for a Docket to Investigate findings and conclusions under C-2516 and NUSF-26 Regarding Competitive Business Telecommunications Services* (Joint Petition filed July 15, 2005).

Significant to this proceeding, instead of using zones developed at a wire center level to determine cost differences, the Staff proposed utilizing in-town versus out-of-town breakpoints similar to the methodology used in the NUSF-26 Findings and Conclusions Order. To support this deaveraging proposal the Staff argued that geographic cost deaveraging should account for the cost differences on a more targeted basis which looks at cost breakpoints below a wire center level. For background purposes, the in-town and out-of-town breakpoints were described in great detail in the Commission’s NUSF-26 proceeding and were approved by the Commission in that docket. The Commission’s NUSF-26 distribution model which uses in-town and out-of-town variations to determine support is a matter of public record and the model is accessible via the Commission’s website.

**II. Motion to Strike**

By motion filed April 26, 2007, and renewed at the hearing, the Staff argues the Commission should strike the testimony of Qwest’s witnesses. The Staff argues the testimony filed by Peter Copeland and William Fitzsimmons goes beyond the scope of the proceeding and collaterally attacks a final order of the Commission. Mr. Copeland contends in testimony that Qwest’s costs have increased and that the Commission must increase the rates adopted and made effective in C-2516. Dr. Fitzsimmon’s testimony challenges the Commission’s long-term funding mechanism adopted by the Commission in the NUSF-26 Findings and Conclusions Order. The Staff argues that Dr. Fitzsimmons raises concerns that were already raised, considered and rejected in the NUSF-26 proceedings.

Upon consideration of the Motion to Strike, the Commission is of the opinion and finds that the testimony should be accepted into the record and given the weight that it deserves. Portions of the testimony filed by Dr. Fitzsimmons do indeed seem to challenge and re-hash the arguments made in the NUSF-26 proceeding. Those arguments go beyond the scope of this docket. Accordingly, the Commission will give little weight to those arguments which challenge the Commission’s final order in that proceeding.

In addition, if Qwest would like the Commission to revisit the UNE rates established in Docket C-2516, Qwest should file a request for the Commission to open a proceeding to determine whether the rates established in Docket C-2516 should be reviewed in light of alleged rising costs, evolution in technology, increases in competition and other market changes.

For the purposes of this proceeding, however, the Commission finds it appropriate to utilize the rates which became effective and are still in effect from the Docket C-2516 as a baseline for the deaveraging of loop rates into an appropriate number of zones.

## III. Analysis

*Legal Standard*

All parties agreed that the rates established must be TELRIC compliant. Section 252(d)(1)(A)(I) requires that rates be “based on the cost . . . of providing . . . the network element.” The FCC rules define “just and reasonable rates” to be those rates established pursuant to TELRIC principles 47 CFR §§ 51.503(b)(1), 51.505(a). However, the parties dispute whether the Staff’s proposal meets the legal criteria.

The Staff, Allo and NT&T all argue the Staff’s deaveraging proposal is consistent with TELRIC principles and is based on forward-looking, cost-based rates. The Staff deaveraging proposal (the Unifying Method) begins with the current TELRIC cost-based rates for the three zones established in Docket C-2516.[16] The rate in each zone is then multiplied by the total number of residential access lines in each zone to determine the total TELRIC cost by zone.[17] The results of the TELRIC compliant regression analysis are used to allocate the costs between high-cost, out-of-town areas and low-cost, in-town areas.[18] Because the Staff begins with already established TELRIC rates and uses regression results from a TELRIC model to further deaverage those TELRIC rates, the Staff, Allo and NT&T argue the Staff proposal meets Section 252(d)(1)(A)(I).

Qwest argues the Staff’s deaveraging proposal fails to meet the legal criteria because it is a statistical attempt to allocate the results of cost models rather than employment of a cost study to determine the absolute loop cost for in-town and out-of-town areas.[19] Embarq states that the Staff deaveraging proposal “appears to only loosely adhere to TELRIC principles, if it does so at all.”[20]

[16] We note that all Qwest access lines were included in the cost docket to develop the TELRIC compliant rate not just residential lines.
[17] See Transcript (Tr.) 12:3-7; *see also* Direct Testimony of Tyler Frost (April 17, 2007) at 3.
[18] Tr. 12:11-19.
[19] Qwest Corporation’s Post-Hearing Brief (filed May 30, 2007) at 10 (“Qwest Brief”).
[20] Post-Hearing Brief of Embarq (filed May 30, 2007) at 2(“Embarq Brief”).

Based on the testimony and arguments presented, the Commission is of the opinion and finds the Staff deaveraging proposal meets the legal criteria of the 1996 Act and FCC rules regarding TELRIC pricing as the proposal is modified by the Commission herein. All parties agreed that the underlying rates utilized from Docket C-2516 were TELRIC compliant. The UNE loop rates in zone 1, 2 and 3 were derived from three economic cost models designed to arrive at TELRIC compliant rates. Although Qwest voluntarily reduced the rates established by the Commission, all parties agreed that the effective rates were TELRIC-based.[21] In addition, the FCC endorsed the rates as being TELRIC based when it issued its order granting §271 approval to Qwest. The cost models used to set the UNE rates were transparent, verifiable and explained with specificity. Thus, the rates established for UNE loops in Docket C-2516 adhered to TELRIC principles.

The Staff proposal seeks to take the effective TELRIC compliant rates and further deaverage those rates based on geographic cost differences. 47 CFR §51.507(f) provides:

> (f) 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 rate zones.

The Commission finds the Staff deaveraging proposal recognizes that it costs more to provide local exchange service in rural areas than in non-rural areas. Therefore, rates across areas should be deaveraged.[22]

Clearly, the FCC acknowledged that service within a rural area of a state may cost more to provide than in a non-rural area in that state. In its Local Competition Order, the FCC delegated to state commissions the ability to determine how to establish geographic zones reflecting different cost

[21] Tr. 165-166 and 171:3-10

[22] *See MCI Worldcom Communications, Inc. v. Bellsouth Telecommunications Inc.*, 446 F.3d 1164, 1176 (11th Cir. 2006)(citing to the Local Competition Order).

characteristics. The FCC requires state commissions to establish at least three cost-related rate zones. However, a state commission "may establish more than three zones where cost differences in geographic regions are such that it finds that additional zones are needed to adequately reflect the costs of interconnection and access to unbundled elements."[23] The Commission possesses broad discretion to decide whether the zones should be based on these rural/non-rural distinctions and based on population density.

In addition, nothing in the FCC rules regarding TELRIC pricing and deaveraging forbids state commissions from deaveraging at a sub-wire center level. Qwest argues the underlying cost models were not developed to price UNEs on a sub-wire center basis. In contrast, the Staff points out that by Qwest's admission, the BCPM model designs plant to serve customers at a sub-wire center level and only in its final steps aggregates costs to the wire center level. The Staff further argues that the method for disaggregation of costs at the sub-wire center level is TELRIC compliant. It uses regression results from a TELRIC compliant model and uses them to disaggregate TELRIC compliant zone rates. We agree with the Staff that its deaveraging proposal simply deaverages the TELRIC compliant rates established in Docket C-2516 into areas below the wire center level which does not endanger the validity of the TELRIC characteristics of the models upon which the rates are based.[24] We agree with Dr. Rosenbaum's statement that the starting point of the Staff's deaveraging proposal was TELRIC based and the method of allocation is TELRIC compliant.[25]

*Statistical Reasonableness of the Staff Deaveraging Proposal*

The Staff through Dr. Rosenbaum's testimony asserts that the deaveraging methodology is statistically reasonable.[26] Dr. Rosenbaum points out the density-based regression results explain approximately 80 percent[27] of the variation in the underlying data. He also confirms that a variety of statistical tests establish a clear relationship between cost and density.[28]

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[23] Local Competition Order ¶ 765.
[24] While Qwest warns the Commission about the weight it should afford its Staff experts, the Commission finds the cases cited by Qwest in its brief distinguishable from the proceeding before us. See Qwest Brief at 8, n.9,10.
[25] Tr. 85:9-12.
[26] *See Post-Hearing Brief of Commission Staff* (filed May 30, 2007) at 10("Staff Brief").
[27] *Id.*
[28] *Id*.

In addition, the Staff argues that the Commission previously found in NUSF-26 that the regression results were reasonable.[29]

Qwest argues the Staff proposal is statistically inaccurate and inappropriate. Qwest argues that a "twenty-two percent loss of accuracy is unacceptable."[30] Qwest states that the deaveraging results are not reasonably aligned with results the BCPM would produce; accordingly, according to Qwest's witness the disaggregation process is not credible.[31] Mr. Fitzsimmons discussed in his slides the various points where the Staff deaveraging results are not aligned with results the BCPM would produce.

Based on the Commission's previous findings approving the distribution model and finding its level of statistical accuracy in determining cost variation was reasonable, the Commission sees no reason to re-hash the arguments made by Qwest on this point. The Commission finds that the Staff deaveraging proposal produces a sufficiently accurate method for deaveraging costs based on geographic variations. Finally, although given ample opportunity, the Qwest witness did not provide any alternative statistical criteria for evaluating whether or not the fit of the regression model was poor or the variation substantial.

*Business versus Residential Loops*

The Staff deaveraging proposal includes only residential lines. Qwest argues the Staff deaveraging proposal excludes loops or lines used to serve business customers. Qwest points out that 47 CFR §51.503(c) requires that UNE prices assessed by an incumbent carrier "shall not vary on the basis of class of customers served by the requesting carrier, or on the type of services that the requesting carrier purchasing such elements uses them to provide." Based on the general pricing standard rule in §51.503(c), the Commission agrees with Qwest that the Staff deaveraging proposal should include all retail and wholesale residential and business access lines.

In the NUSF-26 Findings and Conclusions Order, the Commission found that business lines were located mostly within urban lower cost areas and, accordingly as a policy matter, found the high-cost program should not support business lines, with limited exception. Thus, because it was not readily available as reported data, the Staff did not include business lines in the deaveraging proposal. Qwest, through Mr. Copeland's

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[29] NUSF-26 Findings and Conclusions Order at 4, 5 and 15.
[30] Qwest Brief at 22.
[31] *See id.*

testimony, filed an exhibit which contained all lines served by Qwest.[32] The Commission finds that in order to appropriately account for cost variations in UNE pricing, however, the Staff should include the appropriate measure of demand in its methodology. Accordingly, the Staff deaveraging model should be updated to include all retail and wholesale business and residential lines, as reported by Qwest through Mr. Copeland’s filed testimony and in its post-hearing brief.

As the inclusion of business lines was supported by Qwest and RIC, the Commission is of the opinion and finds that parties have had an opportunity to review and raise any objections to the inclusion of the business lines into the Staff deaveraging proposal. In its post-hearing brief, Qwest argues that the Commission cannot simply order a recalculation.[33] The Commission disagrees. The interested parties have had access to the Staff deaveraging proposal and could have independently calculated the Staff proposal based on information Qwest or a CLEC has in its possession or is advocating. In addition, the Qwest witness sponsored an exhibit with Qwest’s total lines in service which was filed with testimony on April 17, 2007, and available at the hearing. Accordingly, Qwest in particular had all the necessary tools to calculate the effect of adding business lines to the Staff deaveraging proposal. The Commission finds interested parties have had adequate notice and time to fully develop a record with the inclusion of business lines. The addition of business lines into the calculation does not make the analysis any less reliable or accurate.[34] Accordingly, the Commission finds that the Staff deaveraging methodology should contain business lines as well as residential lines. The Staff’s model with the inclusion of total lines as provided by Qwest is attached hereto and fully incorporated herein as Attachment A.

Similar to its findings in the NUSF-26 Findings and Conclusions Order, the Commission is adopting a model for the further deaveraging of UNE cost related zones and delegating the calculation and updates of the model to Staff. Should any company find a discrepancy between the model adopted today and the calculated results that company is free to bring that to Staff’s attention for consideration and recalculation. Contrary to Qwest’s assertions in its Post-Hearing Brief, there is

[32] We find Qwest correctly excluded the access lines of the 9 wire centers in the Omaha Metropolitan Statistical Area since loops in those wire centers are no longer required to be unbundled at TELRIC rates.
[33] *See id* at 17.
[34] *See id.* The Commission has already concluded that the weighted inputs to the regression analysis performed by the Staff are TELRIC compliant. It does not believe by adding more lines into the calculation that it somehow makes the deaveraging model less accurate.

adequate opportunity for review of the Commission's findings herein.[35]

*Staff Deaveraging Proposal Implementation*

The Staff deaveraging proposal we adopt today is the four zone variation released by the Staff on February 13, 2007, with the inclusion of business lines discussed *supra*. We find that four zones is sufficient in order to capture geographic cost variations of in-town and out-of-town lines. Should the Commission desire to create more cost based zones, federal law clearly provides that the Commission may create more than three zones. There is no limit on the number of cost-related zones created by the Commission. However, the Commission recognizes that the number of zones should be manageable and should be designed in a manner where carriers can determine which price point a subscriber may be subject to when determining wholesale business plans.

We further find Qwest should determine in-town and out-of-town customers on the basis of the NUSF-26 distribution model. The Commission agrees with the Staff and RIC that any in-town versus out-of-town support area should mirror the same support areas used in the NUSF-26 model. Accordingly, in-town areas are cities, villages or unincorporated areas with 20 or more households and densities greater than 42 households per square mile. Out-of-town areas are the remaining areas that have not been assigned to a town.[36] As testified to by the Staff, companies should already have the ability to capture in-town and out-of-town customers within their current billing systems. We recognize that adjustments will need to be made by the carriers impacted by this Order, however, we believe the extent to which the Commission is plowing new ground with an in-town and three out-of-town zones is overstated.

To implement the four zone deaveraging proposal, the Commission finds it appropriate to give carriers sufficient time to make adjustments to their billing systems to accommodate in-town and out-of-town wholesale pricing. Accordingly, there should be a transition period to give the impacted carriers time to make the necessary adjustments. The transition period should be completed by July 1, 2008.

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[35] *See id.*

[36] *In the Matter of the Nebraska Public Service Commission, on its own motion, seeking to establish a long-term universal service funding mechanism*, NUSF-26, Progression Order No. 5, Attachment A at 6.

*NUSF Ported Support to CLECS*

In addition to the deaveraging proposal, the Staff released a porting proposal which would be implemented concurrently and determine the amount of support “ported” from Qwest to the CLEC per captured line. Comments and testimony were received in response to the porting proposal.

NT&T opposed the proposed porting methodology for the out-of-town zones because the proposed UNE rates would render it financially impossible for CLECs such as NT&T to offer the benefits of competition to customers residing out-of-town. NT&T also argues that existing lines must be permanently grandfathered. In support of this argument NT&T states that to keep the NUSF “predictable” these lines must be grandfathered. In the alternative, NT&T asks for a five (5) year transition period during which the current levels of ported NUSF support remain the same.

Allo Communications generally supported the Staff’s porting methodology. Qwest also generally supported the Staff’s porting methodology with changes as proposed by Mr. Copeland, Qwest’s witness. Mr. Copeland recommended updated UNE loop costs to be utilized and made other adjustments.

Upon consideration of the evidence and the arguments of the parties, the Commission is of the opinion and finds the Staff’s porting methodology which was released herein and in NUSF-50 Progression Order No. 2 should be adopted. Given the Commission’s findings relative to the deaveraging proposal, the Commission declines to change the UNE loop costs as recommended by Qwest.

In addition, in consideration of NT&T’s request for either a permanent grandfathering of the lines or a five (5) year transition period, the Commission declined to permanently grandfather existing lines. However, the Commission finds that a transition period should be used to provide carriers with time to make adjustments for the Commission’s findings. Accordingly, all affected carriers will have until July 1, 2008, to implement the findings in this Order.

An example of the porting mechanism adopted herein is attached hereto as Appendix A. The Appendix demonstrates the amount of support which will be eligible for porting from the ILEC to the CLEC serving the subscriber.

*Application of this Order*

We emphasize that this Order deaverages cost differences in Qwest's ILEC territory only and does not apply to other ILEC territories in Nebraska. So, for example, the Commission is not requiring Embarq to deaverage UNE loops based on geographic cost differences at this time. The Commission may at a later time open a proceeding to review or deaverage loop rates for other carriers where it finds such action would be appropriate. The NUSF porting methodology, likewise would be applicable to CLECs leasing UNE loops from Qwest in Nebraska. The NUSF porting methodology does not apply to other ILECs or CLEC porting in areas not served by Qwest's ILEC entity.

O R D E R

IT IS THEREFORE ORDERED by the Nebraska Public Service Commission that the findings and conclusions are adopted as set forth herein.

IT IS FURTHER ORDERED that the Commission staff's proposal as modified with the inclusion of residential and business wholesale and retail access lines in the four-zone deaveraging model as provided herein is hereby adopted. Any corrections to the Staff inclusion of business lines must be filed on or before November 30, 2007.

IT IS FURTHER ORDERED that the porting model described in this Order and identified as Attachment A be and it is hereby adopted.

MADE AND ENTERED at Lincoln, Nebraska this 10th day of October 2007.

NEBRASKA PUBLIC SERVICE COMMISSION

COMMISSIONERS CONCURRING:

Chairman

ATTEST:

Deputy Director