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December 6, 2018

By ECFS

Marlene H. Dortch
Office of the Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: ***In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 38**

Dear Ms. Dortch:

AT&T Services, Inc. ("AT&T") submits for filing the **Public Version** of its Opposition in the above-referenced proceeding to the Direct Case of Iowa Network Services, Inc. d/b/a Aureon Network Services ("Aureon"), which was filed on November 28, 2018. Consistent with the Commission's rules and the March 26, 2018 Protective Order entered by the Commission Staff, AT&T has redacted all "Confidential Information" from the **Public Version**, which it is filing by ECFS.

AT&T is also filing by hand with the Secretary's office one hard copy of the **Confidential Version** of this submission. In addition, copies of all versions of the submission are being served electronically on Aureon's counsel. Two copies are also being provided to Joseph Price at the Wireline Competition Bureau.

Please contact me if you have any questions regarding this matter.

Sincerely,

James F. Bendernagel, Jr.

Enclosures

Joseph Price, FCC
Pam Arluk, FCC
Joel Rabinovitz, FCC

PUBLIC VERSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
Iowa Network Access Division **Tariff F.C.C. No. 1**	**WC Docket No. 18-60** **Transmittal No. 38**

AT&T SERVICES, INC.'S OPPOSITION TO DIRECT CASE OF IOWA NETWORK ACCESS DIVISION d/b/a AUREON NETWORK SERVICES

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Dated: December 6, 2018

Counsel for AT&T Services, Inc.

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Washington, D.C. 20554

In the Matter of	**WC Docket No. 18-60**
Iowa Network Access Division Tariff F.C.C. No. 1	**Transmittal No. 38**

AT&T SERVICES, INC.'S OPPOSITION TO DIRECT CASE OF IOWA NETWORK ACCESS DIVISION d/b/a AUREON NETWORK SERVICES

Pursuant to the Commission's November 9, 2018 *Second Designation Order*,[1] AT&T Services, Inc. ("AT&T") respectfully submits this Opposition to the Direct Case submitted by Iowa Network Services, Inc. d/b/a Aureon Network Services ("Aureon") in support of its September 24, 2018 Tariff Filing ("Aureon Second Direct Case").

As demonstrated below, Aureon's Second Direct Case fails to answer critical questions that the Commission identified in its *Second Designation Order* bearing on the reasonableness of Aureon's rate and the allocation method that Aureon used to develop that rate. Nevertheless, based on the incomplete information Aureon has provided, it is clear that Aureon's September 2018 Tariff Filing violates the Commission's rules, its *Rate Order*,[2] and Section 201(b) of the Communications Act. The Commission should therefore (a) find Aureon's current rate to be unreasonable; (b) prescribe a rate of no greater than [redacted]

[1] Order Designating Issues for Investigation, *In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 38 (Nov. 9, 2018) ("*Second Designation Order*"); *see also* Order Designating Issues for Investigation, *In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 36 (Apr. 19, 2018) ("*First Designation Order*").

[2] Memorandum Opinion and Order, *In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 36 (July 1, 2018) ("*Rate Order*").

[redacted] (c) direct Aureon to refund the difference between the prescribed rate and its current CEA rate of $0.00296/min.;[3] and (d) initiate an investigation into Aureon's accounting and ratemaking practicespractices.

INTRODUCTION

On September 28, 2018, the Commission suspended Aureon's Tariff because significant questions had been raised regarding the lawfulness of Aureon's switched transport rate,[4] and subsequently designated for investigation the following issues:

- Given the declining demand for centralized equal access ("CEA") service, does Aureon's $4.4 million increase in central office switching equipment investment represent a "used and useful" investment?

- Does Aureon's lease expense for access to the Aureon Division's network facilities (the "Filed Lease Expense") violate the Commission's affiliate transaction rules because it is greater than the lower of:

    - the fair market value ("FMV") rate for the leased facilities; or

    - the fully distributed cost rate for the leased facilities?

Aureon begins its Second Direct Case, not by answering these questions or defending the reasonableness of its current CEA rate, but rather by again arguing that it should not be subject to regulation both as an Incumbent Local Exchange Carrier ("ILEC") and a Competitive Local Exchange Carrier ("CLEC").[5] In fact, Aureon even suggests that the Commission should suspend this rate investigation until Aureon's pending appeals of both the *Rate Order* and the *Liability*

[3] These refunds would be in addition to the refunds arising as a result of the *Rate Order*.

[4] Order, *In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 38 (Sept. 28, 2018) ("*Second Suspension Order*").

[5] Aureon raised this exact argument in the *Rate Order*, and the Commission properly rejected it. *Rate Order*, ¶ 20 n.72, ¶¶ 114-121. There are no grounds for the Commission to reconsider its decision here.

Order[6] have been completed. *See* Aureon Second Direct Case at 1-2. Aureon further claims that "the affiliate transaction and other accounting issues raised in the *Designation Orders* are inapplicable to Aureon, and that it should not be subject to Part 32 accounting regulations." *Id*. at 2-4.

These claims are nothing more than a smokescreen, intended to distract from the fact that Aureon can neither answer the questions posed in the *Second Designation Order* nor justify the reasonableness of its current CEA rate. Aureon has now had multiple chances to justify its rate, and it has defaulted on each chance, including in its current Direct Case. In fact, the materials submitted with the current Direct Case only heighten Aureon's problems, because they further reinforce that Aureon's prior CEA rates—and the cost studies underlying those rates—were largely works of fiction that hid from review serious flaws in methodology and misstated even basic information about Aureon's network.

During the course of the AT&T Complaint case, it increasingly became clear that a critical part of calculating Aureon's tariffed CEA rate was the lease rate charged to its Access Division for the use of Aureon's fiber network, and yet Aureon simply could not explain how it determined that lease rate. The "Filed Lease Expenses" underlying Aureon's rate calculations were the product of a "black box" and thus wholly unsupported. *See infra* Part III.C. In the Commission's rate investigation earlier this year, Aureon admitted as much, and sought refuge behind the affiliate transaction rules that it now asserts are inapplicable. *See id*.; *see also* Aureon Consolidated Rebuttal, at 35-36 (May 17, 2018) ("Aureon First Rebuttal"). In the *Rate Order*, the Commission permitted Aureon to rely on the affiliate transaction rules, but found that the cost methodology that

[6] Memorandum Opinion and Order, *AT&T Corp. v. Iowa Network Servs., Inc., d/b/a Aureon Network Servs.*, 32 FCC Rcd. 9677, ¶ 23 (2017) ("*Liability Order*").

Aureon had used since at least 2006 to develop its lease rate and to allocate its Central Office Equipment ("COE") transmission and Cable & Wire Facilities ("C&WF") costs was unlawful. *See Rate Order*, ¶¶ 63-91.

In its current Direct Case, Aureon makes an even more astounding admission: it concedes that the circuit inventories it used in its prior rate calculations were based on "a flawed inventory reporting system that was found to be inaccurate." *See* Aureon Second Direct Case at 36-37. Aureon further concedes that it cannot reconcile its past inventories with what it now contends is an accurate inventory. *Id.* Aureon offers no valid explanation for why it provided the Commission and ratepayers with "flawed" data to support its rates. Worse yet, it has now become apparent from Aureon's brand new circuit inventory that Aureon has been manipulating the results of its prior cost allocations: Aureon disregarded the fact that [redacted] which resulted in ratepayers of its CEA service paying excessive rates.

Notwithstanding these significant new deficiencies, Aureon contends that it would be reasonable for the Commission to ignore these problems, accept as accurate Aureon's new rate calculations based on a completely new methodology and data, and approve Aureon's current CEA rate of $0.00296 as just and reasonable. The Commission should decline to do so. As shown in greater detail below, there are still many serious issues with Aureon's current rate calculations.[7]

For example, as explained in Part I, Aureon has not shown that the inclusion of $4.4 million in additional central office switching equipment in its rate calculation—which raises Aureon's

[7] In support of AT&T's Opposition, AT&T presents herein a declaration from Brian F. Pitkin, Managing Director at FTI Consulting, Inc. ("Pitkin Decl."). Mr. Pitkin has extensive experience in rate-setting actions, including those involving large network infrastructure. *Id.* ¶¶ 1-2 & Ex. A.

CEA rate by about 20%—is either reasonable or used and useful. Aureon's justification for this investment is based on a single paragraph in the declaration of one of its employees. No documentation is provided supporting the need for this investment or describing the specific investments to be made in connection with this so-called "extensive project." Further, the explanation of the timing of the investment is unpersuasive. The only reasonable conclusion is that these costs are not "used or useful," and that Aureon included them to unlawfully inflate its CEA rate.

Further, as explained in Part II, Aureon has not demonstrated that the "Filed Lease Expense" underlying its current CEA rate is lower than the fair market value of the transport services that the Access Division is purchasing from Aureon's Network Division. To the contrary, the evidence shows the CEA transport service on which Aureon initially relied to support its current rate, when properly computed, is significantly lower than Aureon's Filed Lease Expense. Further, the evidence relating to Aureon's sales of D-3 circuits on a non-regulated basis establishes that Aureon's Filed Lease Expense is excessive.

Finally, as explained in Part III, Aureon's new data raise numerous questions regarding the structure of Aureon's fiber network and the reliability of Aureon's circuit inventory. In addition, Aureon still has not explained in any detail the basis for its new circuit forecasts, nor can it reconcile those forecasts with [redacted] And, its new cost allocation methodology continues to over-allocate COE and CWF costs to its CEA service. Thus, for example, [redacted] Aureon's Filed Lease Expense is reduced from about

$4.9 million to less than [redacted]

In view of the foregoing and the additional reasons set forth below, the Commission should reject Aureon's current CEA rate and, given the multiple opportunities Aureon has already had to present a just and reasonable rate, prescribe a rate of no greater than [redacted]

In addition, the Commission should set for additional investigation Aureon's prior accounting and ratemaking practices, particularly its practices relating to its leasing of circuit capacity to the Access Division. Aureon at best has been grossly negligent, and at worst has misled the Commission and the public, relying on improper cost methodologies that it did not disclose, and submitting admittedly "flawed" data to justify its rates.

BACKGROUND

This case arises from Aureon's unlawful billing of CEA service in Iowa. Although Aureon was established in 1988 for the express purpose of providing a tandem switching and transport service for carriage of traditional long distance calls to and from small rural carriers, for the past decade the vast preponderance of Aureon's CEA traffic has consisted of access stimulation traffic routed to a handful of access stimulating CLECs operating in Iowa. Further, during this period, Aureon has misallocated its network costs, thereby inflating its rates for CEA service and cross-

subsidizing both the expansion of its backbone fiber network and the growth of its non-regulated telecommunications services.

I. HISTORY OF THE CASE THROUGH THE *RATE ORDER*[8]

In July 2013, Aureon raised its composite rate for CEA service from $0.00623/min. to $0.00896/min., thereby violating the rate cap regulations that the Commission adopted in late 2011.[9] AT&T objected to Aureon's unlawful rate increase and began to withhold payment of Aureon's billed charges to the extent that they exceeded the Commission's caps or related to access stimulation. Aureon subsequently brought a collection action in New Jersey federal district court, which the court eventually referred to the Commission on primary jurisdiction grounds. This led to AT&T's filing of a formal complaint against Aureon in June 2017, which alleged four claims, including a claim that Aureon had unlawfully manipulated its rates for CEA service, thereby making them unreasonable.[10]

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[8] A detailed history of this case is set forth in AT&T's Opposition to the Direct Case that Aureon submitted in support of its February 2018 tariff filing. *See* AT&T Opposition, *In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 36 (May 10, 2018) ("AT&T First Opp."). A more abbreviated version of that history is provided herein.

[9] *See Liability Order*, ¶ 23; *In re Connect Am. Fund*, 26 FCC Rcd. 17763, ¶¶ 800-01, 812 (2011) ("*Transformation Order*").

[10] In support of its rate manipulation claims, AT&T submitted a declaration from Daniel P. Rhinehart, an internal AT&T cost analyst, with extensive experience in cost of service ratemaking. AT&T Ex. 1, Declaration of Daniel P. Rhinehart, *AT&T Corp. v. Iowa Network Services, Inc., d/b/a Aureon Network Services*, Proceeding Number 17-56 (June 1, 2017) ("Rhinehart Initial Decl.") (AT&T Ex. 1). More specifically, Mr. Rhinehart submitted a total of six declarations addressing the reasonableness of Aureon's rates—three in the complaint proceeding, and three during the Commission's previous rate investigation. Mr. Rhinehart's initial declaration in the complaint proceeding is hereinafter referenced as "Rhinehart Initial Decl."; his reply declaration is referenced as "Rhinehart Reply Decl." (AT&T Ex. 2); and his supplemental declaration is referenced as "Rhinehart Supp. Decl." (AT&T Ex. 3). His declaration submitted in support of AT&T's initial Petition to Reject or Suspend is referenced as "Rhinehart Rate Decl."; his declaration in support of AT&T's Opposition to Aureon's First Direct Case is referenced as "Rhinehart Supp. Rate Decl"; and his declaration in support of AT&T's Surrebuttal is referenced

During the course of discovery in the complaint proceeding, and in response to an order from the Commission,[11] Aureon submitted a letter disclosing for the very first time [redacted] Nevertheless, based on the discovery it was able to obtain, AT&T demonstrated that Aureon had [redacted]

On November 5, 2017, the Commission ruled in AT&T's favor on several issues in its *Liability Order*. Relevant here, the Commission required Aureon to submit a revised tariff filing that complied with the Commission's rules, and it noted that AT&T had "raised a number of significant questions about Aureon's CEA practices and rates that deserve further exploration."[14] These issues included "Aureon's treatment of network investment, its cost allocations, and the role of lease costs involving the regulated entity and a competitive services affiliate."[15]

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as "Rhinehart Second Supp. Rate Decl."

[11] Order, *AT&T Corp. v. Iowa Network Services, Inc., d/b/a Aureon Network Services*, Proceeding Number 17-56 (July 25, 2017).

[12] *See* AT&T Ex. 4, INS Discovery Letter, dated August 7, 2017, *AT&T Corp. v. Iowa Network Services, Inc., d/b/a Aureon Network Services*, Proceeding Number 17-56.

[13] Final Brief of AT&T Corp., *AT&T Corp. v. Iowa Network Services, Inc., d/b/a Aureon Network Services*, Proceeding Number 17-56 (Aug. 21, 2017) ("AT&T Final Brief"); AT&T Ex. 3, Rhinehart Supp. Decl., Table P.

[14] *Liability Order*, ¶ 30.

[15] *Id.*

On February 22, 2018, Aureon submitted its revised Tariff Filing, setting forth a new proposed rate of $.00576/min., contending that that rate "represent[ed] a reduction of $0.0032 or -36%" versus the prior CEA rate that the Commission had found to be unlawful.[16] The Commission suspended Aureon's February tariff filing,[17] and in its subsequent *Rate Order*, rejected that tariff filing, finding that significant issues continued to exist as to the reasonableness of Aureon's revised tariff rate for CEA service, particularly with respect the amount of network costs allocated to Aureon's Access Division. Having repeatedly failed to explain the basis for the specific lease rate charged to the Access Division, Aureon sought to rely on the Commission's affiliate transaction rules. However, the Commission rejected as inadequate Aureon's unsupported assertion that it could not estimate the fair market value of the network facilities leased to the Access Division. *See Rate Order*, ¶ 62. And, with respect to the fully distributed cost issue, the Commission identified numerous deficiencies in Aureon's submission (most notably its use of an inappropriate method of allocating C&WF costs). *See id.* ¶¶ 87-88.

To address these issues, the Commission again directed Aureon to file a revised tariff, along with revised cost support, within 60 days from the release date of its order. *Rate Order*, ¶ 122. The Commission also directed Aureon to address a number of specific issues and to provide additional documentation. *See id*. ¶¶ 62, 72, 78-79, 89-91, 123. In particular, the Commission

[16] Aureon February 2018 Tariff Filing, Description and Justification, at 1. As Mr. Rhinehart pointed out in his declaration in support of AT&T's Petition to Reject or Suspend, that decrease was almost entirely the result of Aureon's decision not to include so-called "Uncollectible Revenues" in the revenue requirement supporting its new CEA rate. *See* Rhinehart Rate Decl., ¶ 18. And, Mr. Rhinehart explained in detail in his declarations in the Complaint proceeding (and further discussed in his supplemental rate declaration) why the inclusion of those amounts was never justified. *See* AT&T Ex. 1, Rhinehart Initial Decl. ¶¶ 38-43; AT&T Ex. 2, Rhinehart Reply Decl. ¶¶ 52-57.

[17] Order, *In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 36 (Feb. 28, 2018) ("*First Suspension Order*").

made clear that Aureon's revised tariff filing should include all relevant data for all circuit types included in its study, including an explanation of the regulated or non-regulated services provided over each circuit, and a circuit inventory matching such explanation. *Id.* ¶ 90, n.283.

II. HISTORY OF THE CASE FOLLOWING THE *RATE ORDER*

A. Aureon's September 24 Rate Submission

On September 24, 2018, Aureon filed a revised tariff rate of $0.00296/min., which is roughly half of the $0.00576/min. rate that Aureon proposed in its February 22, 2018 tariff filing. Aureon also provided supporting documentation, including a new circuit inventory, an analysis supporting its Filed Lease Expense that purports to reflect the fair market value of the facilities being leased, and a revised fully distributed cost analysis based on a new methodology for allocating COE and C&WF costs.[18]

Aureon's revised tariff filing, however, failed to include much of the relevant data required by the *Rate Order*. And the new Filed Lease Expense—[redacted]

[18] In support of its Proposed Tariff, Aureon has filed seven separate excel files. In conjunction with its September 2018 Tariff Filing, Aureon included: (a) a file entitled "PUBLIC VERSION JSI INS 2018 FCC Filing" (hereinafter, "Public Workpaper"); (b) [redacted] NS 2018 FCC Filing -updated 9-2018 v 4 11-2018" (hereinafter, "Revised Public Workpaper"); (e) [redacted]

In light of these deficiencies (among many others), AT&T filed a Petition to Reject or Suspend Aureon's revised tariff filing.[19] AT&T's Petition focused on the significant problems underlying Aureon's fair market value analysis, as well as the calculation of Aureon's cost of service rate and its fully distributed cost study. The Commission thereafter suspended Aureon's revised tariff filing, finding—for a third time—that "there are substantial questions regarding the lawfulness of Aureon's tariff revisions that require further investigation." *Second Suspension Order*, ¶ 4.

B. Second Designation Order

On November 9, 2018, the Commission issued its *Second Designation Order* and designated for investigation the issues identified above. With respect to each of these issues, the Commission directed Aureon to respond to a series of questions and to supply additional supporting information.

First, the Commission required Aureon to provide a detailed explanation and support regarding the rationale for the $4.4 million increase in its central office switching investment and to explain why that increase is "used and useful," given the declining demand for CEA service. *See Second Designation Order*, ¶¶ 15-17.

Second, the Commission directed Aureon to provide additional detail in support of its Filed Lease Expense, and to specifically justify whether that expense was equal to or below the lesser of the fair market value of or the fully distributed cost for the leased network facilities. *See id.* ¶¶ 18-20. As to the fully distributed cost analysis, the Commission identified four principal areas in need of further detail and justification: (a) Aureon's circuit inventory; (b) Aureon's circuit

[19] Petition of AT&T Services, Inc. to Reject, or to Suspend and Investigate, Iowa Network Services, Inc. Tariff Filing, *In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 38 (Sept. 27, 2018) ("AT&T Second Pet.").

forecasts; (c) Aureon's new allocation methodologies; and (d) several potential calculation errors. *See id.* ¶¶ 21-34.

Third, the Commission required Aureon to identify the individuals most knowledgeable on each of the foregoing issues. *See id.* ¶ 14.

C. Aureon's November 28 Direct Case Submission

On November 28, 2018, Aureon filed its Second Direct Case. While Aureon's Second Direct Case provides some of the information requested by the Commission in its *Second Designation Order*, information critical to an evaluation of the reasonableness of Aureon's current CEA rate is still missing. Further, its submission raises additional questions regarding the lawfulness of both its current and prior CEA rates.

Perhaps the most significant of these new issues is Aureon's admission that the circuit inventories used in connection with the calculation of its CEA rates since 2006 were based on "a flawed inventory reporting system that was found to be inaccurate," and its concession that it cannot reconcile its past inventories with what it now contends is an accurate inventory, or with its new circuit forecasts. *See* Aureon Second Direct Case at 36-37.

In its Second Direct Case, Aureon also admits that that its Filed Lease Expense exceeds—by approximately $800,000—one of the measures of fair market value presented in its September 2018 Tariff Filing (*i.e.*, the CEA transport rate of Minnesota Independent Equal Access Corp. ("MIEAC")). *Id.* at 27. Aureon also does not dispute AT&T's showing that [redacted]

See Aureon Second Direct Case at 9-11. Other points of note include: (a) Aureon's failure to provide any documentation in support of its addition of $4.4 million in central office switching

investment (*id.* at 23-24); (b) its unwillingness or inability to explain the specific basis for its new circuit forecasts (*id.* at 42-45); [redacted] and (d) its failure to identify the individuals "in the company" most knowledgeable as to each of the issues designated by the Commission for investigation. *See Second Designation Order*, ¶ 14

Each of these and the other deficiencies in Aureon's Second Direct Case are discussed in greater detail below.

DISCUSSION

I. AUREON'S FAILURE TO JUSTIFY THE INCLUSION OF ADDITIONAL SWITCH INVESTMENT IN THE COMPUTATION OF ITS REVISED CEA RATE.

In its Petition to Reject or Suspend, AT&T questioned the reasonableness of the $4.4 million increase in Aureon's central office switching investment—given that the overall demand for CEA service had significantly declined since 2011, and the demand for traditional CEA service (*i.e.*, non-access stimulation traffic) had steadily dropped since at least 2007. AT&T Second Pet. at 19-20. AT&T further questioned the timing of this investment—given that Aureon's prior tariff filings (including its recent filing in February of this year) had not indicated any need for further investment in central office switching equipment. *Id.* The Commission therefore directed Aureon "to provide a detailed explanation and support" for the supposed increase, including "why the increase is 'used and useful' in its provision of regulated service." *Second Designation Order*, ¶ 17.

Aureon's entire presentation regarding this issue consists of a single paragraph in the declaration of Frank Hilton. *See* Declaration of Frank Hilton ("Hilton Decl."), ¶ 8. Mr. Hilton does not, however, [redacted]

[redacted] Further, neither Mr. Hilton nor Aureon present any documents or other material in support of the claim that Aureon's current switches "are difficult to maintain due to their vintage," and that "Aureon's switch was manufacturer discontinued in 2016 with limited technical support available, and no new hardware is available." *Id*. ¶ 8; *see also* Aureon Second Direct Case at 23-24.

In addition, they do not provide any detail or documentation regarding what Mr. Hilton characterizes as [redacted] *See* Hilton Decl. ¶ 8. As Mr. Pitkin points out, they do not indicate the specific types of switching equipment that have been, or will be, purchased with the $4.4 million investment. *See* Pitkin Decl. ¶ 43. Nor do they state whether that investment represents the entirety of the amount to be expended in upgrading Aureon's switches, or whether it is just a first installment. *Id*. Also, neither Aureon nor Mr. Hilton present any planning documents, engineering specifications, purchase invoices, or other similar documents that should necessarily exist for this purportedly [redacted] *Id.* Indeed, it is not clear from Aureon's submission when or even if these proposed expenditures have occurred.

Aureon also does not address or appear to take account of the offsetting reductions in net switching investment and switching expenses that would likely be caused if Aureon was to undertake an [redacted] As Mr. Pitkin explains, "such a project would normally involve both a write-off of its retired equipment and a corresponding reduction in its

anticipated switching expenses in the future. *See id.* ¶ 45. However, there is nothing in Aureon's filing addressing offsetting reductions in net switching investment, nor does any attempt appear to have been made to reduce ongoing switching expenses. *Id.* Without these corresponding reductions, it would be completely inappropriate to include Aureon's increased switch investments related to the new, more efficient switching technologies. *Id.*

Additionally, neither Mr. Hilton nor Aureon address the issue of whether the declining levels of CEA traffic and the uncertainties surrounding access stimulation justify the expenditure of an additional $4.4 million for central office switching equipment. As AT&T demonstrated in the Complaint case, the demand for Aureon's switched access services reached its peak in 2011 at about 3.8 billion minutes, but has declined by almost 35% since that time. *See* AT&T Complaint, ¶ 40; *see also* Aureon Direct Case, *In the Matter of Iowa Network Access Division Tariff F.C.C. No. 1*, WC Docket No. 18-60, Transmittal No. 36, at 59-61 (May 3, 2018) ("Aureon First Direct Case"). Part of that decline has resulted from variations in the levels of access stimulation traffic, but the bulk of it has been due to a [redacted]

Moreover, these concerns are particularly relevant given the size of the rate increase associated with Aureon's proposed additional $4.4 million investment. As Mr. Pitkin explains, if one simply recalculates Aureon's current CEA rate based on the central office switch investment in Aureon's February 2018 Tariff Filing, Aureon's current CEA rate would be $0.00249/min., not $0.00296/min. *See* Pitkin Decl. ¶ 46. In other words, by increasing its central office switch investment by $4.4 million, Aureon increased its CEA rate by almost 19 percent. Moreover, if the

Commission were to eliminate this additional $4.4 million from Aureon's revenue requirement and both adjust the COE and C&WF allocators and correct the CEA growth rate for the reasons discussed below, Aureon's CEA rate would be [redacted] *See id.* ¶ 50. Given the magnitude of this rate overstatement—when coupled with the steep declines in traditional CEA traffic over the past decade and the reality of potential bypass—this rate overstatement should raise concerns about further declines in the demand for CEA service, necessitating additional rate increases, thereby leading to further declines in demand. At a minimum, these types of concerns should have been discussed in Aureon's Second Direct Case. But they were not.

Instead, Aureon asserts that its investment decision is the product of the refusal of Sprint and AT&T to pay amounts that they had previously been billed for CEA service. *See* Hilton Decl. ¶ 8; *see also* Aureon Second Direct Case at 23-24. Putting aside the fact that Aureon's own submissions demonstrate that Aureon's prior CEA charges of nearly a penny per minute (*i.e.*, $0.00896/min.) were grossly inflated, Aureon's claim does not ring true for a number of reasons.

- *First*, both Sprint and AT&T, consistent with their rights under Aureon's tariffs, have been withholding disputed amounts relating to CEA service for a number of years. In Sprint's case, since 2008; in AT&T's case, since mid-2013. Yet, Aureon had not asserted in any of its prior tariff filings, including its filing in February 2018, that that there was a need for additional investment in central office switching equipment, or that such expenditures were being delayed as a result of Sprint and AT&T's withholding of disputed amounts.

- *Second*, the claim that those withholdings have adversely impacted Aureon's ability to invest in its network is difficult to reconcile with that fact that Aureon has expended more than $50 million since 2010 on its backbone fiber network. Aureon extensively discussed its fiber network investments in its prior tariff filings, in order to justify its (now clearly excessive) rates. *See* AT&T Exs. 12-19 (Aureon's 2010, 2012, 2013, 2014, and 2016 Tariff Filings). It never indicated in these filings that it wanted to invest in more switching, and its new claim that it could not spend $4.4 million on switching even though it was spending over $50 million on fiber is dubious.

- *Third*, a much more plausible explanation for Aureon's insistence that the investment of $4.4 million in central office switching equipment is appropriate at this particular moment

is because it now needs this additional investment to boost its CEA rate, which Aureon was finally forced to reduce as a result of the Commission's determination in the *Rate Order* that Aureon's prior cost allocation methodology was unlawful. Of course, that explanation would not, and could not, justify the additional investment.

In sum, Aureon has not met its burden of showing that its proposed investment of an additional $4.4 million in central office switching equipment is either reasonable or "used and useful."[20]

II. AUREON'S "FILED LEASE EXPENSE" IS HIGHER THAN THE FAIR MARKET VALUE OF THE LEASED FACILITIES

As previously established, a principal component of Aureon's costs of its CEA service is the lease expense for fiber capacity and associated equipment, which Aureon's Access Division obtains from its affiliated Network Division. The Commission's affiliate transaction rules provide that "[w]hen services are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and fully distributed cost establishes a ceiling, above which the transaction cannot be recorded." 47 C.F.R. § 32.27(c)(2). As the Commission has pointed out, a carrier cannot simply assert "that it cannot determine a fair market value for the transaction." *Rate Order*, ¶ 58. Carriers are permitted to use a variety of independent valuation methods to make this valuation, "depending on the type of transaction" at issue, "includ[ing] appraisals, catalogs listing similar items, competitive bids, replacement cost of an asset, and net realizable value of an asset." *Id.*

[20] Alternatively, should the Commission permit Aureon to include the additional $4.4 million switch investment in its rate calculation, it should direct Aureon to reduce both its net switching investment (to account for the retirement of old equipment) *and* substantially reduce the maintenance costs (since its purchase contract would undoubtedly include several years of maintenance as part of the purchase price). As Mr. Pitkin explains, these adjustments would likely avoid substantial expense, which in turn would flow through to its revenue requirement. *See* Pitkin Decl. ¶ 47. In addition, the Commission should direct Aureon to correct a double count of depreciation that has occurred as a result of Aureon's having included a full year of depreciation associated with its new switch investment and the full depreciation expenses from 2017 in its 2018 analysis. *Id.* ¶ 48.

(quoting *Implementation of The Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd. 17539, ¶ 154 (1996) ("*Accounting Safeguards Order*")). One accepted valuation method is the "prevailing company price" valuation, which stands "as a proxy for fair market value." *In the Matter of Puerto Rico Tel. Co.*, 15 FCC Rcd. 7044, ¶ 2 n.5 (1999); *Accounting Safeguards Order*, 11 FCC Rcd. 17539, ¶ 127 (1996) (requiring affiliates and carriers to charge the "generally available price" for services). The Commission has emphasized, however, that "[s]trict enforcement" of the affiliate transaction rules "will help ensure that the Commission can detect any anticompetitive behavior." *In Re Verizon Tel. Companies, Inc.*, 18 FCC Rcd. 18796, ¶ 8 (2003).

Aureon entirely disregarded this requirement in its February 2018 Tariff Filing, informing the Commission that "[t]here are no readily available rates for comparable service to develop a fair market value rate because the Network Division does not provide service to third parties to access the more than 2,700 mile CEA fiber network." Aureon First Direct Case at 34. Setting aside for a moment that this statement is flatly inaccurate,[21] the Commission rejected Aureon's position and required Aureon to either "[1] demonstrate compliance with this requirement or [2] seek a waiver." *Rate Order*, ¶ 62. Aureon chose the first option and—without any narrative explanation—attempted to comply with the requirement in its September 2018 Tariff Filing by comparing its Filed Lease Expense against the regulated CEA rates of South Dakota Network ("SDN") and Minnesota Independent Equal Access Corp. ("MIEAC"). The "type of transaction" at issue here, however, is not the purchase of CEA service, but rather the purchase of the network capacity

21 [redacted]

needed to transport traffic within Iowa. *See infra* Part II.B. And the fair market value analysis in Aureon's September 2018 Tariff Filing failed to estimate the market value of that service.

In its *Second Designation Order*, and in response to AT&T's various criticisms of Aureon's approach, the Commission required Aureon to justify its compliance with the fair market value component of the affiliate transaction rules—either by: (a) providing "a full narrative explanation of its fair market value calculation, including all assumptions made, justification for such assumptions, and justification for Aureon's methodology;" or (b) by filing an alternative calculation with a similarly robust narrative explanation. *Second Designation Order*, ¶ 20. The Commission also required Aureon to answer a number of specific questions regarding the basis for its fair market value calculation. *Id.*, bullets 1 to 7. In particular, the Commission inquired as to whether Aureon leased its network facilities to other entities, what Aureon charged for those services, and whether, [redacted] *See id.*, bullets 6-7. Aureon's Second Direct Case fails to properly address the Commission's inquiries, and is otherwise flawed in significant respects.

First, the regulated transport rates of SDN, MIEAC, and other carriers are not appropriate proxies for the fair market value of the transport capacity that the Access Division purchases from Aureon's Network Division. Moreover, even *if* a regulated rate could somehow serve as a proxy for the cost of transport capacity, Aureon has conceded that MIEAC's transport rate is priced well below the Filed Lease Expense.

Second, the most accurate measure of fair market value is the non-regulated rate for transport capacity that Aureon charges to unaffiliated third parties. The lease data that Aureon has now provided confirms both that such capacity exists on Aureon's fiber network and that Aureon

is leasing significant capacity [redacted] Aureon's attempts to contrast a non-existent "CEA Transport Service" with the transport services actually provided by the Network Division is disingenuous, particularly because Aureon's *own fair market value analysis* compares the Filed Lease Expense against point-to-point dedicated transport rates of other carriers, and because Aureon acknowledges that "a comparison using these rates is valid." *See* Aureon Second Direct Case at 28.

Third, Aureon puts forward an array of additional valuation methods, including a prevailing price analysis, additional regulated rates (from NECA and CenturyLink), and a new "Replacement Cost" analysis. These valuation methods are all inadequate. In particular, Aureon's own evidence demonstrates that the prevailing price for DS-3 transport service on Aureon's fiber network is [redacted] In the alternative, Aureon requests a waiver, but that request should be denied. The third-party lease data that Aureon has now provided confirms that there is ample "relevant data available for Aureon to make a good faith market estimate." Aureon Second Direct Case at 19.

A. Regulated, Rate-of-Return Tariff Rates Are Not Accurate Comparators for Purposes of a Fair Market Value Analysis

In its September 2018 Tariff Filing, Aureon's fair market value analysis was based on a comparison between its Filed Lease expense ($4,904,646) and a composite rate calculated using the regulated CEA rates of SDN and MIEAC. However, as AT&T explained in its Petition to

[22] *See* Pitkin Decl. ¶¶ 10 and 52.

Reject or Suspend, Aureon's reliance on regulated tariff rates is misplaced, as those carriers' rates are not for comparable services under the applicable rules. AT&T also explained that Aureon's use of MIEAC's transport rate was significantly flawed because the vast majority of Aureon's traffic is terminating traffic, yet Aureon had calculated the rate based on a 50/50 split between terminating and originating traffic.

In the *Second Designation Order*, the Commission required Aureon to explain: (a) why Aureon selected the particular SDN and MIEAC rate elements that it selected; (b) why rate-of-return rates were relevant to a fair market value determination; (c) why Aureon believes it is similarly situated to SDN and MIEAC to justify its use of their transport rates as a valid basis for comparison; (d) whether Aureon originates as much CEA traffic as it terminates and, if not, why it is reasonable to compute MIEAC's "unitary" rate using a non-weighted average of MIEAC's originating and terminating transport rates; and (e) how tariffed per-MOU switched access rates are relevant to determining the fair market value rate for wholesale transport capacity. *Second Designation Order*, ¶ 20, bullets 1-5.

In its Second Direct Case, Aureon again relies primarily on the regulated rates of SDN and MIEAC in its fair market value analysis, with some adjustments. However, those rate are still improper points of comparison for a variety of reasons. *First*, Aureon continues to misstate SDN's present rate. Aureon now relies on SDN's CEA rate of $0.005122/min., and it claims its use of that rate is justified because the CEA rate is lower than the "Access Transport" rate and appears to have been updated more recently. *See* Aureon Second Direct Case at 27. However, SDN eliminated its "Access Transport" rate in its September 2018 tariff. Moreover, SDN lowered its CEA rate from $0.005122/min. to $0.004871/min. *See* SDN Tariff F.C.C. No. 1, 9th Revised Page

134. Finally, the SDN rate on which Aureon relies is for switching—not transport—and thus is irrelevant.

Second, Aureon repeatedly attempts to justify its use of the SDN and MIEAC tariff rates on the basis that the carriers are similarly situated. It claims, for example, that they are "engaged in a materially similar service offering," their rates are "subject to the same review and scrutiny as Aureon," and they provide "CEA transport service" on networks that enable IXCs to connect to other LECs. *See* Aureon Second Direct Case at 12-16, 30-31. To the extent that SDN and MIEAC's position as CEA carriers is a valid comparison here at all, the offering that Aureon should evaluate for purposes of the fair market value analysis is *not* their regulated CEA offerings, but rather the rates for DS-3 transport capacity on those carriers' networks (if that service is even provided by those carriers). Their commonality as regulated carriers is therefore inapposite.

Furthermore, as AT&T explained in its Petition to Reject or Suspend, SDN's and MIEAC's rates are not for *wholesale* transport, which is the service provided by Aureon's Network Division to the Access Division. *See* AT&T Second Pet. at 8. Aureon again fails to address this criticism. Moreover, the SDN and MIEAC rates are not proper points of comparison because, unlike Aureon, those carriers do not *mandate* service under their tariff and instead are willing to provide deeply discounted contractual rates to wholesale customers for traffic associated with access stimulation.[23] Aureon ignores this critical distinction as well.

[23] *See, e.g.*, Petition for Expedited Declaratory Ruling of South Dakota Network, WC Docket No. 18-41, at 1 (filed Feb. 7, 2018) (explaining that SDN has a contract with an IXC entered into for the purpose of terminating large volumes of traffic bound to a CLEC engaged in access stimulation). *See also In re Connect Am. Fund*, 26 FCC Rcd. 17663, ¶ 812 & n.1524 (2011) ("the framework we adopt today encourages carriers to enter into contracts in lieu of the tariffing framework"); 47 C.F.R. § 51.905(a) ("Notwithstanding any other provision of the Commission's rules, telecommunications carriers may agree to rates different from the default rates.").

Third, Aureon attempts to defend its use of the SDN and MIEAC rates with a discussion of "market value," noting that "[t]he FCC has agreed that carriers required to estimate fair market value under Section 32.27(c) should be able to do so by comparing service prices associated with an affiliate transaction to those available on the open market." *See* Aureon Second Direct Case at 13 (emphasis added). And Aureon cites to a law review article, which it suggests supports its use of regulated CEA rates as a point of comparison. *Id*.

Aureon's cursory analysis here undermines, rather than supports, its position. To begin, the market for CEA service is *not* an "open market." Aureon acknowledges as much with its continued reliance on a supposed "mandatory use policy." *Id*. at 28. Further, the law review article on which Aureon relies undermines its analysis: the article notes that economic theory supports the use of market prices in setting rates, and that those rates should be set based on comparable sales *in an unregulated market environment*.[24] Indeed, the article highlights significant problems with regulated rates, which "cause allocative inefficiency" and often "deviate from market prices." *Id*. at 897.[25]

Fourth, Aureon suggests that the Commission has previously endorsed the use of "tariff-based valuations" for purposes of the fair market value analysis. *See* Aureon Second Direct Case

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[24] *See* Daniel F. Spulber & Christopher S. Yoo, *Access to Networks: Economic and Constitutional Connections*, 88 Cornell L. Rev. 885, 895 (2003) (hereinafter, "*Access to Networks*") ("The consensus economic position is that so long as competition is sufficiently robust, market prices represent the best reflection of value. The market price is the outcome of the forces of supply and demand."); *id*. at 970 ("the best way to promote economic efficiency when compelling access to an input is to price the input at its market value.").

[25] Even the portion of the Article quoted by Aureon does not support Aureon's use of regulated CEA rates. The quoted portion notes that the easiest measure of market price occurs "when a network owner sells into an external market the same type of access mandated by the government." *Id*. at 901. This statement supports the use of Aureon's *unregulated* market rates for DS-3 transport in the fair market value analysis, not the regulated rates of other carriers. As applicable here, the network owner is the Network Division, and the external market is the third-party market for DS-3 transport. *See also infra* Part II.B.

at 16. That is inaccurate. Aureon quotes from the *Accounting Safeguards Order*, which acknowledges only that qualified carriers can record the value of "charges appearing in *publicly-filed agreements* submitted to a State commission." 11 FCC Rcd. at 17612, ¶ 158 (emphasis added). This recording rule (which is not applicable here) has no application to the fair market value analysis, which looks to the value of services "on the open market." *Southern New England Telephone Co.*, 14 FCC Rcd. 7159, ¶ 5 (1999); *see also* Spulber & Yoo, *Access to Networks*, at 987 ("Basing access rates on the price that would be paid for access on the open market thus typically represents the best way to promote economic efficiency.").

Fifth, Aureon undermines its own use of the SDN and MIEAC rates by contrasting those carriers' networks only when it suits its purposes. Aureon ultimately concludes—without any evidentiary support—that its own rates "must necessarily be higher" than SDN's and MIEAC's rates because those carriers' transport services "are not as extensive" as Aureon's CEA offering. *See* Aureon Second Direct Case at 16, 27. If that is true, then Aureon should be using its *own* network service offerings as a comparison, rather than those of SDN and MIEAC.

Finally, even if MIEAC's rate could be used, Aureon now admits that that rate results in a lease charge of $4,036,478, which "is less than Aureon's lease charge by $868,168." *Id*. at 27. Aureon attempts to discount this sizeable decrease by claiming—without any evidence—that MIEAC's network is "far less extensive" than Aureon's. *Id*. But the fact remains that the resulting charge is far below Aureon's Filed Lease Expense. Moreover, the originating/terminating traffic ratio that results in that lease charge is not an anomaly. Aureon produced information in the AT&T Complaint case demonstrating that [redacted]

[redacted]

[redacted]

B. The Network Division's Average DS-3 Lease Rate Is the Most Accurate Point of Comparison for Aureon's Filed Lease Expense

The fair market value for Aureon's New Filed Lease Expense should not be determined by comparing that Filed Lease Expense against the rates for disparate services under the regulated rates of other carriers (such as SDN and MIEAC), which as Aureon admits provide far "less extensive" services on their networks. *See* Aureon Second Direct Case at 27. Instead, the most accurate valuation method here is to compare Aureon's Filed Lease Expense against *its own third-party lease rate* for the network capacity needed to transport traffic between the Access Division's tandem switch in Des Moines and the seven POIs at which CEA traffic is delivered to the subtending LECs.[27] That is, after all, the service that Aureon's unregulated Network Division provides to the Access Division. AT&T previously raised this issue by [redacted] *See* Rhinehart Initial Decl., ¶ 17; AT&T First Opp. at 66-67; AT&T Surrebuttal at 38. Tellingly, Aureon declined

[26] [redacted]

[27] This issue is distinct from the mileage issue relating to the calculation of the CLEC benchmark. The CLEC benchmark issue relates to the market rate for the service that competes against Aureon's service, whereas this issue pertains to the market rate for the transport facilities that the Access Division would purchase in order to offer CEA service.

to discuss its third-party lease rates in the earlier proceeding, so the Commission required it to do so in the *Rate Order*.[28]

In its September 2018 Tariff Filing, Aureon *again* declined to address this issue or to provide any information relating to its unregulated lease rates to third parties. In fact, the Commission recognized that Aureon did "not appear to have complied with paragraph 62" of the *Rate Order*, and so it "again direct[ed] Aureon to do so in its [Second] Direct Case." *Second Designation Order*, ¶ 20 n.58. Specifically, the Commission has directed Aureon to explain: (a) "[w]hether [Aureon's] Network Division leases its network facilities to any other entities, who they are and how much the Network Division charges for such services" (*Second Designation Order*, ¶ 20, bullet 6); (b) [redacted] *See id*. ¶ 20 n.78.

Aureon has now provided information on its third-party lease rates sufficient for the Commission to evaluate the fair market value of Aureon's Filed Lease Expense. And that information is significant. *See* Third Party Lease file. *First*, Aureon does not dispute AT&T's showing that Aureon leases capacity to third parties [redacted] *Second*, the

[28] Specifically, the Commission ordered Aureon to "address the relevance and accuracy of AT&T's assertion that [redacted] *Rate Order*, ¶ 62. It also ordered Aureon to discuss "the relevance of Aureon's nonregulated DS3 pricing as it compares to any DS3 pricing that could be derived from Aureon's C&WF allocation methodology." *Id*. ¶ 89.

additional lease information confirms what AT&T explained in the prior tariff investigation—that is, "the amounts paid by the Access Division are significantly above market rates, and … [Aureon's] CEA service is subsidizing [Aureon's] other transport services."[29] [redacted] *See infra* Part II.C.1; Pitkin Decl., ¶ 13, Figure 3. *Third*, this lease information confirms that the fair market value (or prevailing price) of the Filed Lease Expense is [redacted]

Moreover, when the [redacted]

[29] Rhinehart Reply Decl., ¶ 28.

[30] See Pitkin workpaper "CONFIDENTIAL Third party Leases - Circuit Cost.xlsx," "Summary.

[31] This follows Aureon's methodology of [redacted]

[32] *See* Pitken workpaper "CONFIDENTIAL JSI INS 2018 FCC Filing -updated 9-2018 v 4 11-2018 Replication with Corrections.xlsx," "Recovery Benchmarks."

1. Aureon Does Not Dispute the Accuracy of the [redacted] Lease Data, or the Fact That It Leases Fiber Transport to Third Parties at Levels Far Below Its Filed Lease Expense

The Commission has recognized that "large sales volumes to unaffiliated third parties" is a highly accurate comparator for purposes of the fair market value analysis. *See Southern New England Telephone Co.*, 14 FCC Rcd. 7161, ¶ 5. Indeed, the Commission stated in the *Accounting Safeguards Order* that "sales to third parties can provide a benchmark" and "if sales to third parties of a product at a particular price generate large revenues then the sale price is strong evidence of a good faith estimate of fair market value." 11 FCC Rcd. 17610, ¶ 154; Spulber & Yoo, *Access to Networks*, at 895 ("The consensus economic position is that so long as competition is sufficiently robust, market prices represent the best reflection of value."). [redacted] Given the sales volume of these third-party leases, and because Aureon provides CEA transport over the same routes as it does for these third-party leases, its unregulated DS-3 lease rates are the most accurate comparator for purposes of the fair market value analysis. [redacted] nor does it deny that those lease rates are far below its Filed Lease Expense.[34]

[33] [redacted]

[34] It is also noteworthy that Aureon has been extremely hesitant to provide this information. In the complaint case, and in the prior rate investigation, AT&T sought information on the lease rates that the Network Division charges for fiber capacity, but Aureon has continually rebuffed AT&T's and the Commission's requests for this lease data. In the complaint case, Aureon produced a

In opposing Aureon's February 2018 Tariff Filing, AT&T highlighted the fact that Aureon appeared to lease DS-3 transport service to third parties, [redacted] As demonstrated below, Aureon does not dispute the existence or accuracy of this lease data, nor could it—Aureon's own data confirms that Aureon [redacted]

More specifically, the evidence Aureon provided in the Complaint case demonstrated that during the period 2011 to 2017, [redacted]

limited set of lease agreements, including [redacted] Yet Aureon continued to object to AT&T's request for additional information on Aureon's lease rates. *See* Joint Statement on Discovery, at 9. The Commission ultimately required Aureon to produce a limited set of additional information. *See* Status Conference Letter Ruling, at 2 (dated July 25, 2017).

[35] Rhinehart Reply Decl., ¶ 28.

[36] [redacted]

[redacted]

[redacted]

[redacted]

[37] *See* AT&T Ex. 37.

[38] [redacted]

Further, the evidence confirms that Aureon leases this fiber capacity to third parties at rates much lower than the rates it charges the Access Division for capacity on those same routes. In the Complaint case, Aureon presented evidence indicating that in 2014 the lease cost associated with transporting CEA traffic [redacted]

The evidence in the Complaint case further showed that during the period 2011 to 2017, Aureon leased [redacted] Aureon does not—and cannot—deny this fact.

Finally, the disparity between the rates [redacted]

[39] [redacted]

[redacted]

2. Aureon's Attempts to Reclassify Its Filed Lease Expense as "CEA Transport Service" Is a Distraction

In its Second Direct Case, Aureon repeatedly claims that its third party lease rate for fiber transport is not the appropriate comparator for purposes of the fair market value analysis. In support of this claim, Aureon argues that the Network Division provides a "CEA Transport Service" to the Access Division that is purportedly a different kind of transport service than it provides to unaffiliated third parties. Aureon Second Direct Case at 8-12. On closer inspection, however, this argument quickly falls apart: Aureon provides the same DS-3 transport service to the Access Division that it does to third parties.

To begin, the "CEA Transport Service" discussed by Aureon is but an illusion. There is no such service described in Aureon's tariff filings, nor has Aureon *ever* claimed that such a service

[redacted]

[40] [redacted]

[41] [redacted]

exists until now. Aureon nonetheless suggests that the service provided to the Access Division is different because it "enables the Access Division to access all 2,700 miles of the CEA network to route calls to all of the LECs that subtend Aureon's CEA network." *Id*. at 8. Aureon further claims that the third parties who lease transport capacity receive "point-to-point services that only enable them to route traffic from one discrete location to another, or are for a purpose completely different from CEA service, such as 'direct Internet access' circuits for the provision of broadband.'" *Id*. at 8-9. Aureon also identifies several "factors" that it claims differentiate the third party leases, such as excess capacity and wholesale or "larger offering" pricing, which it suggests would cause the third-party lease rates to be priced below the Filed Lease Expense. *Id*. And finally, Aureon contends that "the monthly charges, capacities, features, and mileage" of these services "vary too widely to establish a prevailing rate." *Id*. at 10.

In reality, these factors do not differentiate the DS-3 fiber transport service that Aureon provides to both the Access Division and to third parties. And the Commission has rightly rejected previous attempts to reclassify a service based on the supposed "advantages" of Aureon's CEA network. *AT&T v. Alpine*, 27 FCC Rcd. 11511, ¶ 13 (2012) ("*Alpine*"), *recon. denied*, 27 FCC Rcd. 16606 (2012). In *Alpine*, a number of CLECs subtending Aureon's network re-designated their POIs in a deliberate effort to increase access revenues, while providing zero additional benefit. They tried to claim (in a similar fashion to Aureon) that there were additional "advantages" to this re-designation, such as "cost savings; more efficient aggregation of traffic; the ability to provide a wider variety of increased, future service, redundancy and the ability to interface with the networks of other telecommunications providers." *Id*. ¶ 46. The Commission rejected these justifications as "strained attempts to manufacture other reasons" for the increased charges. *Id*. For the very same reason, the Commission should reject Aureon's claims regarding

purported "advantages." The DS-3 transport service that the Network Division provides to the Access Division is the *same service* that Aureon provides (on a collective basis) to third parties.[42] *See supra* Part II.B.1. A bare assertion that the Filed Lease Expense is for a distinct "CEA Transport Service" does not alter this reality: "The traffic has continued to flow over precisely the same facilities and routes" as it always has. *Alpine*, 27 FCC Rcd., ¶ 13.

Moreover, the distinctions that Aureon uses to justify a higher charge for its "CEA Transport Service" are of no import when the third-party lease rates are viewed (as they should be) on an average or on a collective basis. That is, Aureon's leases for DS-3 fiber capacity may differ on an individual basis, but those purported differences wash out when one uses an average overall rate to measure the fair market value of DS-3 transport service. Indeed, [redacted] Stated differently, although customer "A" may only receive point-to-point traffic for Des Moines to Spencer, Iowa, customers "B" through "Z" receive point-to-point service, collectively, to the entire set of POIs and nodes served by Aureon's network. In fact, those customers appear to have access to a *more extensive* network, as the Network Division [redacted]

42 [redacted]

43 [redacted]

[redacted]

Aureon attempts to ignore these basic facts by highlighting a set of individual DS-3 lease rates that are priced much higher than the Great Lakes DS-3 rates highlighted in AT&T's Petition to Reject or Suspend. Specifically, Aureon contrasts [redacted]

Finally, Aureon's attempt to distinguish the third-party leases is disingenuous, because as discussed later, Aureon itself uses point-to-point dedicated transport rates in its own fair market

[redacted]

[redacted]

value analysis when comparing its Filed Lease Expense with rates under the CenturyLink and NECA tariffs. *See* Aureon Second Direct Case at 28-29.[46]

C. Aureon's Additional Valuation Methods and Arguments Should Be Rejected

In its Second Direct Case, Aureon has raised an array of new valuations and arguments in an attempt to defend its Filed Lease Expense. But Aureon's new presentation is nothing more than another effort to distract attention from the most accurate valuation: the lease rate for DS-3 transport that Aureon's own Network Division charges to unaffiliated third parties.

First, Aureon's analysis of the prevailing price requirement of the affiliate transaction rules is inaccurate; if anything, the data Aureon has provided confirms that the prevailing price here is the third-party lease rate for DS-3 transport capacity. *Second*, Aureon adds CenturyLink's and NECA's regulated tariffed rates as additional points of comparison, but as with the rates of SDN and MIEAC, the CenturyLink and NECA rates are inapposite or, in the case of the CenturyLink dedicated transport rate, *lower* than the Filed Lease Expense. *Third*, Aureon's "replacement cost" analysis is highly flawed. *Finally*, the Commission should reject Aureon's alternative request for

[46] The distinguishing factors Aureon mentions, such as "excess capacity" and "larger offering" pricing, also offer no solace to Aureon's inflated Filed Lease Expense. *Id*. at 9. If anything, Aureon's use of these factors to distinguish its third-party offerings is alarming, because it suggests that Aureon believes unaffiliated third parties should be able to take advantage of discounts and efficiencies where there are economies of scale, but that the Access Division should not (or does not) have access to the same benefits. The reality is that the Access Division has a long-term need (if declining over time) for a significant level of transport capacity; the economies of scale presented by that situation should lead to *lower*—not higher—prices for transport, particularly on Aureon's network which offers transport services to hundreds of other parties. Additionally, Aureon's suggestion that its leases for "direct Internet access" are somehow different in kind for these purposes is misleading. Aureon cannot deny that its broadband traffic is transported over the very same network as its CEA traffic. The only difference is that the internet traffic utilizes greater fiber capacity, which is why carriers lease 10G or GigE circuits to carry this traffic. If anything, those services should be required to bear a greater proportion of the C&WF cost.

a waiver because the third-party lease data that Aureon has now provided confirms that there is ample "relevant data available for Aureon to make a good faith market estimate."

1. The Access Division Has Failed to Record the Filed Lease Expense at a Level Below the Prevailing Price for DS-3 Fiber Transport

Aureon begins its brief with a lengthy discussion of the "prevailing price" requirement of the Commission's affiliate transaction rules. *See* Aureon Second Direct Case at 5-12; 47 C.F.R. § 32.27(c). The prevailing price requirement was not addressed in the Commission's *Second Designation Order*, so Aureon's decision to dedicate a significant portion of its brief to this is perplexing, in view of the evidence presented in its Second Direct Case. Aureon claims that "there is no prevailing price" for its Filed Lease Expense (Aureon Second Direct Case at 7), but the data Aureon has produced suggests both that Aureon is subject to the prevailing price requirement, and that Aureon has priced its Filed Lease Expense above the prevailing price for its DS-3 fiber transport service.

The Commission's affiliate transaction rules provide that carriers "shall" record an affiliate transaction at the "prevailing price," where "greater than 25 percent of the total quantity" of a service is sold by the nonregulated affiliate "to third parties." 47 C.F.R. § 32.27(c), (d). The Commission has explained that "if no tariff exists [for the service] and a carrier transfers or sells a service to its regulated affiliate that it also provides to third parties, the carrier must record the transaction at the prevailing company price. Non-tariffed services that are sold or transferred by an affiliate to its regulated carrier and are also sold to third parties at a generally available price, must also be recorded by the carrier at that price." *Accounting Safeguards Order*, 11 FCC Rcd. 17539, ¶ 127; *In the Matter of 800 Data Base Access Tariffs & the 800 Serv. Mgmt. Sys. Tariff & Provision of 800 Servs.*, 12 FCC Rcd. 5188, ¶ 46 (1997) ("services provided by an affiliate to the regulated entity must be recorded at market rates when those same services are also provided by

the affiliate to unaffiliated entities. … no further clarification is necessary."). Boiled down, the Commission's affiliate transaction rules require the Commission to analyze three questions pertinent to the analysis here: *first*, what "service" is sold in the transaction at issue; *second*, whether the nonregulated affiliate sells more than 25 percent of that service to third parties; and *third*, if so, whether the carrier has accurately recorded the affiliate transaction at the "prevailing price."

First, the general "service" provided by the Network Division to third parties and to the Access Division is unregulated fiber transport, which Aureon acknowledges. *See* Aureon Second Direct Case at 6, n.17 ("The service provided by the Network Division to the Access Division by way of the facilities lease is an unregulated, non-tariffed service."); [redacted] The Commission has clarified, however, that the relevant service must be identified on a "service-by-service basis, rather than on a … service-line basis." 47 C.F.R. § 32.27(d). Aureon suggests that, because its "CEA Transport Service" is provided only to the Access Division, this analysis is not possible. *See* Aureon Second Direct Case at 8. For the reasons discussed above, this argument is unfounded. *See supra* Part II.B.2. Further, it is clear that the specific service at issue here is DS-3 fiber transport, given the Network Division's lease of DS-3 circuits to the Access Division and unaffiliated third parties.[47]

Faced with this reality, Aureon suggests that instead of using DS-3 fiber transport as the "service," [redacted]

[47] The "service-line" prevailing price valuation would result in a price for general fiber transport services (collectively, DIA, DS-1, DS-3, etc.), and the "service-by-service" valuation would result in a price for each distinct transport capacity (as relevant here, DS-3 fiber transport).

[redacted]

Second, the data that Aureon has produced shows that Aureon sells more than 25 percent of its DS-3 fiber transport service to unaffiliated third parties. [redacted] The overall rate for Aureon's DS-3 fiber transport service therefore appears to qualify as a prevailing price, so its Filed Lease Expense should be recorded at that price. 47 C.F.R. § 32.27(c).

Third, notwithstanding the foregoing, Aureon has not recorded its Filed Lease Expense at the prevailing price. As discussed above, [redacted]

[redacted]

2. The NECA And CenturyLink Tariff Rates Are Also Inapt Comparisons

In its Second Direct Case, Aureon has added regulated rates from NECA's and CenturyLink's tariffs in its fair market value analysis, ultimately concluding that the average rates from those carriers (and for SDN and MIEAC) results in a "market comparison" cost of $7,896,616, or nearly $3 million higher than its Filed Lease Expense. *See* Aureon Second Direct Case at 26-29.[48] However, the NECA and CenturyLink rates fail for the same reasons as the SDN and MIEAC tariff rates discussed above. *See supra* II.A. *First*, those regulated, rate-of-return tariff rates cannot be compared to the unregulated rates for wholesale fiber transport.

Second, Aureon's use of NECA and CenturyLink dedicated transport rates is telling: Aureon decries the use of point-to-point transport rates for the prevailing price and fair market valuation analyses, *see* Aureon Second Direct Case at 12 ("[t]he point-to-point services provided by Aureon to third party … vary greatly"), yet in the next breath when it suits its purposes, it declares that "a comparison using these rates is valid." *Id*. at 28.

Third, Aureon abandons the NECA switched transport rate in its lease comparison, acknowledging that the NECA rate is an "outlier." NECA's dedicated transport rate is also not a

[48] Specifically, Aureon calculates the revenues that would result from each carrier's service(s) based on either its projection of 2.6 billion CEA minutes or 116 CEA DS-3 circuits. This includes: (a) the "Access Transport" rate on SDN's network of $0.005122/min.; (b) the MIEAC transport rate of $0.001553 (based on a revised mix of 92% terminating and 8% originating traffic); (c) the dedicated transport rate for DS-3 service on Aureon's network of $6,185.26 per month per DS-3 circuit; (d) a CenturyLink transport rate of $0.003346/min.; and (e) a CenturyLink dedicated transport rate of $3,469.51 per month per DS-3 circuit. *See* Aureon Second Direct Case at 26-29.

proper comparator, as NECA offers services to smaller rural customers who do not have the need to lease significant capacity like the Access Division. NECA's rates are, as a result, much higher.

Fourth, as to the CenturyLink dedicated transport rate, Aureon disingenuously selects a 36-month DS-3 rate from Page 6-313 for CenturyLink Tariff F.C.C. No. 11. Not only is that 36-month rate already *less* than the Filed Lease Expense (because it results in revenues of $4,828,968.17), but there is a much less expensive 120-month rate that Aureon fails to mention. Given the number of DS-3 circuits being leased by the Access Division, and the length of time those circuits have been (and will be) leased, the 120-month lease is the more accurate service to compare, which results in annual revenues of $3,258,268,[49] or $1,646,378 (or 34 percent) less than Aureon's Filed Lease Expense.

3. Aureon's "Replacement Cost" Analysis Suffers from Serious Flaws

In a likely recognition of the flaws in its other valuation methods, Aureon adds a new "replacement cost" approach to its fair market value analysis, declaring it to be "the next best method" following the SDN and MIEAC rates. *See* Aureon Second Direct Case at 16. Aureon describes this approach as being "based on the replacement cost of the fully operational CEA network" and claims that it "should approximate the market value of all the inputs used to create and operate the network." *Id.* Ultimately, Aureon concludes that its "replacement cost" valuation results in an annual revenue requirement of $6,579,794, which is higher than the Filed Lease Expense. This approach, however, suffers from serious flaws that undermine its utility as a valuation method in this case.

First, Aureon itself acknowledges the serious flaws in its valuation method, as its study

[49] *See* CenturyLink Tariff F.C.C. No. 11, Page 6-317. The $3,258,268 charge is calculated based on a fixed charge of $211.90 and a per mile charge of $25.70 for each of Aureon's 116 CEA DS-3 circuits.

does not include all necessary inputs. *Id*. at 18. Further, many of the assumptions and costs set forth in its study are not supported by hard data, and there has been no showing that the data cobbled together in support of certain of the costs is representative of the costs that would actually be incurred if Aureon's entire CEA network was being replaced. In such an undertaking, there inevitably would be economies of scope and scale and other efficiencies. However, none of that is taken into account in Mr. Vaughn's 5-page declaration and handful of exhibits.

Second, Aureon's replacement cost is based on inappropriate COE and C&WF allocators. Aureon's declarant Brian Sullivan explains that he applied a "composite allocation of 23%, applied to the COE and CWF components separately." *See* Sullivan Decl., ¶ 18. As the Commission has previously explained, use of a composite allocator is inappropriate, and it ordered Aureon not to do so in the future. *Rate Order*, ¶ 72 ("We agree with AT&T that Aureon's fully distributed cost study should, in fact, use the separate COE transmission and C&WF allocators rather than a weighted average.").

Third, when the allocation percentages are changed to [redacted] This is now the *fourth* valuation method Aureon has selected which, when properly run, results in a lease rate below the Filed Lease Expense. *See supra* Part II.C.2 (CenturyLink dedicated transport); Part II.B (average DS-3 transport rate); Part II.A (MIEAC rate).

Finally, Aureon's replacement cost analysis is immediately suspect, because Aureon has previously been unable or unwilling to provide meaningful backup data to support its CEA lease rate. No such data was provided in the AT&T Complaint case, and in the previous rate proceeding,

Aureon responded to the Commission's request for such data by indicating that it does not exists. Yet, it now purports to provide a replacement cost analysis for the entire network. Aureon cannot have it both ways, and it certainly cannot be permitted to present a replacement cost study when it cannot provide the data underlying its own rates.

4. The Commission Should Reject Aureon's Request for A Waiver

Finally, Aureon requests—in the alternative—that the Commission grant it a waiver of the fair market valuation requirement to the extent it "determine[s] that additional information is needed to support" Aureon's fair market value analysis. *See* Aureon Second Direct Case at 19. The Commission should reject Aureon's request. As Aureon acknowledges, waiver of the Commission's Part 32 rules requires a significant showing of "special circumstances." *See* 47 C.F.R. §§ 1.3, 32.18. And Aureon has not made that showing here. The third-party lease data that Aureon has now provided confirms that there is ample "relevant data available for Aureon to make a good faith market estimate." *See id*; *supra* Part II.B.

III. AUREON HAS NOT DEMONSTRATED THAT ITS FILED LEASE EXPENSE IS LOWER THAN THE FULLY DISTRIBUTED COSTS OF THE LEASED FACILITIES

In its September 2018 Tariff Filing, Aureon completely revised the network cost allocation methodology that was used in its previous tariff submissions to allocate COE and C&WF costs, which strongly suggests that its prior cost allocation methodology – which was not disclosed in its prior filings – was based on improper accounting methods. *Cf.* Order on Reconsideration, *AT&T Corp. v. Iowa Network Services, Inc. d/b/a Aureon Network Services*, Proceeding No. 17-56, ¶ 16 (Aug. 1, 2018). While that issue is to be examined by the Commission in the damages phase of the AT&T Complaint case (*see id*.), what is most relevant here is whether Aureon's new methodology (which has resulted in [redacted].

[redacted] As explained below, Aureon's Filed Lease Expense is still overstated.

In calculating this new Filed Lease Expense, Aureon [redacted]

In light of these changes, the Commission directed Aureon to provide a full justification for its costs of service calculation and in that connection, identified four principal issues to be addressed: (a) Aureon's new circuit inventory; (b) its circuit forecasts; (c) its new allocation methodology; and (d) several apparent calculation errors. *Second Designation Order*, ¶¶ 21-34. The inadequacies of Aureon's responses to the specific issues identified by the Commission as to each of these issues is discussed below.

A. Aureon's New Circuit Inventory Cannot Be Reconciled with its Prior Circuit Inventories and Raises Additional Questions Regarding the Reasonableness of Aureon's Current CEA Rate.

In prior submissions supporting its CEA rates, Aureon claimed that [redacted]

In both the Commission's previous rate investigation and in the prior AT&T Complaint case, AT&T and its cost expert, Daniel P. Rhinehart, relied on that circuit data to demonstrate that Aureon's allocation of the C&WF costs to its CEA service was grossly overstated. AT&T First Opp. at 58-68; Rhinehart Supp. Decl., ¶¶ 22-24; Rhinehart Supp. Rate Decl., ¶¶ 26-29. In addition, as part of the previous rate proceeding, AT&T demonstrated that there were significant discrepancies in the circuit inventories that Aureon had submitted, and the Commission therefore required Aureon to provide an updated circuit inventory with additional detail. *See Rate Order*, ¶ 89 & n.283.

In response, Aureon provided, as part of its September 2018 Tariff Filing, a dramatically different circuit inventory that bears little resemblance to Aureon's prior circuit inventories, including the circuit inventory submitted with Aureon's February 2018 Tariff Filing, *i.e.*, Annex 3. For example,

[50]

[51] *Compare, e.g.*, Annex 3

[redacted]

In its September 2018 Tariff Filing, Aureon provided no explanation for these disparities, and as a consequence, the Commission directed Aureon to provide a complete narrative explanation of the circuit counts/inventory it used in the calculations made in support of Transmittal 38. *See Second Designation Order*, ¶ 23. The Commission further directed Aureon to specifically provide the following information:

- An explanation of why the data differs so significantly between Transmittal 36 and 38;
- Information about the relative vintages of the data and, if the vintages vary, why a newer vintage was used;
- An explanation of the relationship between the various spreadsheet worksheets/tabs;
- Definitions of the terms "ring" and "ring node," and the relationship between those terms, as well as POIs between Aureon and its subtending carriers; and
- [redacted]

The Commission also directed Aureon to provide specific information regarding each of [redacted] As Mr. Carl Albright explained in his declaration in Aureon's

[52] *Compare, e.g.*, Annex 3 [redacted]

previous rate case, "it is the cost of those … fibers that should be considered in allocating CWF costs to the traffic being transported over the particular optic system being used." *See* Declaration of Carl Albright, Jr. ("Albright Decl."), ¶ 7. The Commission further directed Aureon to (a) explain "[t]he disposition in Aureon's inventory of each of the circuits that Aureon previously used for cost allocation purposes that are of capacity greater than DS3 and why such disposition is reasonable," and (b) provide "[a]n affirmative unqualified statement that no services are sold by the Network Division on the "Joint and Common" rings that are not represented on the corresponding tabs in the circuit inventory. *See Second Designation Order*, ¶ 23.

In its Second Direct Case, Aureon does not put forward a declaration from an Aureon employee either to respond to the Commission's questions regarding the structure of its fiber network, or to explain the differences between its current circuit inventory and the circuit inventories that it relied on its past tariff filings dating back to at least 2006. Instead, it appears to have hired an outside consultant, Paul Nesenson of John Staurulakis, Inc., ("JSI"), to create a new circuit inventory for use in this proceeding. [redacted]

In his declaration, Mr. Nesenson indicates that [redacted]

[redacted]

Given that *since at least 2006* Aureon has relied on what it now says is a "flawed circuit inventory reporting system" to set its inflated CEA rates, this explanation is wholly inadequate. At a minimum, Aureon should have presented one of its executives to specifically describe this flaw and explain why it was not discovered earlier, particularly in light of the fact that the accuracy of its circuit inventories was specifically put in issue in both the AT&T Complaint case and in the previous rate proceeding. In those proceedings, Aureon submitted declarations [redacted]

[redacted]

53 [redacted]

[redacted]

54 [redacted]

[redacted] As explained below, this information is important in evaluating the reasonableness of Aureon's new COE allocation methodology. *See infra* Part III.C.

In responding to the Commission's inquiries, Aureon also does not [redacted]

55 [redacted]

[redacted]

B. Aureon's New Circuit Forecasts Are Not Adequately Supported and Cannot Be Reconciled With Aureon's Prior Circuit Inventories

As the Commission explained in the *Rate Order*, the Commission's rules require Aureon to allocate costs based on "the relative regulated and nonregulated usage of the investment during the calendar year when nonregulated usage is greatest in comparison to regulated usage during the three calendar years beginning with the calendar year during which the investment usage forecast is filed." 47 C.F.R. § 64.901(b)(4); *Rate Order*, ¶ 78. The circuit inventory in Aureon's February 2018 Tariff Filing failed to allocate costs on this basis, so the Commission required Aureon to provide a revised circuit forecast in its subsequent tariff filing. *Rate Order*, ¶ 78 (Aureon "must include calculations based on forecasted data (including circuit forecasts) for each of calendar years 2018, 2019, and 2020," and to select appropriate allocators for each type of cost for 2018, 2019, and 2020).

The Commission also recognized the disconnect between the growth in Aureon's DS-1 circuit inventory assigned to CEA service and the decline in demand for CEA traffic. Despite a significant decline in demand between 2016 and 2018, [redacted]

Aureon's September 2018 Tariff Filing failed to address the Commission's concerns, and also did not provide the specific data required by the *Rate Order*. To begin, Aureon's revised circuit inventory [redacted] Aureon also failed to explain the growth factors that it

selected, which appear to be [redacted]

As a result, the Commission set this issue for investigation and required Aureon to explain "the basis of the circuit count projections that it uses, including any supporting data." *Second Designation Order*, ¶ 24. The Commission further made clear that "[t]his applies to projections regarding all types of circuits." As regards the issue of [redacted] The Commission also noted that "Aureon's implementation of its circuit count projections for future years appears to be flawed." *Id.* ¶ 28.

To address these issues, the Commission directed Aureon to [redacted] *See id.* ¶ 27. It also directed Aureon to explain [redacted]

[redacted]

In its Second Direct Case, Aureon does not provide "an explanation of the basis of the circuit projections it use[d]" or any supporting data. Instead, it simply repeats what it said in its September 2018 Tariff Filing, re-publishes a snapshot of the same table that was included in that tariff filing, and asserts that its projections comply with the Commission's regulations. *See* Pitkin Decl. ¶ 38. If that was all that was needed, there would have been no reason for the Commission to have designated this issue for investigation or requested additional data. But that is not what the Commission did. Rather, the Commission requested [redacted]

Mr. Sullivan, who apparently was tasked with responding to this request, indicates that he [redacted]

[redacted]

[redacted]

[redacted]

---

56 [redacted]

[redacted]

[redacted]

In sum, Aureon has not adequately responded to the Commission's inquiries regarding its circuit forecasts and its failures in this regard further undermine the credibility of its September 2018 Tariff Filing.

C. Aureon's New Cost Allocation Methodology Significantly Over-Allocates Costs to Aureon's CEA Service

A critical component of a just and reasonable CEA rate involves ensuring that Aureon does not assign an inappropriately high share of its network costs to its regulated CEA service. The Commission has determined that Aureon's prior rate filings violated this requirement, and made clear that any new rate must be based on a proper and reasonable allocation. *See Rate Order,* ¶¶ 87-90. Yet, while Aureon has completely revamped the methodology it used in allocating both COE and C&WF Costs to its Access Division, its new methodology continues to over-allocate those costs to its CEA service.

In its September 2018 Tariff Filing, Aureon included documentation supporting its new allocation methodology, but it did not provide any narrative justifying that methodology. Further, as AT&T pointed out in its Petition to Reject or Suspend, there seemed to be a number of unexplained discrepancies between Aureon's new methodology and its prior methodology, including that fact that Aureon's new methodology did not appear to take into account all of the circuits that have been a part of Aureon's fiber network, such as the OC-48 and other high bandwidth circuits. *See* AT&T Second Pet. at 15-17. AT&T also questioned [redacted] *Id.* at 16.

To address these issues, the Commission directed Aureon to provide "a full narrative explanation for the new methodology for both the [COE] and [C&WF] allocators, including support for all assumptions made, an explanation of how such methodology is compliant with the [*Rate Order*], and citation to relevant statutory and regulatory authority, where applicable. *Id.* ¶ 29. The Commission further made clear that this explanation should include "a description of how Aureon's methodology relates to the manner in which costs on the Network Division's network are actually incurred, that is, among other things, whether these costs vary based on the number of fiber pairs, the provisioned high-capacity optical or other services, etc." *Id.*

The Commission also directed Aureon to [redacted] (b) discuss the "relevance and accuracy of AT&T's claims regarding the manner in which a wholesale customer, such as the Access Division, would actually lease circuits for use [on] Aureon's network, as well as the relevance of Aureon's nonregulated DS3 pricing as it compares to any DS3 pricing that could be derived from Aureon's C&WF allocation methodology" (*id.* n.78; *see also Rate Order*, ¶ 89); and (c) explain why the circuit counts that it seeks to use are reasonable and how they are "used and useful" in the provision of CEA service, to the extent Aureon proposes using a COE and/or C&WF allocator that is reliant on circuit counts that do not [redacted] *Id.* ¶ 30.

Notwithstanding the importance of this issue to assessing the reasonableness of Aureon's current CEA rate, Aureon's responses to the Commission's inquiries are not presented until page 45 of its Second Direct Case and are less than four pages long. *See* Aureon Second Direct Case at 45-48 & n.135. Further, the explanation largely parrots paragraphs 32 to 40 of Mr. Sullivan's

declaration, who Aureon asserts is "the person most knowledgeable about the issues designated for investigation in" paragraph 29 of the *Second Designation Order*. *See* Sullivan Decl., ¶¶ 32-40.[57]

As explained below, Aureon has not adequately addressed the issues raised by the Commission. In addition, Aureon's treatment [redacted]

1. Aureon Has Not Adequately Responded to the Commission's Inquiries

Contrary to Aureon's claim (*see* Aureon Second Direct Case at 35), nowhere in the *Rate Order* did the Commission require that "all allocations for [C&WF] be done using DS-3 level allocations as opposed to DS-1 allocations." In his declaration, [redacted] In the *Rate Order*, the Commission did not tell Aureon how to conduct its revised cost allocation methodology—without specific knowledge as to the structure of Aureon's

[57] Aureon's designation of Mr. Sullivan as "the person most knowledgeable about the issue designated" for investigation in paragraph 29 (*see* Aureon Second Direct Case at 48, n.135) is absurd. [redacted]

fiber network, how could it? Rather, the Commission rejected Aureon's prior allocation methodology, and directed Aureon to "take a more nuanced approach to determining the C&WF allocator and recalculate the costs based rate accordingly." *See Rate Order*, ¶ 89. The Commission further indicated that it expected that Aureon would elaborate fully on its rationale and provide complete data, including, as relevant, circuit inventories to support its recalculated cost-based rate. *Id.* And, the Commission telegraphed for Aureon some of the factors that should be considered, including "among other things, whether these costs vary based on the number of fiber pairs." *See Second Designation Order*, ¶ 29.

That has not occurred. As noted above, there are serious deficiencies in the circuit data that Aureon has provided. *See supra* Part III.B. Moreover, as explained in Mr. Pitkin's declaration, Aureon's revised cost allocation has a number of serious deficiencies and produces results that do not make economic sense. The problems identified by Mr. Pitkin include [redacted]

Aureon's response to the Commission's inquiries regarding whether the DS-1 circuits used for CEA service (particularly the circuits in excess of 1,265) are "used and useful" is similarly

deficient. This issue is only discussed in Mr. Sullivan's Declaration, where he simply declares

[redacted]

2. Aureon's Revised Allocation of COE Costs Significantly Over-Allocates COE Costs to Aureon's CEA Service

Aureon was not required by the *Rate Order* to revise its allocation methodology for COE costs, but it did so anyway (*see Second Designation Order*, ¶ 29), thereby [redacted]

[redacted] Aureon's new COE allocation methodology is set forth in the "CCT Inventory and Allocations" Tab of the Revised Confidential Workpaper. As can be seen from that workpaper, Aureon's new methodology is [redacted]

[redacted]

There are two major problems with Aureon's COE allocation methodology that completely undermine the validity of its [redacted]

[redacted]

In its Second Direct Case submission, Aureon does not address this issue, which is a significant omission.

Second, even if Aureon could overcome this first problem, a second issue exists with respect to Aureon's handling of what [redacted]

[redacted]

3. Aureon's Revised Allocation of C&WF Costs Significantly Over-Allocates C&WF Costs to Aureon's CEA Service

Aureon's revised allocation of C&WF costs, like its revised COE allocation, is based on

[redacted]

As noted above, and explained in greater detail in both Mr. Albright's declaration from the previous rate proceeding and Mr. Pitkin's declaration in this proceeding, the cost driver for C&WF costs is not circuit mileage, but route mileage and fiber mileage. *See supra* Part III.A; *see also* Albright Decl., ¶ 7 and Pitkin Decl., ¶¶ 30-32. As Mr. Pitkin shows,

[58]

to 53%, which results in only 17.5% of the C&WF costs ultimately being allocated to CEA service. *Id.,* Exhibit BFP-B at 5.

This approach, as Mr. Pitkin points out, "is an improvement, [but] it does not reflect the most proper cost allocation approach, which is [to] allocat[e] C&WF costs based on sheath miles." *Id.* ¶ 31. Based on the data that Aureon provided in its September 2018 Tariff Filing, as supplemented by the additional information provided as part of its Second Direct Case, including the third party sales data, Mr. Pitkin developed an alternative calculation (*see id.* ¶¶ 31-35) which shows that, when C&WF costs are located on a route mile basis, the C&WF allocator is further reduced to 9.6% (*see id.* ¶ 35, Exhibit BFP-B at 5) and the amount of C&WF costs allocated to CEA service is reduced from about $4.4 million to about $1.7 million. *Id.* Further, when this reduction is combined with the reduction resulting from adjusting the COE allocator (*see supra* Part III.C.2), Aureon's current CEA rate is reduced to $0.00198/min. *Id.* ¶ 36. **[[END CONFIDENTIAL]]**

4. Aureon's Overall Lease Expense is Both Unsupported and Excessive

Finally, Mr. Pitkin's discussion of [redacted]

[redacted]

As Mr. Pitkin explains, Aureon's overall Lease Expense is unsupported and is grossly inflated, which necessarily results in Aureon's Filed Lease Expense and its CEA rate being similarly inflated. *See* Pitkin Decl., ¶¶ 50-54. Indeed, if Aureon's CEA rate were computed [redacted]

Similarly, if Aureon had used its third-party lease information to determine the fair market value of the [redacted]

D. Aureon's Fully Distributed Costs Calculation Shows (When Corrected) That Aureon's "Filed Lease Expense" Is Excessive.

In its Petition to Reject or Suspend, AT&T identified a number of calculation errors in Aureon's fully distributed costs calculation, including its calculation of the accumulated

[redacted]

depreciation reserves for the "COE Circuit" and the "Cable and Wire Facilities" accounts set forth in its work papers (*see* AT&T Second Pet. at 20), its handling of the "COE Switching and COE Transmission Maintenance" (*id.*); and its failure to recognize deductible interest in its income tax calculation. *Id*. at 21.

In its *Second Designation Order,* the Commission takes note of these apparent errors and directs Aureon to explain: (a) the calculation of the accumulated depreciation reserves, given Aureon's apparent addition of depreciation expense for the prior year, rather than the test year (*Second Designation Order*, ¶ 32); (b) the treatment of central office expense, particularly whether it includes both COE transmission and switching expense (*Id*. ¶ 33); and (c) the failure to deduct for tax-deductible interest expense in the calculation of federal and state taxable income. *Id*. ¶ 34.

In its Second Direct Case, Aureon acknowledges that these errors occurred, asserts that they have been corrected, and claims that the impact was not material. *See* Aureon Second Direct Case at 49-50; *see also* Sullivan Decl. ¶¶ 31-33. Although AT&T agrees that the errors relating to the accumulated depreciation reserves and the deductible interest/income tax calculation appear to have been fixed, the amounts allocated to COE Transmission Maintenance still appear to be inflated. *See* Pitkin Decl. ¶ 55. AT&T also disputes Aureon's claim that corrections in costs—which total about $1.3 million—are not material in assessing the reliability of Aureon's calculation of the fully distributed costs of the network facilities and equipment leased to the Access Division. *See id.*

Moreover, when those cost corrections are made to Aureon's fully distributed cost calculation and the allocation factors are adjusted to properly reflect the corrected COE and C&WF allocators (*see supra* Part III.C, Sections 2 and 3), the resulting fully distributed lease cost decreases from [redacted]

[redacted]

IV. AUREON'S REVISED CEA RATE IS UNREASONABLE, AND THE COMMISSION SHOULD BOTH PRESCRIBE A RATE AND INITIATE AN INVESTIGATION INTO AUREON'S PRACTICES

Aureon has now had two opportunities to justify its revised CEA rate, and in both instances has come up well short. In the *Rate Order*, the Commission rejected the revised CEA rate that Aureon filed in February 2018, finding that significant issues continued to exist, and directed to file a new rate. *See Rate Order*, ¶¶ 46, 122. The Commission further provided Aureon with specific guidance regarding the issues that needed to be addressed and provided Aureon with an additional 60 days to make the necessary corrections.

As detailed above, Aureon's current proposal suffers from many of the same problems as its earlier submission. Aureon is still unable to explain the basis pursuant to which its Filed Lease Expense was computed; that remains a black box. Further, Aureon has not demonstrated that its Filed Lease Expense passes muster under the Commission's affiliate transaction rules. *First*, Aureon has not shown that it is lower than both the fair market value and fully distributed costs of the leased facilities. To the contrary, the evidence show the exact opposite. The evidence relating to [redacted] and the evidence relating to MIEAC's transport applied to Aureon's originating and terminating CEA volumes both support the conclusion that Aureon's revised CEA rate is excessive. *Second*, the evidence relating to Aureon's fully distributed cost calculation

supports the same conclusion. Indeed, that evidence strongly suggests that Aureon's CEA rate should be no greater than [redacted]

In light of this record, the Commission should reject Aureon's revised CEA rate of $0.00296/min. Moreover, given the multiple opportunities that Aureon has had to justify its CEA rate, the Commission should direct Aureon to file a new CEA rate that is no greater than [redacted] In addition, the Commission should set for additional investigation Aureon's prior ratemaking practices, particularly its practices relating to its leasing of circuit capacity to the Access Division. Aureon at best has been grossly negligent, and at worst has misled the Commission and the public, relying on improper cost methodologies that it did not disclose, and submitting admittedly "flawed" data to justify its rates. *See* Aureon Second Direct Case at 36-37.

CONCLUSION

For the foregoing reasons, the Commission should: (a) find Aureon's revised rate to be unreasonable; (b) prescribe a rate of no greater than [redacted] (c) direct Aureon to refund the difference between the prescribed rate and its current CEA rate of $0.00296 per minute ("/min.");[60] and (d) initiate an investigation into Aureon's practices.

[60] These refunds would be in addition to the refunds arising as a result of the *Rate Order*.

Respectfully submitted,

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Dated: December 6, 2018

Counsel for AT&T Services, Inc.

CERTIFICATE OF SERVICE

I hereby certify that on December 6, 2018, I caused a copy of the foregoing AT&T Services, Inc.'s Opposition to Direct Case of Iowa Network Access Division d/b/a Aureon Network Services to be served via email on the following:

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Respectfully submitted,

/s/ Spencer D. Driscoll
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Pitkin Declaration

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MATERIALS OMITTED

AT&T Exhibit 40

Total DS-3 Circuit Comparison

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MATERIALS OMITTED

AT&T Exhibit 41

Total CEA DS-1 Circuit Comparison

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MATERIALS OMITTED

AT&T Exhibit 42

Total DS-3 and Equivalent DS-3 Circuit Comparison

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MATERIALS OMITTED