

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Pricing Proceeding)	DOCKET NO. UT-960369
for Interconnection, Unbundled Elements,)	
Transport and Termination, and Resale)	
.....)	
In the Matter of the Pricing Proceeding)	DOCKET NO. UT-960370
Interconnection, Unbundled Elements,)	
Transport and Termination, and Resale for)	
)	
U S WEST COMMUNICATIONS, INC.)	
.....)	
In the Matter of the Pricing Proceeding)	DOCKET NO. UT-960371
for Interconnection, Unbundled Elements,)	
Transport and Termination, and Resale for)	
)	17th SUPPLEMENTAL ORDER:
)	INTERIM ORDER DETERMINING
GTE NORTHWEST INCORPORATED)	PRICES; NOTICE OF
)	PREHEARING CONFERENCE
.....)	(September 23, 1999)

BACKGROUND

The Commission initiated this proceeding on November 21, 1996,¹ to consider cost and pricing issues arising out of the Commission's October 23, 1996 Order² in several arbitration dockets. The issues also arose from the Commission's general obligations under the Telecommunications Act of 1996³ to establish rates for interconnection, unbundled network elements, transport and termination, and resale. 47 U.S.C. § 252(d). While this proceeding implements the 1996 Act, the Commission also acts under Title 80 RCW and Title 480 WAC. See, Fourth Supplemental Order, Docket No. UT-941465 *et. seq.*

¹ Order Instituting Investigations; Order of Consolidation; and Notice of Prehearing Conference, Docket Nos. UT-960369, -960370, -960371 (November 21, 1996) (Generic Cost Order)

² Order on Sprint's Petition to Intervene and to Establish Generic Pricing Proceeding, Docket Nos. UT-960307, 960309, -960310, -960323, -960326, -960332 (October 23, 1996)

³ Telecommunications Act of 1996, 47 U.S.C. § 151 *et. seq.* (1996) (Act).

SUMMARY

Scope of Proceedings: The Commission established a "Phase I" to consider cost issues on a generic basis, and a "Phase II" to consider pricing for U S WEST Communications, Inc. (U S WEST), and GTE Northwest Incorporated (GTE). The Commission resolved most of the Phase I cost issues in the April 16, 1998 Eighth Supplemental Order (8TH ORDER) in this proceeding.

The 8TH ORDER also established topics for the parties to address in the pricing phase of the proceeding. The parties identified specific issues for investigation and the Administrative Law Judge published an exclusive statement of issues for this pricing phase of the proceeding on July 10, 1998.

In this Order, the Washington Utilities and Transportation Commission will be referred to as the Commission, and the Federal Communications Commission will be referred to as the FCC.

Parties: The appearances, for Phase II of this proceeding, included: Lisa Anderl for U S WEST; Pam Ballard for Shared Communications Systems; Doug Bonner for MSF and GST Telecommunications; Art Butler for TRACER; Rick Finnigan for WITA; Brooks Harlow for Covad Communications, Co.; Nancy Judy for United Telephone of the Northwest; Greg Kopta for TCG and NEXTLINK; Clyde H. Maclver for WorldCom and Telecommunications Ratepayers Association; Robert M. Manifold for Public Counsel; Rogelio Pena for MCI and MCI Metro; Timothy Peters for Electric Lightwave, Inc.; Ann C. Pongracz for Sprint of Nevada; Lewis F. Powell and Christopher Huther for GTE; Susan Proctor for AT&T; Ann Rendahl and Shannon Smith for Commission Staff; Sara Siegler Miller for Frontier Telemanagement.

Commission: In the instant Order on Phase II pricing issues, the Commission reaches the following decisions:

Four-Wire Loop Costs: The Commission finds that the cost of a four-wire loop for U S WEST is 85 percent more than the cost of a two-wire loop. The Commission sets the price of a four-wire loop for U S WEST at 85 percent more than the price of a two-wire loop. In the Ninth Supplemental Order (9TH ORDER) in this proceeding, the Commission determined that the cost of a four-wire loop for GTE was 50 percent more than the cost of a two-wire loop (because GTE's service territory has different characteristics which lead to use of different technology). The Commission set the four-wire loop price for GTE at 50 percent more than the price for a two-wire loop. See, ¶¶79 *et seq.*

Operations Support System (OSS)/Transition Costs: The Commission concludes that because OSS is a network element, CLEC's should pay reasonable costs of modifying OSS to support a competitive environment. For U S WEST, this includes the IMA (interconnection mediated access) interface. Neither U S WEST nor GTE provided adequate documentation of their OSS costs, so the Commission directs both companies to file new cost studies no later than January 31, 2000. The Commission finds that it should set interim prices for both manual and electronic interfaces, and does so in this Order. *See, ¶103 et seq.*

Recovery of Common Costs: For U S WEST's loop cost, the Commission applies a 4.05 percent common cost factor to U S WEST's RLCAP model cost estimate, a 12.5 percent common cost factor to the Hatfield model cost estimate, and \$3.47 to the BCPM model cost estimate. For GTE's loop cost, the Commission applies a 24.47 percent common cost factor to the GTE model cost estimate, a 12.5 percent common cost factor to the Hatfield model cost estimate, and \$3.10 to the BCPM model cost estimate. The markup for the GTE model is larger relative to the Hatfield and U S WEST RLCAP model mark-ups because the RLCAP and Hatfield models attribute more costs directly to individual network elements.

The Commission rejects proposals for an additional markup beyond a reasonable amount of common costs because the resulting proposed prices are not consistent with the 1996 Act. The result is a permanent unbundled statewide average loop price of \$18.16 for U S WEST and \$23.94 for GTE. In Phase III of this proceeding, the Commission will create geographic rate zones designed to produce target revenues equal to the \$18.16 and \$23.94 statewide average rates for U S WEST and GTE, respectively. *See, ¶176 et seq.*

Loop Conditioning: In the 8TH ORDER, the Commission directed U S WEST to adjust the inputs to its loop conditioning cost study. The Commission adopts the study which U S WEST filed in response to that Order and applies the 4.05 percent common cost markup to establish conditioning prices. The resulting interim price for load coil removal on a 25-pair binder group is \$304.12 and the price for bridge tap removal at a single location is \$147.37. In Phase III, we will determine if this revenue should be recovered from the party that requests the activity or from all unbundled loops.

The Commission cannot set permanent conditioning prices for GTE because GTE did not file an adequate cost study early enough in this proceeding to be addressed by the parties and considered by the Commission. Pending consideration of GTE's study in Phase III of this proceeding, the Commission will use U S WEST's prices as interim prices for GTE. *See, ¶235 et seq.*

Grooming: The Commission declines to consider GTE's proposed grooming prices because GTE did not submit cost data providing adequate time to be addressed by the parties and considered by the Commission. For U S WEST, the Commission's Fourteenth Supplemental Order (14TH ORDER) resulted in an increase of \$1.65 in the U S WEST RLCAP loop cost estimate to reflect the cost of grooming. The Commission notes that grooming is not necessary when a CLEC orders a bundled loop and port; in that situation, U S WEST's loop price will be \$17.59. *See, ¶247 et seq.*

Operator Services/Directory Assistance (OS/DA) Avoided Cost Discount: The Commission concludes that the OS/DA avoided cost discount for GTE should be 0.6 percent and the discount for U S WEST should be 7.97 percent. *See, ¶254.*

Collocation: The majority of the parties asked the Commission to open a new proceeding or a new phase of this proceeding to address collocation issues. The Commission therefore will consider a number of key policy issues, and the new collocation cost studies which U S WEST and GTE are developing, in Phase III of this proceeding. In the instant of this proceeding, the Commission rejects NEXTLINK's market price proposal. The Commission also concludes that GTE may not require CLECs to use separate entrance facilities and directs GTE to remove separate entrance facility costs from its cost studies. With that adjustment, the Commission adopts GTE's existing collocation cost study as the basis for GTE's interim collocation prices. The Commission will not use U S WEST's existing study as the basis for its interim prices because it contains unreasonable assumptions. The interim prices for U S WEST will be the same as GTE's prices. *See, ¶258 et seq.*

U S WEST's SPOT [Single Point of Termination] Frame Proposal: U S WEST did not include SPOT frame costs in its collocation cost study. If U S WEST intends to pursue the SPOT frame concept as a general requirement, it must support its request with a filing demonstrating the basis for its proposal. *See, ¶338 et seq.*

Interim Local Number Portability: The Commission adopts the "New York" method for recovering the cost of interim local number portability. We order a common cost additive of 15 percent, which results in a price of \$1.73 for interim local number portability. *See, ¶367 et seq.*

Shared Transport: The Commission adopts a modified version of U S WEST's proposal for a capacity-based pricing structure. The modifications continue to encourage CLECs to accurately forecast demand while allowing CLECs to aggregate their forecasts and share usage before imposition of penalties for under forecasting. The modifications also include the concept of rebates and penalties if U S WEST fails to provide enough capacity for forecasted demand.

The Commission believes that a usage-sensitive option should be available for shared services/elements. We direct U S WEST to file and support a minutes-of-use rate as part of its compliance filing. *See*, ¶396 *et seq.*

Transport and Termination Pricing: The Commission prefers a capacity-charge concept because it better reflects the cost structure of the telecommunications network. While the Commission directs Staff and interested parties to develop a compliance capacity-charge filing, the Commission also wants to provide interconnecting parties with flexibility in this regard. The Commission will, to the extent possible, resolve interconnection disputes on this issue by adopting one of the parties' proposals. *See*, ¶421 *et seq.*

Non-Recurring Charges: The Commission adopts U S WEST's non-recurring cost study, a 19.65 percent additive for attributed costs, and a 4.05 percent additive for common costs. The Commission does not adopt U S WEST's pricing structure and directs the Company to make a compliance filing with separate rates for manual and electronic ordering, and separate rates for connection and disconnection. *See*, ¶435 *et seq.*

For GTE, the Commission modifies cost study inputs as described in the instant Order and requires the Company to use the same rate structure as we order for U S WEST. *See*, ¶452 *et seq.*

Customer Transfer Charge: The Commission adopts Staff's proposed adjustments to U S WEST's rate structure. We also require U S WEST to remove wholesale OSS costs from its OSS cost study. *See*, ¶464 *et seq.*

Billing Issues: ILECs should not bill for services in advance, so the Commission directs GTE and U S WEST to bill separately for connection and disconnection. The Commission also finds that there should be only one charge for ordering and billing per customer location. We accept U S WEST's assertion that its billing system can handle only one unbundled network element (UNE) per service order, but direct the Company to file evidence in Phase III showing whether a billing system which could accommodate multiple UNEs on a single order would produce cost savings. *See*, ¶475 *et seq.*

Deaveraging: The Commission has determined that deaveraged prices for interconnection and unbundled network elements (UNEs) should be established. Therefore, the current interim rates for interconnection and UNEs which were approved by the Commission in agreements filed pursuant to the arbitration and negotiation provisions of the Act will remain in effect pending the outcome of Phase III of this proceeding.

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INTRODUCTION

1. On January 25, 1999, the United States Supreme Court issued its decision in *AT&T Corp. v. Iowa Utilities Board*, No. 97-826, slip op. (U.S. Jan. 25, 1999). The decision affirms in part and reverses in part the Eighth Circuit's decision in *Iowa Utilities Board v. FCC*, 120 F.3d 753 (8th Cir. 1997). Since the decision potentially constrains the Commission's legal and policy options in this case, the Commission directed the parties to file supplemental briefs addressing the effect of the Supreme Court's decision. This Order first addresses legal issues and, thereafter, resolves the substantive issues.

2. Due to the technical complexity of the subject matter of this proceeding, the Commission has integrated its findings of fact and conclusions of law into the body of the text. It makes additional general findings and conclusions of law at the end of the Order.

LEGAL ISSUES

I. IMPACT OF SUPREME COURT DECISION

BACKGROUND

3. Several components of the Supreme Court decision have a potential impact on the Commission's decision in this case. They are:

4. *FCC Pricing Methodologies*. The Court reinstated the FCC's pricing rules after concluding that the FCC has authority to establish pricing methodologies for state commissions to apply. The reinstated rules include the FCC's proxy prices.

5. *Geographic De-averaging*. One of the FCC pricing rules which the Court reinstated was 47 C.F.R. § 51.507(f). It requires state commissions to calculate geographically de-averaged costs and adopt at least three rate zones.

6. *FCC List of Network Elements*. While the Court upheld the FCC's broad interpretation of the term "network element," it concluded that the FCC failed to properly consider the "necessary" and "impair" standards in 47 U.S.C. § 251(d)(2) in developing 47 C.F.R. § 319 (the list of mandatory network elements that incumbent local exchange companies (ILECs) must provide). The Court then vacated the rule. That leaves a statutory obligation for ILECs to provide network elements without a federal rule obligating ILECs to provide any particular element.

7. *ILEC Ability to Disassemble Elements*. The Court upheld 47 C.F.R. §

51.315(b) which prohibits ILECs from separating already-combined elements.

8. *ILEC Obligation to Assemble Elements.* The Eighth Circuit Court held that 47 C.F.R. § 51.315(c) through (f), which require ILECs to combine network elements for competitive local exchange companies (CLECs), violate the Act. It is not clear whether the Supreme Court intended to reinstate those rules when it stated that its decision only invalidated 47 C.F.R. § 51.319.

9. *CLEC Ability to Replicate ILEC Services.* CLECs may replicate ILEC services through network elements. This disposes of ILEC “sham unbundling” and “arbitrage” arguments.

10. *The “Pick & Choose” Rule.* The Supreme Court reinstated 47 C.F.R. § 51.809, which allows CLECs to select individual provisions from any of the ILEC’s other interconnection agreements.

11. In the following section we summarize the parties’ analyses of the effect of the Supreme Court’s decision. We follow this summary with our conclusions on the issues raised by the parties.

ILEC POSITIONS

U S WEST

12. The impact of the Supreme Court decision will not be fully known for some time because the Court still has the ability to entertain petitions for reconsideration. The impact will not be known until the Court issues its mandate to the Eighth Circuit Court, the Eighth Circuit interprets the mandate, and both the Eighth Circuit and FCC conduct additional proceedings in compliance with the mandate.

13. Despite the importance of the Supreme Court decision, it has little, if any, impact on this proceeding because:

- To the extent the FCC’s pricing rules apply, the rates and costs U S WEST has proposed in this proceeding fully comply with the FCC’s methodology.
- The non-pricing portions of the decision do not apply because they are outside the scope of this proceeding.

GTE

14. The Commission cannot establish a *permanent* price for a network element until the FCC and federal courts have resolved 1) whether the element is

among those an ILEC must provide and, if it is among them, 2) how to price that element consistent with the Act and the Constitution. While this Commission may continue with its decision-making in this proceeding, the Commission should recognize that GTE no longer has an obligation to provide any network elements and that a state commission will have no basis for requiring an ILEC to provide a particular element until the FCC completes its work on that issue. GTE states that it will allow CLECs to continue interconnecting through existing and new interconnection agreements.

15. Under those agreements, GTE will provide any requested network element provided the CLEC does not seek UNE “platforms” or “already bundled” combinations of UNEs. GTE also will continue to seek full recovery of its actual costs. There is nothing the Supreme Court’s opinion that undermines GTE’s right, under the 1996 Act and U.S. Constitution, to full cost recovery.

CLEC POSITIONS

AT&T/TCG

16. The provisions of the FCC’s *Local Competition Order* (FCC Order No. 96-325, 11 FCC Rcd. 15499) which the Court reinstated are immediately applicable to existing interconnection agreements. While the Court vacated 47 C.F.R. § 51.319, the Act obligates ILECs to provide network elements and the Court did not require the FCC to adopt a different list of elements. The Court’s decision does not eliminate the ILECs’ obligations to provide the elements in their arbitration agreements with AT&T/TCG because the ILECs voluntarily agreed to provide those elements.

17. In the Court’s discussion of Rule 319(b), the Court stated that the FCC rationally concluded that allowing ILECs to unbundle existing element combinations would be inconsistent with 47 U.S.C. § 251(c)(3). That section requires ILECs to provide network elements on a nondiscriminatory basis, and the Court’s reasoning in reinstating Rule 319(b) implicitly rejects “anti-competitive” practices—such as U S WEST’s SPOT Frame proposal— which impose wasteful costs on CLECs.

COVAD

18. **Pricing.** Now that the Court has reinstated the FCC’s pricing rules, the current state of the record prevents the Commission from setting rates higher than the FCC proxy rates in 47 C.F.R. 51.513⁴ or from providing an additional amount for recovery of common costs. The Commission must apply the proxy prices because the

⁴ The proxy ceiling for loops in Washington is \$13.37.

Commission has not determined costs for at least three defined geographic areas.⁵ See, 47 C.F.R. 507(f). The Commission also does not have information from U S WEST or GTE about their *forward-looking* common costs. The Commission should adopt the proxy prices unless the cost from Phase I for a particular element is below the proxy or there is no proxy price for the element.

19. The Commission must follow the FCC's rules unless the Eighth Circuit Court issues a stay. The Eighth Circuit is not likely to do so because the party requesting the stay must show that it is likely to prevail. ILECs are not likely to make that showing because courts generally defer to agency technical expertise and numerous district courts have rejected the ILECs' "taking" arguments.

20. **Network Elements.** Nothing in the statute or the Supreme Court's decision precludes states from requiring ILECs to provide specific elements under state law or under 47 C.F.R. § 317(a), which allows states to require ILECs to provide elements beyond the list in Rule 319.

MCI WorldCom

21. **Pricing.** The FCC's pricing rules are binding on the Commission until a federal court stays or vacates them. This means that the Commission must adopt geographically de-averaged prices. The Commission may not incorporate universal service funding into network element pricing. It also may not include other costs specifically rejected by the FCC. Those costs include the "opportunity costs" which the "efficient component pricing rule" calculates from the ILEC's past revenues.

22. **Network Elements.** Since the Court reinstated 47 C.F.R. § 51.315(b), an ILEC cannot separate existing element combinations.

NEXTLINK/ELI

23. **Pricing.** The Commission must modify its Phase I decision to be consistent with FCC's total element long-run incremental cost (TELRIC) methodology. In particular:

24. **Geographic De-averaging.** The Commission must either adopt the geographically de-averaged costs from the Phase I Hatfield Model or re-open the proceeding for the taking of additional evidence.

⁵This argument is now moot because the FCC stayed the effectiveness of the geographic deaveraging rule in Order No. FCC 99-086.

25. **Total Costs.** The Commission must ensure that its Phase I costs are consistent with the FCC's pricing methodology. Costs must be "based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers," and may not include embedded costs, retail costs, opportunity costs, "stranded" costs, "transition" costs, or revenues to subsidize other services (which includes support for universal service). The FCC's methodology includes a reasonable profit. With respect to nonrecurring costs, the Commission must limit recovery to forward-looking costs and efficiently allocate them among carriers.

26. **Network Elements.** Both arbitrated and fully-negotiated agreements provide for access to a specific list of UNEs and the list generally was not in dispute. To the extent the list was in dispute, the Court's reinstatement of the Pick & Choose rule gives one CLEC access to that portion of another CLEC's agreement. Since the Court left 47 C.F.R. § 51.317 intact, this Commission can require access to specific elements under the 96 Act. The Commission also can exercise its authority under state law to specify elements. See, Docket Nos. UT-941464 *et al.*, Fourth Supplemental Order at 51-52 (October 31, 1995).

OTHER POSITIONS

PUBLIC COUNSEL

27. **Resale vs. Unbundled Access.** The Supreme Court set aside the ILEC argument that a combination of the FCC's rules would destroy the distinction between resale and unbundled access necessary to prevent "arbitrage" between the wholesale discount and element prices. The opportunity for "arbitrage" is inherent in the statute.

28. **Cost Determinations.** The Commission should carefully review its Phase I cost decisions to ensure that they are consistent with the FCC's TELRIC methodology. In particular, the Commission relied on model outputs that did not necessarily comply with TELRIC and then based its Phase I loop costs on an ambiguous adjustment process. The Commission also did not establish costs for a minimum of three rate zones. Given the evolution of cost modeling during Phase I, the Commission may want to reopen the cost phase of the proceeding before adopting "generic" prices to replace the existing interim prices.

29. **Cost Recovery.** Unbundled element prices cannot include embedded costs, retail costs, opportunity costs, or revenues to subsidize other services. 47 C.F.R. § 51.505(d). As a result, the U S WEST and GTE proposals are not consistent with the federal rules because they seek to recover embedded costs and opportunity costs. ILEC attempts to recover "stranded" costs and universal service surcharges are not consistent with the rules, and Staff's parity pricing concept improperly ties element

prices to retail rates. There is no need for an additional “markup” to recover common costs or to provide a reasonable profit because the FCC’s methodology includes them.

TRACER

30. The FCC pricing rules are in effect and binding on the Commission.

COMMISSION STAFF

31. **Pricing.** The FCC’s pricing methodology is now binding on state commissions. That methodology requires the Commission to set rates equal to TELRIC plus a reasonable allocation of forward-looking joint and common costs. Rates under the FCC’s methodology include a reasonable profit because TELRIC recovers the forward-looking cost of capital. It is not appropriate for a state commission to include embedded/historical costs, retail costs, opportunity costs, or revenues to subsidize other services.

32. **Phase I Cost Decisions.** When the Commission established costs in Phase I, it deviated from the FCC methodology only with respect to geographic de-averaging. There is no need to re-visit the Phase I costing decisions.

33. **Geographic De-averaging.** The Commission has three options:

(1) If the Commission believes it has sufficient evidence in the record, it should establish geographically de-averaged rates in the pricing phase of this proceeding.

(2) If the Commission lacks sufficient evidence, it should reopen Phase I, initiate a new phase for this proceeding, or open a separate proceeding.

(3) There is a possibility that the FCC will modify, relax, or stay its de-averaging rule, so the Commission may want to wait before making a decision.

34. **Collocation Pricing.** The Commission required the ILECs to show that their collocation cost studies comply with the FCC’s Physical Collocation order. Therefore, the Supreme Court decision does not affect the Commission’s approach to collocation pricing.

35. **Network Elements.** The Commission has looked to 47 C.F.R. 319 only for guidance in defining network elements and determining which elements ILECs must offer to CLECs. The Commission, under 47 C.F.R. § 51.317, retains the ability under federal law to require ILECs to offer specific network elements. The Commission should specify elements under 47 U.S.C. § 251(d)(2) and RCW 80.36.140.

36. While it is not clear that the Supreme Court reinstated 47 C.F.R. § 51.315(c)-(f), the Commission has independent authority under state law to require ILECs to combine network elements. It should do so.

COMMISSION DECISION

Impact on Phase I Decisions

37. The Supreme Court upheld the FCC's authority to select costing/pricing methodologies for state commissions to apply and then reinstated the FCC's pricing rules. The Eighth Circuit Court will be reviewing the rules on the merits, but it has not stayed or vacated the rules. The rules are appropriate because the FCC's forward-looking TELRIC methodology is consistent with the statutory mandate to set prices without reference to a traditional rate of return proceeding.

38. On April 28, 1999, in CC Docket 96-98, the FCC stayed its geographic deaveraging rule. The stay will be in effect until six months after the FCC releases its order in CC Docket No. 96-45 finalizing and ordering implementation of high-cost universal service support for non-rural local exchange carriers. The FCC's decision recognizes the need to address deaveraging and universal service support in a coordinated manner. It is not necessary to establish geographically de-averaged prices in the instant Order. Interim rates will remain in effect. The Commission anticipates completing Phase III in the time frame established by the FCC.

Impact on Network Element Availability

39. While the Supreme Court upheld the FCC's broad definition of a network element, it vacated the rule specifying the unbundled network elements an ILEC must make available to CLECs. The temporary absence of a federal rule does not provide ILECs with an opportunity to impose unreasonably high payments upon CLECs or impose anti-competitive conditions. Pending a new FCC rule in conformance with the Supreme Court's decision, the Commission exercises its state regulatory authority and directs the ILECs to continue providing network elements pursuant to their interconnection agreements. *See, In the Matter of the Petition for Arbitration of An Interconnection Agreement Between AT&T Communications of the Pacific Northwest, Inc. and GTE Northwest Incorporated*, Docket No. UT-960307, Commission Order Partially Granting Reconsideration, Page 5, et seq. (March 16, 1998).

Recovery of Actual Costs

40. GTE asserts that the Commission must set prices at a level sufficient to allow it to recover their actual costs. In the absence of the FCC pricing rules, this Commission would have to resolve GTE's statutory and constitutional issues before resolving the various cost recovery issues. That is no longer necessary.

41. The Supreme Court's reinstatement of the FCC's pricing rules greatly simplifies the pricing decisions in this case. The federal rules allow recovery only of TELRIC plus a reasonable allocation of forward-looking common costs. 47 C.F.R. § 51.501 through § 51.513; *Local Competition Order* at ¶¶ 694-703. The Commission in subsequent sections of this order resolves the various cost recovery issues in a manner consistent with the federal rules.

II. IMPACT OF THE FCC'S ISP DECISION

BACKGROUND

42. On February 26, 1999, the FCC issued a decision relating to inter-carrier compensation for traffic flowing to Internet service providers (ISP). The decision is a Declaratory Ruling on the issue of whether ISP-bound traffic is intrastate or interstate. The FCC's short answer to that question is: "After reviewing the record[,] we conclude that ISP-bound traffic is jurisdictionally mixed and appears to be largely interstate." FCC Order No. 99-38 ¶1.

43. The FCC's conclusion does not resolve the underlying question of whether ISP-bound traffic is subject to reciprocal compensation. The FCC's next sentence states: "This conclusion, however, does not in itself determine whether reciprocal compensation is due in any particular instance." FCC Order No. 99-38 ¶1.

44. The FCC goes on to say that, in general, carriers are compensated for carrying calls either through access charges or reciprocal compensation. The FCC specifically noted that it currently is appropriate for state commissions to require reciprocal compensation: "While to date the Commission has not adopted a specific rule governing the matter, we note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic." FCC Order No. 99-38 at 25.

45. Nothing in the Act or the FCC's current rules prohibits reciprocal compensation for ISP-bound traffic. Thus, a state commission may conclude that reciprocal compensation is appropriate for ISP-bound traffic even though the FCC has concluded that it is interstate traffic: "We recognize that our conclusion that ISP-bound traffic is largely interstate might cause some state commissions to re-examine their conclusion that reciprocal compensation is due to the extent that those conclusions are based on a finding that this traffic terminates at an ISP server, but nothing in this Declaratory Ruling precludes state commissions from determining, pursuant to contractual principles or other legal or equitable considerations, that reciprocal compensation is an appropriate interim inter-carrier compensation rule pending completion of the rulemaking we initiate below." FCC Order No. 99-38 at 19.

46. The FCC then noted that it lacked a sufficient record to determine whether reciprocal compensation should apply to ISP-bound traffic. It initiated a rulemaking proceeding and left interim reciprocal compensation decisions to the states: “Until adoption of a final rule, state commissions will continue to determine whether reciprocal compensation is due for this traffic.” *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Inter-Carrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98 and 99-68, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, FCC 99-38 (February 26, 1999) (Declaratory Ruling and NPRM, respectively) at ¶28.

ILEC POSITIONS

U S WEST

47. On March 5, 1999, U S WEST requested an opportunity to file a supplemental brief on this issue. U S WEST contends that the FCC’s decision requires this Commission to conclude that traffic bound for an ISP is interstate traffic and, therefore, exempt from reciprocal compensation provisions.

GTE

48. GTE supports the U S WEST motion and position on the issue.

CLEC POSITIONS

MCI WorldCom

49. The FCC decision allows state commissions, pending a federal rule to the contrary, to require payment of reciprocal compensation for ISP traffic. Reciprocal compensation is necessary because the FCC’s access charge rules prevent carriers from collecting access charges for ISP-bound traffic.

ELI; NEXTLINK; TCG SEATTLE; AT&T

50. U S WEST mischaracterizes the FCC’s order as “dispositive” on the issue of reciprocal compensation for ISP traffic. The FCC expressly authorized state commissions to require reciprocal compensation for ISP traffic pending a rule to the contrary.

GST Telecom

51. The FCC’s order clearly recognizes this Commission’s authority to

establish a compensation mechanism for ISP-bound traffic.

OTHER POSITIONS

COMMISSION STAFF

52. The FCC clearly and repeatedly stated in the order that, until the FCC completes a rulemaking on the issue, individual states are free to determine whether reciprocal compensation should apply to ISP traffic.

COMMISSION DECISION

53. **Need for Additional Briefing.** The text of the FCC decision is clear and unambiguous and, therefore, we find that no additional briefing on this issue is required.

54. **Decision on the Merits.** This Commission has authority to resolve this issue pending an FCC rule requiring one outcome or another. The FCC currently exempts ISP-bound traffic from access charges,⁶ so the resolution most consistent with existing FCC rules is to require reciprocal compensation. The FCC's conclusion that ISP-bound traffic is primarily interstate is not dispositive because neither the Act nor FCC rules preclude interstate traffic from reciprocal compensation. The Commission concludes that ISP-bound traffic should remain subject to reciprocal compensation.

FOUR-WIRE LOOP COSTS

I. OVERVIEW

55. The cost of the four-wire loop is a carry-over issue from Phase I of this proceeding. U S WEST and GTE presented evidence on this issue in Phase I, and the Commission, in paragraphs 189 through 195 of the 8TH ORDER, determined that the cost for a four-wire loop was 125 percent of the cost of a two-wire loop. U S WEST requested reconsideration of this determination. On reconsideration, the Commission agreed that the 125 percent represented only the incremental difference in materials between the four-wire and the two-wire loops, and not the full TELRIC of the four-wire loop. 9TH ORDER at ¶3. At paragraph 21 of the 9TH ORDER, the Commission found the weighted average cost of a four-wire loop for GTE to be 50 percent higher than that of a two-wire loop. In paragraph 22 of the 9TH ORDER, the Commission noted that it was not making a determination on the proper price differential between a two-wire and

⁶ Current FCC rules treat ISPs and other ESPs (enhanced service providers) as end-users and permit them to purchase their links to the public switched network through intrastate business tariffs rather than interstate access tariffs.

a four-wire loop.⁷

56. In both the 9TH ORDER and the Tenth Supplemental Order (10TH ORDER), at paragraph 20 and paragraph 24, respectively, the Commission directed U S WEST to recalculate its estimate of the difference in the cost of providing a two-wire and four-wire loop. On August 5, 1998, in compliance with the Commission's directive, U S WEST provided its comparison of its two-wire and four-wire loop costs. In order to better understand and clarify the compliance filing, the Commission requested that U S WEST make its expert witnesses available to discuss this issue with the Commission. The request for a meeting was made on August 31, 1998, and the discussion occurred on September 1, 1998. All parties of record were notified in advance of the September 1, 1998 discussion and were invited to attend through the Commission's teleconference bridge.

57. Subsequent to the September 1, 1998 discussion, TRACER filed testimony in which it states that had it been permitted to ask questions or make statements during the teleconference, it would have identified problems with the representations being made by U S WEST. TRACER witness Zepp also filed testimony on this issue on August 20, 1998; U S WEST moved to strike this testimony and filed rebuttal testimony on this issue on September 4, 1998. TRACER responded to USWC's *Motion to Strike and Petition for Reconsideration* on September 10, 1998.

58. In the 14TH ORDER, at paragraph 26, the Commission made the decision to postpone its determination on U S WEST's cost for a four-wire loop until after it had heard all parties testimony on this issue during the evidentiary hearings in Phase II.

II. PARTY POSITIONS

U S WEST

59. U S WEST states that, in response to paragraph 20 of the Commission's 9TH ORDER, it has re-calculated the cost of a four-wire loop. The Company avers that its four-wire loop calculation is based on its two-wire analysis and assumes double the copper investment costs, but holds the 257C digital loop carrier (DLC) investment constant. According to U S WEST, this analysis produced results showing the cost of the four-wire loop to be 182 percent of the cost of a two-wire loop. U S WEST goes on to note, however, that "if the DLC investments were set at 30 percent higher for the four-wire loop, as suggested in GTE's study, the weighted average investment would be

⁷The cost difference is larger for U S WEST than for GTE, because a higher proportion of GTE's loops are served with digital loop carrier. When digital loop carrier is used, the additional investment is smaller than when copper is employed. Digital loop carrier investment appears in Account 257C (257C).

187 percent of a two-wire loop.” Brief at 11.⁸

60. U S WEST takes issue with the Commission’s conclusion, at paragraph 20 of the 9TH ORDER, that it is unreasonable to assume that four-wire 257C investment is twice that required for two-wire investment. U S WEST goes on to argue that a four-wire DLC investment necessitates taking into consideration the impact that a four-wire circuit has on the capacity of the system and the cost of the channeling units. It is U S WEST’s contention that if these considerations were taken into account in the four-wire loop calculation, the result would be greater than 200 percent of the two-wire loop cost.

61. U S WEST avers that TRACER’s contention that the cost of the four-wire loop should be determined as an incremental cost of the two-wire loop is without merit and is counter to the Commission’s rulings in the 9TH ORDER, at paragraph 13, and the 10TH ORDER, at paragraph 26, and so should be rejected.

62. U S WEST argues that TRACER’s four-wire loop analysis relies on runs performed by a modified version of the Hatfield 5.0a (HAI 5.0a) model which is not in evidence in these proceedings, and which the Commission declined to adopt when it was introduced into the proceedings in Docket No. UT-980311(a). U S WEST goes on to make the point that TRACER witness Zepp did not perform the modifications to HAI 5.0a himself, and did not himself perform the model runs which generated the four-wire price figures he advocates the Commission adopting. Therefore, U S WEST argues that it is impossible to explore the validity of the model adjustments and no reliance can be placed on Dr. Zepp’s testimony regarding the proper cost of a four-wire loop. U S WEST declares that since the Commission has previously rejected attempts to rely on HAI 5.0a for other purposes in this proceeding, the Commission should similarly reject TRACER’s attempt to utilize HAI 5.0a to establish the cost of a four-wire loop.

63. U S WEST also argues that TRACER’s assertion that each loop, regardless of whether it is a two-wire or four-wire loop, should bear the same amount of placement cost is contrary to the Commission’s prior rulings in this proceeding. Such an assignment of cost would result in the second pair of wires in a four wire loop being assigned less than its full placement cost. It is U S WEST’s contention that “each line (i.e., each *pair*) must bear the same amount of placement costs, consistent with the

⁸ It should be noted that U S WEST contradicts itself concerning these investment calculations on page 12 of its Brief. There it states that the assumption that DLC investment is 30 percent greater for a four-wire loop produces an investment result for the four-wire loop which is 195 percent the cost of a two-wire loop.

Commission's 9TH ORDER, paragraph 17.⁹ Brief at 14.

64. U S WEST further points out that while both the Hatfield and RLCAP models estimate the cost of the loop, in each of these models the loops are always assumed to be two-wire loops. U S WEST asserts that any testimony suggesting that either model includes four-wire loops as part of its modeling algorithms, is mistaken at best and misleading at worst.

65. U S WEST concludes by finding that the cost of a four-wire loop is at least 82 percent higher than the cost of a two-wire loop, and that the price of a four-wire loop should be set at twice that of a two-wire loop to avoid arbitrage of the four-wire loop to provide two separate lines.

GTE

66. GTE limits its comments to noting that the Commission's 9TH ORDER, paragraph 21, sets GTE's four-wire loop cost at a 50 percent markup above the cost of a two-wire loop.

STAFF

67. Staff agrees with the Commission's determination of four-wire loop costs in its 8TH and 9TH ORDERS in this proceeding. Staff goes on to state that in the pricing phase of the proceeding the Commission should address only the price of the four-wire loop, applying the cost-based pricing methodology in the FCC's pricing rules. Staff makes no further recommendation as to what that price should be. Brief at 11.

PUBLIC COUNSEL

68. Public Counsel does not address this issue.

MCI

69. MCI does not address this issue.

⁹ Paragraph 17 of the 9TH ORDER states: "At paragraph 179 [8TH ORDER], we adopted the methodology proposed by AT&T/MCI. Under this approach, if two loops are ordered at the same location, each loop is assigned an equal share of the structure costs. Each loop uses two wires and therefore the use of two loops requires four wires. We concur therefore with GTE and U S WEST that regardless whether four wires are used to provide two, two-wire loops, or one, four-wire loop, the distribution and feeder cable costs assigned to those two configurations should be identical."

AT&T

70. AT&T supports TRACER's position that the price of a four-wire loop should be no more than 25 percent above the price of a two-wire loop.

NEXTLINK

71. NEXTLINK contends that U S WEST's proposed price for a four-wire loop is flawed and would lead to the adoption of a four-wire loop price which far exceeds its TELRIC, in violation of the Act and the FCC's pricing rules. NEXTLINK maintains that "a four-wire circuit is not just a combination of two two-wire circuits. A four-wire circuit is configured differently, requiring fewer facilities (and correspondingly lower cost) than a two-wire circuit." Brief at 15. Because of this, NEXTLINK contends that a four-wire circuit cannot be accurately priced by merely doubling the price of a two-wire loop.

72. It is NEXTLINK's position that TRACER's cost study is the only one which accurately estimates the cost of a four-wire loop. This being the case, NEXTLINK goes on to argue, it is TRACER's four-wire loop rate of 1.25 percent times the geographically deaveraged unbundled two-wire loop rate that should be adopted by the Commission. Brief at 15.

COVAD

73. COVAD has not briefed this issue, but notes that not doing so should not be construed as agreement with the ILECs' positions.

TRACER

74. TRACER points out that one of the issues surrounding the determination of the cost of a four-wire loop in this proceeding is the inconsistency between U S WEST's proposed four-wire loop costs of 200 percent of the cost of a two-wire loop, contrasted with GTE's proposed four-wire loop costs of 150 percent of the cost of a two-wire loop. Brief at 10.

75. TRACER believes that U S WEST's contention that a four-wire loop causes twice the placement cost of a two-wire loop is incorrect and based on the false assumption that four-wire loops were actually modeled as two two-wire circuits in Phase I. It is TRACER's contention that, in Phase I, four-wire circuits, other than special access lines, were modeled as one pair and not as two two-wire circuits. This being the case, TRACER goes on to state that the loop counts used in the models were counts of loops and not counts of pairs and so placement costs were assigned to loops and not to pairs. Continuing this line of reasoning, TRACER states that, given the foregoing, the total demand utilized by the proxy models in computing unit costs is in loop units and not pair units, thus the unit cost of production is (total cost)/loops and not (total

cost)/pairs. TRACER goes on to argue that, while four-wire circuit costs would have to be larger to reflect the additional pairs of copper and the different DLC cards required, the same amount of placement cost should be assigned to each loop, be it a four-wire loop or a two-wire loop. Brief at 10-11.

76. It is TRACER's belief that the above proves that merely doubling the two-wire costs to determine four-wire costs is inconsistent with the two-wire link UNE costs the Commission has already found to be reasonable.

77. TRACER contends that part of the confusion concerning the proper cost of four-wire loops arises from the fact that no TELRIC study of the four-wire loop was presented in Phase I of this proceeding. Since two-wire and four-wire loops are separate elements, it is TRACER's opinion that separate TELRIC studies need to be done for each. Brief at 12.

78. To address this situation, TRACER states that it "asked HAI Consulting, Inc. (HAI), to compute how much more it would cost to provide four-wire versus two-wire circuits in the state of Washington for USWC. HAI modified the Distribution and Feeder Modules in its cost proxy model to respond to this request. It found that, if loops were assumed to require two wire pairs per line instead of one (*i.e.*, loops were four-wire circuits), and if the four-wire circuits provided on Digital Loop Carrier were assumed to require DLC channel units at a price of \$300 per two-line card, costs for four-wire circuits would be approximately 28 percent higher than for two-wire circuits. This study indicates that the Commission should not determine a cost for four-wire circuits that is more than 28 percent greater of the cost determined for two-wire circuits." Brief at 12.

III. COMMISSION DECISION

79. In its 9TH ORDER, at paragraph 21, the Commission set GTE's four-wire loop cost at a 50 percent markup above the cost of a two-wire loop. We reaffirm that finding here, and set the price of a GTE four-wire loop at 50 percent above the price of a GTE two-wire loop.

80. For U S WEST, the evidence shows that the cost of a four-wire loop is at least 82 percent above the cost of a two-wire loop. U S WEST submitted a number of cost studies demonstrating that the cost differential was in the range of 82-100 percent. Brief at 11-12. We find that a value in the lower end of this range to be more reasonable and to be consistent with the Company's initial analysis of the cost differential. 10TH ORDER at ¶21. For U S WEST, we determine that the appropriate cost differential between a two-wire and a four-wire loop is 85 percent.

We turn now to a determination of the appropriate price differential between a two-wire and a four-wire loop. We find that the price differential between the two-wire and four-wire loop should be set at 85 percent.¹⁰ The Commission finds that such a price is consistent with the FCC's requirement that the price for an unbundled network element not exceed the TELRIC plus a reasonable allocation of forward-looking common costs. The Commission notes that our decision is consistent with a recent decision by the U. S. District Court for the District of Arizona.¹¹ In that decision, at section 2, the Court found that since a four-wire loop appears to be roughly equivalent to a two two-wire loops, a small markup for a four-wire loop is inappropriately low without adequate foundation proving the contrary

81. The Commission finds that TRACER's assertions, at paragraph 76 above, and at page 11 of their Brief, that placement costs were assigned to loops, not pairs, are incorrect. TRACER witness Zepp appears to agree that in both RLCAP and the proxy models, structure is assigned to each pair and not to the loop. (See, for example, Tr. at 750-753, 756-757, and 758-759) This position is further supported by U S WEST witness Reynolds at Tr. 646-647 and U S WEST's response to Bench Request 02-114.

82. U S WEST has contended, at paragraph 66 above, that the price of a four-wire loop should be set at twice that of a two-wire loop to avoid arbitrage of the four-wire loop price to provide two separate lines. In response to this position, the Commission points out that the Act and the FCC's rule mandate that rates be cost-based, not that they be set so as to avoid the possibility of arbitrage.

OSS/TRANSITION COSTS

I. OVERVIEW

83. Operational Support Systems (OSS) are used by telephone companies -- both CLEC and ILECs -- to provision plant, to process service orders, to manage service connections, disconnections, moves and changes, and to track network

¹⁰The cost difference is larger for U S WEST than for GTE, because a higher proportion of GTE's loops are served with digital loop carrier. GTE's loops are longer than those of U S WEST, and, therefore, a higher proportion of its customers are served by digital loop carrier via fiber. When digital loop carrier is used, the additional investment is smaller than when copper is employed. Digital loop carrier investment appears in account "257C."

¹¹*U.S. WEST COMMUNICATION, INC., a Colorado corporation, et al., Plaintiffs, RENZ D. JENNINGS, as a member of the ARIZONA CORPORATION COMMISSION, et al., Defendants, CONSOLIDATED CASES CV 97-26-PHX-RGS-OMP (Lead Case), CV 97-394-PHX-RGS-OMP, CV 97-1723-PHX-RGS-OMP, CV 97-1856-PHX-RGS-OMP, CV 97-1927-PHX-RGS-OMP, CV 97-2025-PHX-RGS-OMP, CV 97-2324-PHX-RGS-OMP, CV 98 342-PHX-RGS-OMP, CV 98-626-PHX-RGS-OMP, CV 98-629-PHX-RGS-OMP, United States District Court For The District Of Arizona, (May 4, 1999, Decided), 1999 U.S. Dist. LEXIS 6821*

maintenance. OSS consists of computer hardware and software such as databases.

84. The FCC has established that OSS is one of the categories of network access which ILECs must provide to CLECs. In defining the network elements that ILECs must offer, the FCC specifically included "[o]perations support systems functions consist[ing] of pre-ordering, ordering, provisioning, maintenance and repair, and billing functions supported by an incumbent LEC's databases and information." 47 C.F.R. § 51.319(f)(1).

85. In its recent ruling, the U.S. Supreme Court agreed with the Eighth Circuit Court, which found "eminently reasonable" the FCC's determination that operator service, directory assistance, operational support systems and vertical services were "network elements" was "eminently reasonable" because it fell "squarely within the statutory definition." (See *AT&T v. Iowa Utilities Bd.*, 1999 WL 24568 at *10.)

86. In Phase I of this proceeding, the Commission determined that "transition costs" were any expenditures, including those for operational support systems, "that ILECs make to their networks to comply with the statutory requirements of the Act." 8TH ORDER at ¶39. The Commission requested that the parties address the level of transition costs the ILECs should recover and the appropriate method for recovery in the pricing phase of the proceeding. *Id.* at ¶41.

87. U S WEST and GTE filed cost studies which calculated their transition costs to upgrade existing OSS and start-up costs to establish mechanized systems. Staff does not believe that either U S WEST or GTE have sufficiently supported the transition costs set forth in their cost studies. Staff maintains this position, even after reviewing U S WEST's and GTE's data request responses. In particular, Staff is concerned that U S WEST's and GTE's system changes are not being used solely for local competition. Staff has also voiced concern that U S WEST has overstated its OSS costs. Staff asserts that the amount that U S WEST is requesting for OSS in this proceeding is two and one-half times the amount the Company requested in its Interconnection Cost Adjustment Mechanism filing. In addition, Staff cannot validate or verify the information the companies have provided to the Staff in order to determine if the amount requested is appropriate. Brief at 40-41. Other parties share this concern. NEXTLINK/ELI Brief at 33.

88. U S WEST responds that it provided Staff with significant support documentation. Therefore, it believes that it should be permitted to recover the costs identified in its OSS study. Brief at 52-53.

89. There are two types of costs associated with OSS. First, the cost of converting the operational support systems so that the ILECs' back-office operations are accessible to the CLECs. Second, an ILEC incurs transaction-specific costs each time a CLEC places an order. There is little dispute that this second type of cost should

be recovered from the CLEC. However, there is a dispute over the method of recovery of the first type of costs, the start-up costs involved with OSS conversion. The start-up costs identified by the ILECs are large and Staff is concerned that, if the costs are recovered exclusively from wholesale customers, the charges will create a barrier to entry. Staff further notes that the ILECs will have an incentive to overstate these start-up costs as the companies do not have any incentive to minimize them. Brief at 42.

90. AT&T provides the following summary of U S WEST's proposal:

For start-up costs, U S WEST proposes to assess a \$14.54 per order charge for yet-to-be-determined start-up costs for 1997, 1998, and 1999, for an indefinite time until it recovers those costs. Ex. 515, p. 20. For its on-going maintenance costs, U S WEST proposes to assess an additional per order charge of \$2.49 for yet-to-be-determined costs. Ex. 515, p.18. These charges are based upon what U S WEST calls "actual" costs for 1997 and "its best estimates" of costs for 1998 and 1999. *Id.* at 20. U S WEST states that it "intends to recover only actual costs." *Id.* U S WEST proposes that it would supply periodic reports of its "actual" costs to the Commission but provides no further detail on this process. *Id.*, pp. 20-21. (AT&T Brief at p. 57)¹²

91. Staff initially suggested that the OSS's start-up costs be recovered through a rate case. However, in light of the recent U.S. Supreme Court decision, they no longer believe that this is appropriate. Rather, Staff recommends that these costs be recovered from wholesale and retail customers. Brief at 44.

92. NEXTLINK/ELI argue that the FCC's TELRIC rule prohibits the recovery of transition costs from CLECs. The FCC requires that a TELRIC study be "based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." 47 C.F.R. § 51.505(b). "Such a cost recovery standard excludes any recovery of the actual costs the ILECs incur to convert existing inefficient network configurations to a forward-looking environment." Brief at 32. MCI/Worldcom, AT&T, and TCG share NEXTLINK/ELI's view that the cost estimates should reflect the operations of an efficient firm. AT&T/TCG Brief at 58, MCI/Worldcom Brief at 22.

93. In the arbitration between U S WEST and MCI, U S WEST argued that its proprietary Web-based interface, IMA, should be approved pending adoption of national standards. The arbitrator, on the other hand, determined that U S WEST

¹²U S WEST's brief states that is requesting a start-up service order charge of \$13.81, not \$14.54. Brief at 49.

should bear the cost of developing the IMA:

It is clear that the current situation is not parity and that national standards are the most effective long term solution. In the meantime, U S WEST should comply with the FCC order to the maximum extent possible. If U S WEST's Web technology is the best it can do at the moment, U S WEST should bear the cost as an incentive to reach a better solution faster and to reflect that there is no hope that the industry will mitigate the cost of implementing Web technology as an interim solution by adopting Web technology as a permanent solution.

Arbitrator's Report and Decision, In the Matter of the Petition for Arbitration of an Interconnection Agreement Between MCI/metro ACCESS SERVICES INC. and U S WEST COMMUNICATIONS, INC., page 60, dated December 23, 1996.

94. MCI argues that as a result of this finding, the Commission should deny U S WEST's request for recovery of these IMA costs. Brief at 24-26.

95. Similarly, AT&T points out that the Commission, in its 1996 AT&T/U S WEST arbitration decision, rejected U S WEST's request for an initial fee to cover the costs of developing its IMA system. Furthermore, AT&T goes on to remind the Commission that in the AT&T/U S WEST arbitration proceeding the Commission found that U S WEST's web page approach did not offer AT&T parity with access to OSS which U S WEST provides for itself and so was in violation of the FCC's interconnection order. Brief at 57.

96. AT&T asserts that about half of the \$100 million in costs for interface development which U S WEST is seeking to recover were incurred with respect to the development of IMA and that these costs were incurred in 1997, after the Commission's decision rejecting use of the IMA interface. Brief at 58. AT&T argues that U S WEST's request for the recovery of these costs ought to be denied on the basis that they were incurred after the Commission's decision rejecting IMA. Brief at 58.

97. AT&T also argues that the recovery of incurred OSS costs is illegal because this would effectively amount to retroactive rate-making. Brief at 53-56.

II. COMMISSION DECISION

98. While Congress required the ILECs, such as U S WEST, to open up their networks to competition, it also sought to ensure that they would be compensated for reasonable costs incurred as a result of their efforts to comply with this mandate.

Accordingly, Section 251(d)(1) of the Act requires that rates for interconnection and network elements be "just and reasonable" and "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable)."

99. The Commission notes that a federal district court recently upheld findings that ILECs are entitled to recover the cost of OSS from CLECS. (See *Memorandum Opinion and Order in AT&T Communications of the South Central States, Inc., v. BellSouth Telecommunications Inc., et al.*, Civil Action 97-79, September 9, 1998 slip op. at 15-16, Federal District Court for Kentucky, 1998 U.S. Dist. LEXIS 14558)

100. It is this Commission's opinion that the Act is designed to facilitate efficient entry into the local market. The Act does not state that an ILEC or its retail customers should subsidize the price of UNEs. Rather, the Act provides that when a CLEC orders a UNE, it must pay a fair and just price, which will compensate the ILEC for its reasonable costs.

101. Some parties to this proceeding have argued that CLECs are not responsible for the OSS cost because, even if no CLEC enters an ILEC market, the ILEC must incur these costs in anticipation of competition materializing. AT&T Brief at 61-62, NEXTLINK Brief at 32. The Commission finds this argument to be faulty because it merely illustrates that should no demand for OSS arise, the ILEC will be unable to recover its costs from a CLEC. A lack of demand does not indicate an absence of cost responsibility. For example, if an ILEC were to spend money attempting to develop a video product, and there turns out to be no demand for the video product, the cost responsibility for the development expenditures should clearly be assigned to the unsuccessful video product.

102. Having found that ILECs are entitled to recover the cost of OSS from CLECs, it remains for the Commission to determine what those costs may reasonably be assumed to be and what the ILECs may reasonably expect to recover.

103. In the arbitration decision between MCI and U S WEST the, Arbitrator concluded, as MCI points out, that U S WEST should bear the cost of IMA development as an incentive to developing an OSS interface in conformity with the national standards. Furthermore, in the MCI-AT&T - U S WEST arbitrations the Arbitrator found IMA to be in violation of the FCC's parity standards for the provision of OSS and rejected the use of IMA for anything other than as an interim measure.¹³

¹³ The Commission notes that, in a 1998 decision, the United States District Court for the Western District of Washington, Seattle, upon reviewing the Commission's arbitrated decision concerning the interconnection agreement between MCI and U S WEST, found that "[t]he provisions for interim access are contrary to binding FCC

104. The Commission notes that the decisions rendered by the Arbitrator concerning their respective interconnection agreements are not binding on the Commission. The purpose of this proceeding has been to hear all the parties' arguments and resolve the outstanding issues. This is a cost and pricing proceeding and, as such, questions concerning nondiscriminatory access have no part in these proceedings. With this in mind, we turn to the question of cost recovery related to the development of U S WEST's IMA interface.

105. AT&T and MCI have argued, respectively at paragraphs 96-97 and at paragraphs 94-95 above, that U S WEST's request for the recovery of costs related to the development of IMA should be denied. The Commission disagrees with these conclusions. U S WEST developed, and AT&T and MCI utilized, IMA as a best-practices interim measure for access to OSS until such time as full, nondiscriminatory access to OSS could be made available. The Commission notes that to our knowledge, no ILEC was able to meet the FCC's January 1, 1997 deadline by which time full, nondiscriminatory OSS access was to have been made available. The Commission also notes that, again to our knowledge, to date neither the FCC nor the Courts have imposed any penalties on any ILEC for failure to provide full, nondiscriminatory access to OSS.

106. Given these facts and the federal district court decision (referenced at paragraph 100 above) that ILECs are able to recover OSS development-related costs from CLECs, the Commission finds that U S WEST's request to recover its costs related to the development of the IMA interface is reasonable and should be allowed. As we describe below, we accept the principal, but make no findings, regarding the appropriate level of aggregate cost recovery.

107. The Commission finds that neither U S WEST nor GTE has provided adequate documentation of its transition costs. Given this finding, OSS rates determined in this proceeding will necessarily be interim rates only.

108. U S WEST and GTE must file new cost studies demonstrating that OSS costs are not already being recovered through their expense factors. In fulfilling this obligation, both carriers must provide work papers demonstrating how the OSS expenses were "backed-out" prior to calculating their annual charge factors that are used in both their recurring and non-recurring cost studies.

regulations and should be removed. The provisions for parity access should remain, but revised to include a clear deadline." The Court did not reverse the Commission's position on the question of U S WEST's ability to recover the cost of IMA from MCI. In *re MCI TELECOMMUNICATIONS CORP., et al., Plaintiff, v. U S WEST COMMUNICATIONS, INC., et al., Defendants*. CASE NO. C97-1508R (Consolidated), United States District Court For The Western District of Washington, Seattle Division, 1998 U.S. Dist. LEXIS 21585, (Decided, July 21, 1998; Filed, July 21, 1998) at §IV.4.B

109. Additionally, both U S WEST and GTE must illustrate how OSS costs that have been identified in their studies are attributable to providing capacity and capabilities to the CLECs. The ILECs are obligated to prove that the expenses and investments reported in the studies would not have been incurred but for the provisioning of the OSS UNE. This will require the ILECs to do more than simply classify expenditures as OSS-related. The ILECs must show that the expenditures are or were incurred in order to provide OSS to CLECs. While not intending to limit the ILECs presentation on this topic, the Commission finds that two obvious types of information should be included in their studies. First, GTE and U S WEST must provide data on the trend in their expenditures for OSS computer hardware and software databases prior to the passage of the Act, and demonstrate whether post-Act expenditures differ significantly from pre-Act expenditures, after changes in price, system size, and other relevant variables have been taken into account. Second, the companies must include a detailed narrative that describes how each of the OSS projects is related to their compliance with the explicit mandate of the Act.

110. Both ILECs also must address and be able to defend their determination of the degree to which these costs have already been recovered through their retail rates. To the extent these costs have been recovered through retail rates, the parties should address whether the revenue should be rebated to retail customers.

111. U S WEST must provide detailed cost support for its request to recover common or shared costs. The documentation must include a showing of why it determined that the common or shared costs should be recovered through the OSS charge.

112. In addition, U S WEST and GTE are directed to make compliance filings, in two months' time, wherein they identify interim rates for IMA, or manual ordering, and EDI, or electronic ordering. By establishing separate rates for manual and electronic access to an ILECs operational support system, we establish rates that reflect the cost of service. For example, parties who do not use manual access will not have to pay for the cost of providing this type of interface.

COMMON COSTS

I. OVERVIEW

113. In the 8TH ORDER the Commission established cost floors for interconnection, unbundled network elements, transport and termination, wholesale and resale discounts, and interim number portability and collocation. These were established excluding common costs, as the recovery of these was deemed to be a Phase II issue. (See, 8TH ORDER at ¶¶251, 265).

114. In our 8TH ORDER, at paragraphs 244-247, we determined that:

Joint, shared, and common costs are expenses that are not attributable to a particular service, nor to a family of product.

The FCC defines joint and common costs as follows:

Certain types of costs arise from the production of multiple products or services. We use the term "joint costs" to refer to costs incurred when two or more outputs are produced in fixed proportion by the same production process (i.e., when one product is produced, a second product is generated by the same production process at no additional cost). The term "common costs" refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers). Such costs may be common to all services provided by the firm or common to only a subset of those services or elements. If a cost is common with respect to a subset of services or elements, for example, a firm avoids that cost only by not providing each and every service or element in the subset. For the purpose of our discussion, we refer to joint and common costs as simply common costs unless the distinction is relevant in a particular context. CC Dockets 96-325 and 96-98; CC Docket 95-185 (August 8, 1996), ¶676.

Shared costs are expenses that are common to a family of products but are not avoided if one of the products is eliminated. Common costs are shared costs where the family of products is the total operations of the firm.

We will follow the convention of the FCC and refer to joint, shared, and common costs as simply "common costs."

115. In this section, we determine the markup to be applied to the cost floors that we have previously established. The markup is added to the cost floors in order to establish prices that are consistent with the pricing standards established by the Act. We will do this first by addressing the markup for the loop. We will then turn to the markup that should be applied to other network elements.

II. PARTY POSITIONS

U S WEST

116. In its Brief, at page 8, U S WEST notes that the Commission “has clearly said that the TELRIC costs established in the 8TH ORDER are the price floors for network elements. (¶491).” The Company goes on to state that the specific cost determinations regarding interconnection and unbundled elements for U S WEST that were determined by the Commission in its Phase I proceedings should be the cost determinations from which the Commission should set prices. The prices should allow U S WEST to recover its costs for interconnection and access to UNEs. U S WEST asserts that its “pricing proposals are based on TELRIC cost and equal percentage markups to cover the remaining costs common to the entire company.” Brief at 9.

117. U S WEST notes that some of the other parties in this proceeding have mentioned that U S WEST has not proposed a markup over TELRIC in any other state. These parties argue that such a markup should not be ordered in Washington. Brief at 9. The Company counters that “the markup it proposes is tied to the level of recovery above Commission-prescribed direct costs that other services provide. U S WEST has advocated that the proper direct cost calculations are in fact much higher than the Commission-ordered costs in this docket. Thus, U S WEST’s proposed markup is neither arbitrary nor unreasonable, but is rationally tied to the level of contribution provided by other customers.” Brief at 10.

118. For those elements for which the Commission ordered specific costs, U S WEST states that it “made specific determinations and calculations on an element-by-element basis, regarding the appropriate attributed and common cost factors. These specific calculations were necessitated by the fact that for some elements the Commission ordered costs based on the results of multiple models and for other elements the Commission simply applied no attributed or common cost factors.” Brief at 28. For purposes of illustration a brief description of U S WEST’s Common Cost calculations in relation to the Unbundled Loop element follows.

119. U S WEST calculated a simple average of the common cost factors from the Hatfield, RLCAP, and BCPM models in order to arrive at an average common cost factor, which it recommends applying to the Commission-prescribed unbundled loop cost of \$16.25. Brief at 29. U S WEST states that it decided on this methodology based on its belief that the Commission derived its unbundled loop cost for the Company by averaging loop estimates generated from these three models. The Company goes on to declare that the cost factors averaged were the “20% Hatfield common cost factor endorsed by Staff, the 4.05 percent common cost factor sponsored by U S WEST, and a common overhead factor of 21.73% for BCPM to arrive at an average common factor of 14.86% $((20.00 + 4.05 + 21.73) / 3 = 14.86)$. This calculation was slightly modified to 15.18% when the Commission changed U S

WEST's unbundled loop cost from \$17.00 to \$16.25." Brief at 29. This results in what the Company refers to as an attributed and common cost additive of \$2.47, bringing the monthly cost of the unbundled loop element to \$18.72.¹⁴

GTE

120. GTE states that "its uncontradicted evidence shows that its total forward-looking common costs are \$118.6 million." GTE allocates these costs using a fixed-allocator approach, under which all UNEs are marked up by the same percentage. The fixed allocator is calculated using a simple formula: fixed allocator = total TELRIC + total common costs/total TELRICs." Brief at 2. GTE goes on to assert that its TELRIC costs determined by the Commission in Phase I for all UNEs is equal to \$217 million. This yields a common cost markup of 55 percent. Brief at 2.

121. GTE derived its \$118.6 million common cost amount by extracting from its 1996 ARMIS data those costs that could not be assigned to particular UNEs and thus were not captured in the Commission's TELRICs. GTE then "projected the data forward, adjusting for reasonable and quantifiable assumptions about the future of GTE's operations and replacement costs." Brief at 44. The resulting sum was \$136.8 million, from which \$18.2 million, currently recovered in the rates of services such as special access and billing and collection, was removed to yield the \$118.6 million. Brief at 44.

122. GTE notes that no party rebutted its account-by-account computation of its forward-looking common costs. Brief at 47. GTE also avers that AT&T's actual common costs may be much greater than the 10.4 percent proposed by AT&T. In making this assertion GTE points out that "Armstrong [CEO of AT&T] vows to shrink AT&T's overhead from a bloated 29% of revenues to an industry average 22%." Brief at 46.

123. GTE stresses the need for the Commission to establish prices that will permit it to earn a reasonable profit. GTE witness Doane testified:

¹⁴In regards to the appropriateness of the 20 percent common overhead factor advocated by Staff, U S WEST notes that it only uses this factor "on the Hatfield portion of those elements for which the Commission used Hatfield Model results in their ordered costs." Brief at 28. U S WEST disagrees with AT&T/MCI that the 10.4 percent common overhead factor used as the Hatfield default value is representative of U S WEST's common overheads. The Company goes on to aver that the 10.4 percent factor is depressed by the inclusion of access charge related revenues in the denominator of the formula. If these are removed, the Company declares that the 10.4 percent figure increases to 15-16 percent, which is close to Staff's proposed 20 percent figure. Brief at 28.

[the] term 'profit' means something very precise: on an aggregate basis, the firm covers its total costs and earns a return on its total investments. In the present case, the set of investments consists of those regulated assets included in the ratebase used by GTE to provide local phone services in Washington. Thus, a firm does not have the possibility to make a profit unless it can recover all of its *actual* costs. (Emphasis in original). Ex. 693 at 4.

124. Doane adds that in order to ensure that GTE can earn a reasonable profit, the Commission must establish wholesale rates that are at parity with retail rates. GTE is concerned that if wholesale rates are set below retail rates, the CLECs will be able to engage in arbitrage. GTE asserts that if a surcharge is not imposed on the CLECs, retail rates would have to be increased to "match the total dollar amount of the contributions siphoned off by CLECs engaged in arbitrage." *Id.* at 5, 48. Doane goes on to argue that this increase in retail rates would be necessary to keep GTE in operation.

125. GTE contends that it "must" be compensated for any reduction in its earnings that results from competitive entry. GTE states that it will be denied an opportunity to earn a fair rate-of-return unless such a mechanism is put in place. Ex. 693 at 7, 31-37, 48; Ex. 697 at 2.

STAFF

126. In Phase I of this proceeding, as noted in the Commission's 8TH ORDER at paragraph 252, Staff had contended "that a factor of 20% be added to the TELRIC loop estimate to account for costs that are not attributed to particular unbundled elements, but are nevertheless part of a proper TELRIC analysis." At paragraph 253 of that Order, the Commission took note that "Staff's Brief does not provide a citation for the 20% factor, but it appears to be based upon U S WEST's claim that there should be a 20% additive for attributable costs. The 20% value was derived from a U S WEST study." The Commission went on to note that Staff used this value only in its HAI runs only and did not indicate if this value should be used in the BCPM and/or GTE model runs. At paragraph 256 of its 8TH ORDER, the Commission stated that "[i]n our running of the Hatfield Model, we use a zero value for common overhead costs, rather than Commission Staff's 20% input value. We have not adopted Staff's recommendation for the Hatfield Model because we are concerned that the 20% loading factor may be associated with costs that are captured elsewhere in the model."

127. Staff commences its Phase II discussion on the recovery of attributed and common costs by stating that its recommendation in Phase I for a 20 percent markup "was really a recommendation to include certain attributable costs in establishing the TELRIC cost floor for the loop." Brief at 24. Staff goes on to state that this factor is more correctly viewed as a 20 percent attributable cost factor which Staff intended to

apply in order to arrive at the TELRIC cost of the loop. Brief at 24. Given that the Commission has already determined the TELRIC cost floor of the loop in Phase I of this proceeding, it is Staff's belief that its proposed 20 percent attributable cost factor is no longer relevant in the pricing phase of the proceeding and so need not be considered by the Commission. Brief at 24.

128. Staff adds that it believes that the only estimates of U S WEST's and GTE's common costs are those which have been presented by the companies. Staff suggests that the Commission review the common cost calculations put forth by the companies, following the FCC's guidelines, so as to determine what reasonable amount of common costs should be added to the TELRIC amount. "Staff believes it is appropriate to apply any allocation of common costs to the TELRIC for each UNE on an equal basis." Brief at 26. However, Staff goes on to urge the Commission to carefully scrutinize GTE's common cost calculations to ensure that they are truly forward-looking and do not include actual, historical, or embedded data.

129. Staff also takes issue with U S WEST's claim that its proposal to "add both attributed and common costs to the TELRIC amount is appropriate, given the FCC's direction that 'a properly conducted TELRIC methodology will attribute costs to specific elements to the greatest possible extent, which will reduce common costs.'" Brief at 25. It is Staff's opinion that U S WEST's attributed costs are already included in the Commission's TELRIC amount and therefore a further allocation of attributed cost is inappropriate.

PUBLIC COUNSEL

130. Public Counsel notes that, with respect to U S WEST's pricing proposal for the recovery of common costs, the Commission stated in its 9TH ORDER that the UNE cost estimates for the Company already include what the Company defined as attributed costs. Brief at 4. Public Counsel goes on to opine that U S WEST, by incorporating additional attributed costs in Phase II of its pricing proposal, will achieve double counting of these costs.

MCI

131. MCI states that, under applicable FCC rules, common costs may only be recovered when an ILEC demonstrates, through a properly designed cost study, which efficient forward-looking common costs need to be recovered. MCI asserts that neither U S WEST, nor GTE, has performed such a study as part of this proceeding. It is MCI's position, therefore, that neither U S WEST nor GTE has properly identified the efficient, forward-looking, common costs that would be incurred to provide the UNEs at issue in this proceeding.

AT&T

132. AT&T points out that “[b]ecause the ILECs have greater access to cost information, the FCC required the ILECs to bear the burden of proving the nature and magnitude of such costs. Accordingly, the ILECs must show which costs are necessary to provide network elements and how those costs were developed.” Brief at 39. AT&T asserts that under the TELRIC methodology common costs should be small. AT&T points out that U S WEST’s cost studies, which show a 4.05 percent common cost factor for UNEs, seems to lend credence to this assertion.

133. AT&T further avers that, before the issuance of the FCC’s First Report and Order on Interconnection, U S WEST’s incremental cost studies included a common cost factor of approximately 25 percent. AT&T makes the claim that, after the FCC order was issued, U S WEST changed their cost studies so that they included a factor for directly-attributed costs of 20 percent. Brief at 40. AT&T states that U S WEST has provided no supporting documentation to substantiate these factors.

134. AT&T maintains that the Commission has included U S WEST’s attributed costs in developing the Commission cost estimates in Phase I of this proceeding. As evidence, AT&T cites the Commission’s 9TH ORDER at paragraph 7, footnote 2, which states: “The U S WEST cost estimate is the sum of the estimated long-run incremental cost and the attributed cost. We included both costs when we reported the RLCAP loop cost of \$13.76 in the Order.” AT&T points to Appendix A of the 9TH ORDER where the Commission stated: “For each account in the WINPC3 OUTPUT tab, common monthly costs was [sic] subtracted from Fully Allocated Costs. The results of this operation were then summed to arrive at fully allocated TSLRIC cost which did not include common monthly costs.” It is AT&T’s position that, in light of these rulings, U S WEST’s inclusion of additional attributed costs in its pricing recommendations is wrong and should be denied.

135. As to GTE’s fixed allocator methodology, and the 55 percent common cost markup it yields, it is AT&T’s position that GTE’s approach is not permitted under the FCC’s pricing rules. AT&T makes this claim because it is their belief that GTE’s analysis looked at revenues, not costs, and because it is their belief that GTE’s analysis relied on historical, embedded numbers and not forward-looking costs. They make the further assertion that GTE’s analysis is flawed because no effort has been made to remove the cost of providing retail service.

136. It is AT&T’s position that, since the Commission’s costs from Phase I were based on averaged costs¹⁵ and not on properly conducted TELRIC studies, there

¹⁵Which costs, in U S WEST’s case, AT&T feels already include a significant amount of directly attributed joint and common costs.

should not be any additional amount added to the Commission-derived cost estimates. Brief at 41. However, AT&T goes on to state that should the Commission determine that a common cost markup is necessary, it should apply U S WEST's common cost factor of 4.05 percent to the costs of both U S WEST and GTE.

NEXTLINK

137. NEXTLINK notes that several economic witnesses in this proceeding have proposed a uniform common cost markup of approximately 10 percent above TELRIC costs, based on the 8 percent to 15 percent markup seen authorized by other state commissions. Brief at 18. It is NEXTLINK's opinion that such a markup is reasonable and should be adopted by the Commission.

138. NEXTLINK states that the inclusion of unspecified, attributed costs in U S WEST's markup for common costs, in contrast to its advocacy in other states, is in violation of the FCC pricing regulations. NEXTLINK also asserts that GTE's failure to specify its common costs, and its proposal to calculate these costs based on the difference between GTE's TELRIC estimates and GTE's intrastate revenues, violate FCC pricing regulations as well.

COVAD

139. It is COVAD's position that GTE and U S WEST have failed to prove the magnitude of forward-looking common costs, as required by the FCC rule. Furthermore, COVAD avers that "GTE expressly seeks to recover its embedded and opportunity costs and to subsidize other services. U S West implicitly seeks to do so. Moreover, neither U S West nor GTE has presented any evidence, much less prima facie evidence, of what their efficient forward-looking common costs are. They have utterly failed to meet their burden of proof that is an essential prerequisite to their ability to recover any allocation of common costs." Brief at 7.

140. COVAD argues that the Commission should not allow U S WEST and GTE to recover any common costs until the Commission conducts proceedings to establish a proper forward-looking basis for common costs and to set the price of loops on a geographically-deaveraged basis. Until these proceedings are concluded, it is COVAD's recommendation that the price of the loop not exceed the FCC proxy prices. It is COVAD's further recommendation that other UNE prices be set at the FCC proxy rates, or the Phase I TELRIC costs, whichever is lower, until proper common cost proceedings have been held.

TRACER

141. TRACER echoes NEXTLINK's sentiments, described above, that U S WEST and GTE have failed to produce any evidence establishing their efficient,

forward-looking common costs. In TRACER's opinion, the Hatfield Model's 10.4 percent markup is more in line an appropriate markup, in light of evidence indicating that some local exchange companies have markups below 9 percent.

142. TRACER goes on to point out that U S WEST and GTE have actual ratios of corporate operations expense to total revenue of 13.6 percent and 15.6 percent, respectively. Brief at 14. However, TRACER notes that because the loop cost set in Phase I is "above the direct costs computed with the Hatfield model, it appears the average price adopted by the Commission already includes some of the costs the 10.4 percent markup is designed to recover." Brief at 14. Therefore TRACER advocates the use of the 4.05 percent markup factor for U S WEST and GTE. Alternatively, TRACER states that the Commission could find that it does not have a sufficient record in this case to determine forward-looking common costs, as required by the FCC, and so it could rely instead on the FCC proxy prices and ranges.

III. ADDITIONAL MARKUPS

PARTY POSITIONS

U S WEST

143. In addition to what it has called its attributed and common cost additive, discussed above, U S WEST states that it requires a further markup to its TELRIC costs in order to recover what it claims are those common costs which cannot be attributed to specific elements. To recover those costs, U S WEST applies a uniform percentage markup to its Commission-determined UNE costs. U S WEST "based its markup on the current average markup over UNE TELRIC costs for its retail exchange and vertical services, adjusted to account for avoidable costs, rebundling, and CLEC return." Brief at 31-32.

144. In deriving its markup factor, U S WEST states that, instead of using the weighted-average 49 percent retail markup for common cost recovery, it used an 18 percent markup, which was then applied to the 4.05 percent common cost factor from RLCAP to arrive at a 22.78 percent overall markup. Brief at 31. U S WEST avers that this additional markup is necessary to recover U S WEST's non-attributed common costs. U S WEST states that this markup results in an additional charge of \$3.51 for the unbundled loop on top of the \$2.47 attributed and common cost additive. Thus, the monthly unbundled price of the loop proposed by U S WEST becomes $\$16.25 + \$2.47 + \$3.51 = \22.08 .

145. U S WEST asserts that its proposed markup is conservative when one considers that its markup calculation for retail service of 49 percent "is heavily weighted by the proportionately smaller residential services margin (26%), while the CLECs have been predominately focused on the substantial margins contained in the U S WEST business services rates (101%)." Brief at 32.

GTE

146. GTE asserts that the plain language of the Act makes clear that UNE prices must allow GTE to fully recover its costs. Under this assumption, GTE claims that the issue then becomes determining the best measure of the Company's actual costs. GTE avers that its revenues are the most reliable indicator of its costs. In making this assertion, GTE reasons that "[e]quating revenues with actual costs follows from the history and purpose of regulation in this state. GTE has been and continues to be a regulated Company. A primary purpose of regulation is to ensure that the regulated Company is given the opportunity to recover its prudently-incurred investment and operating costs plus a reasonable profit -- nothing more and nothing less. Through regulation, the Commission provides GTE with that opportunity. Accordingly, the revenues produced through GTE's tariffed rates reflect GTE's actual costs plus a reasonable profit." Brief at 40.

147. GTE states that its projected revenue as a 100 percent wholesaler of retail services is \$443 million, and, therefore, its revenues as a 100 percent wholesaler of UNEs should also be this amount. Brief at 41. GTE asserts that the Commission-approved TELRICs for all of GTE's UNEs equal \$217 million. Applying GTE's proposed 55 percent markup for the recovery of common cost would yield GTE total revenues of \$335 million. GTE asserts that to recover the \$108 million revenue shortfall this represents ($\$443\text{mm} - \$335\text{mm} = \$108\text{mm}$), it is entitled to a surcharge, in addition to the 55 percent markup for the recovery of its common costs it is requesting, to be added to the Commission-approved UNE costs.

148. GTE refers to this surcharge as an interim universal service surcharge. GTE states that this interim universal service surcharge is required by Section 252(d)(1) and 254(f) of the Act.¹⁶ It is GTE's position that until universal service is funded

¹⁶ Section 252(d)(1) states that:

(1) INTERCONNECTION AND NETWORK ELEMENT CHARGES.--Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section--

(A) shall be--

(i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and

(ii) nondiscriminatory, and

(B) may include a reasonable profit.

Section 254(f) states that:

(f) STATE AUTHORITY.--A State may adopt regulations not inconsistent with

explicitly in the state of Washington, GTE's interim universal service surcharge is the only option which will fulfill the statutory requirements of Section 254(f) of the Act. GTE proposes that this surcharge be set at \$36.71 and that it be levied on "every business loop leased to a CLEC or bypassed by a CLEC with its own facilities." Brief at 3.

149. In addition to the interim universal service surcharge, GTE also proposes a competitive transition surcharge (CTC) to enable it to recover any costs which become stranded as a result of the Act. "GTE has estimated its stranded costs taking into account 1) GTE's existing retail rates and long-run incremental costs, 2) the resale and interim UNE rates established by the Commission, and 3) the manner in which CLECs likely would enter the market. GTE proposes that the CTC be implemented in two parts. The first part would represent the change in earnings resulting from price reductions. This component would be recovered in consumer charges. The second part would represent the reduction in earnings from market share loss, and would be recovered in line charges. The CTC would end when GTE recovers its stranded costs and a fair return on those investments." Brief at 55.

150. GTE states that the CTC is consistent with Section 252(d)(1) of the Act and is consistent with the long-standing regulatory compact in Washington. GTE argues that, under its regulatory compact, it has provided universal service in Washington at rates which are often below the cost of service provision. It has done so in exchange for the opportunity to earn a fair return on the actual cost of its historic investment. Absent the CTC, GTE goes onto argue, the Company will be denied an opportunity to earn such a return, not so much due to the effects of competition, but because current regulatory policy constrains GTE's ability to respond to competition. GTE points out that it has not been deregulated and so lacks the ability to select its own customers and to set its own prices.

COMMISSION STAFF

151. Staff notes that its "position in Phase II of this proceeding on the appropriate markup to apply was integrally related to its parity pricing proposal.

the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

Staff did not propose a specific markup for U S WEST or GTE, but proposed that ILECs be given pricing flexibility to determine their markup within the parity pricing ceiling of retail rates.” Brief at 26. Staff still believes that this idea has merit but believes that, in light of the recent Supreme Court decision, the Commission is bound by the FCC’s pricing rules as they apply to markups.

152. In that regard, Staff goes on to point out that “[t]he FCC adopted rules requiring states to set rates for UNEs and interconnection based only on forward-looking total element long run incremental cost (TELRIC), plus a reasonable allocation of forward-looking joint and common costs. *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, CC Docket No. 96-98 (August 8, 1996) at paragraph 672 (“First Report and Order”); See also, 47 C.F.R. §51.505(a). The FCC also determined that a reasonable profit as set forth in 47 U.S.C. §252(d)(1) is included in prices set under the TELRIC plus common cost methodology and that no further markup is appropriate. First Report and Order at paragraph 700. In particular the FCC found that the cost of capital, which is part of the TELRIC calculation, would allow a company to recover its normal profit and that no additional profit would be appropriate. *Id.* at paragraphs 699-700. Finally, the FCC determined that states may not consider certain factors in setting rates, including embedded or historical costs, retail costs, opportunity costs, or revenues used to subsidize other services. See, First Report and Order at paragraphs 673, 705, 709, 713; see, also, 47 C.F.R. §51.505(d).” Supplemental Brief at 3.

153. Staff interprets these rules to mean that no markup of the established TELRIC price, beyond that required for the recovery of efficient, forward-looking common cost, is appropriate or legal under the FCC’s re-instated pricing regulations. Staff further avers that the recovery of actual costs, as opposed to forward-looking costs, which is part of GTE’s proposal, is a practice not permitted under the FCC’s rules. Brief at 27.

PUBLIC COUNSEL

154. Public Counsel, in its Brief on the impact of the Supreme Court ruling, notes that “[t]he FCC Interconnection Order states that forward-looking economic cost already includes a reasonable profit. The FCC rules do not mention a separate markup which is independent of the factors stated in the rules. The Commission must measure the markup proposals against the FCC pricing rules.” Brief on the SC ruling at page 4. Public Counsel states that UNE prices should not be set based on embedded cost and should be independent of any revenue requirements under rate-base, rate-of-return regulation. Brief at 6.

155. Public Counsel submits that the FCC, in its Interconnection Order, found that TELRIC incorporates a reasonable profit; therefore, any markup proposed in this proceeding which “seeks to recover additional amounts related to existing revenues is

to that extent recovering supranormal rather than reasonable profits and should be rejected. The only purpose of the markup, if any markup is required, is to recover limited forward-looking common costs not recovered in the Commission's cost determination in Phase I." Brief at 7.

156. Regarding GTE's proposal to recover stranded costs, Public Counsel notes that:

- There is no mention in the Act concerning the recovery of stranded costs in UNE prices;
- GTE was unable to point to any court or commission decision anywhere in the country which had adopted GTE's interpretation of the Act's UNE pricing standard, and finally;
- GTE has not established stranded costs in Washington, has presented no evidence that it is not earning its authorized rate of return in Washington, and has presented no evidence indicating that GTE's assets, if sold, would yield returns below their book value.

157. Accordingly, Public Counsel recommends that the Commission reject GTE's proposal to recover stranded costs.

MCI

158. On cross-examination, Staff witness Blackmon noted that GTE's pricing proposal was very similar to the efficient component pricing rule (ECPR) in that whatever UNE a CLEC wants to purchase, that is the UNE on which GTE plans to assess its markup.

159. MCI asserts that the Commission should reject parity pricing. In MCI's view, pricing UNEs in this manner prohibits profitable entry by CLECs into the Washington telecommunications market. MCI opines that parity pricing does not meet the requirements of state or federal law. Brief at 8-10.

160. MCI also believes that parity pricing violates section 252(d) of the Act. MCI points out that section 252(d) "requires that the rates for unbundled loops be 'based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element, and nondiscriminatory, and may include a reasonable profit.'" Brief at 9. MCI goes on to point out that paragraph 705 of the FCC's Local Competition Order states that "neither a methodology that establishes the prices for interconnection and access to network elements directly on the costs reflected in the regulated books of account, nor a price based on forward-

looking costs plus an additional amount reflecting embedded costs, would be consistent with the approach we are adopting.” Brief at 43. Given these and similar arguments, it is MCI’s belief that any plan utilizing retail revenues in determining UNE prices does not meet the requirements of federal law as outlined in the Act and the FCC’s regulations.

161. MCI believes that the pricing proposal of GTE, with its proposed interim universal service fund surcharge and its competitive transition charge, is in violation of federal law and should be rejected. As regards any universal service fund surcharge, MCI notes that paragraph 713 of the FCC’s Local Competition Order states: “If a state collects universal service funding in rates for elements and services pursuant to sections 251 and 252, it will be imposing non-cost based charges in those rates. States may not, therefore, include universal service support funding in the rates for elements and services pursuant to sections 251 and 252, nor may they implement mechanisms that have the same effect.” Brief at 42. Since this Order has been reinstated in full by the recent Supreme Court ruling, it is MCI’s opinion that it has the binding force of law until such time as the courts have ruled on the merits of the FCC’s pricing methodology outlined in the Order. Therefore, MCI believes that GTE’s proposal to add an interim universal service fund surcharge to the Commission-determined UNE costs should be denied as being contrary to federal law.

162. MCI is also of the opinion that GTE’s proposed competitive transition charge is in violation of federal law. MCI bases its opinion on the fact that the FCC explicitly rejected the inclusion of any opportunity cost in price development when it rejected the efficient component pricing rule (ECPR). Therefore, MCI’s position is that the Commission must also reject GTE’s proposed competitive transition charge as being contrary to federal law.

AT&T

163. AT&T takes the position that, under federal law, and according to the pricing guidelines established by the FCC, no additional markup of the UNE prices established by the Commission in Phase I of this proceeding is allowable, beyond that which might be necessary for the recovery of efficient, forward-looking common cost.

164. As to GTE’s interim universal service surcharge, AT&T points out that the Commission has previously denied such a surcharge in its *Fourth Supplemental Order Rejecting Tariff Filings and Ordering Refiling; Granting Complaints in Part*, Docket No. UT-941464 *et al.* In that Order, at page 40, the Commission notes that it rejected an interim universal service surcharge because it would be a barrier to entry.

NEXTLINK

165. NEXTLINK echoes AT&T’s position that U S WEST and GTE (and initially Commission Staff) have proposed markups which are over and above the FCC-

mandated TELRIC plus a reasonable allocation of common costs. NEXTLINK goes on to opine that any additional markups are contrary to federal law and the FCC pricing guidelines. Accordingly, NEXTLINK's position is that the Commission must reject these proposals and establish rates based solely on TELRIC plus a reasonable allocation of forward-looking common costs, without any additional markup.

COVAD

166. COVAD reiterates its position that U S West's and GTE's pricing proposals do not comply with the FCC's rules in 47 C.F.R. §51.505. COVAD goes to state that, "[a]mong other things, GTE expressly seeks to recover its embedded and opportunity costs and to subsidize other services. U S West implicitly seeks to do so. Moreover, neither U S West nor GTE has presented any evidence, much less *prima facie* evidence, of what their efficient forward-looking common costs are. They have utterly failed to meet their burden of proof that is an essential prerequisite to their ability to recover any allocation of common costs." Brief at 7. (Emphasis in Brief.)

TRACER

167. TRACER also believes that markups to the UNE costs established by the Commission in Phase I should be limited to those necessary for the recovery of efficient, forward-looking common costs. Any requested markups beyond this should be denied as being contrary to federal law.

COMMISSION DECISION

168. On January 25, 1999, the United States Supreme Court issued its decision in *AT&T Corp. v. Iowa Utilities Board*, No. 97-826, slip op. (U.S. Jan. 25, 1999). This decision reinstated the FCC pricing rules which had previously been vacated by the Eighth Circuit Court. Given this ruling, the FCC's pricing methodology and rules are currently binding on this Commission.

169. Under the FCC pricing rules, the prices for UNEs may not exceed TELRIC plus a reasonable allocation of forward-looking common costs. 47 C.F.R. § 51.505(a). Furthermore, according to 47 C.F.R. § 51.505(b)(1), the TELRIC of an element is "the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's provision of other elements."

170. In 47 C.F.R. § 51.505(c), the FCC defined what is meant by a "reasonable allocation of forward-looking common costs" in the following manner:

- (1) Forward-looking common costs. Forward-looking common costs are economic costs efficiently incurred in providing a group of elements or

services (which may include all elements or services provided by the incumbent LEC) that cannot be attributed directly to individual elements or services.

(2) Reasonable allocation.

(A) The sum of a reasonable allocation of forward-looking common costs and the total element long-run incremental cost of an element shall not exceed the stand-alone costs associated with the element. In this context, stand-alone costs are the total forward-looking costs, including corporate costs, that would be incurred to produce a given element if that element were provided by an efficient firm that produced nothing but the given element.

(B) The sum of the allocation of forward-looking common costs for all elements and services shall equal the total forward-looking common costs, exclusive of retail costs, attributable to operating the incumbent LEC's total network, so as to provide all the elements and services offered.

171. In 47 C.F.R. § 51.505(d), the FCC also specified that the following factors shall not be considered in calculating forward-looking costs:

(1) Embedded costs. Embedded costs are the costs that the incumbent LEC incurred in the past and that are recorded in the incumbent LEC's books of accounts.

(2) Retail costs. Retail costs include the costs of marketing, billing, collection, and other costs associated with offering retail telecommunications services to subscribers who are not telecommunications carriers, described in 51.609 of this part.

(3) Opportunity costs. Opportunity costs include the revenues that the incumbent LEC would have received for the sale of telecommunications services, in the absence of competition from telecommunications carrier that purchase elements.

(4) Revenues to subsidize other services. Revenues to subsidize other services include revenues associated with elements or telecommunications service offerings other than the element for which a rate is being established.

172. In its First Report and Order on Local Competition, at paragraph 705, the FCC states that “neither a methodology that establishes the prices for interconnection and access to network elements directly on the costs reflected in the regulated books of account, nor a price based on forward-looking costs plus an additional amount reflecting embedded costs, would be consistent with the approach we are adopting.” As MCI noted above, this Order went on to state, at paragraph 713: “If a state collects universal service funding in rates for elements and services pursuant to sections 251 and 252, it will be imposing non-cost based charges in those rates. States may not, therefore, include universal service support funding in the rates for elements and services pursuant to sections 251 and 252, nor may they implement mechanisms that have the same effect.” Furthermore, paragraph 712 of this Order states explicitly that “Section 252(d)(1) requires that rates for interconnection, network elements, and access to network elements reflect the costs of providing those network elements, not the costs of supporting universal service.”

173. Furthermore, the Commission notes with interest a recent U.S. District Court ruling concerning modifications made to an arbitrated interconnection agreement between AT&T and Pacific Bell by the California Public Utilities Commission (CPUC). In reviewing the arbitrator’s decision, the CPUC determined that access charges had long been used to recover the embedded costs of building the network and that, given the Eighth Circuit Court’s stay of the FCC’s pricing regulations, the CPUC was not prohibited from imposing them. In defending its decision, the CPUC argued that the access charges it was imposing would allow Pacific Bell to recover its historical costs, as well as any overhead costs related to providing universal service. The CPUC went on to argue that “the Act does not expressly prohibit the assessment of access charges, and that there is no requirement in the Act that incumbents necessarily be fully compensated solely through the unbundled element prices. According to defendants, if Pacific Bell were not allowed to levy access charges, Pacific Bell would be under-compensated and would be placed at a competitive disadvantage.”¹⁷

174. The Court found otherwise. In its decision the Court concluded “that the CPUC improperly allowed Pacific Bell to assess switched access charges that are not based on the ‘cost . . . of providing . . . the network element.’” 47 U.S.C. §252(d)(1). The Court is not convinced that the access charges cover costs that Congress intended to provide for when it drafted section 252. Rather, the Court believes that section 252(d)(1) directs state commissions to set prices that account only for the specific costs incurred in providing the network elements, along with a reasonable profit. After reviewing the evidence, the arbitrator in this matter used Pacific Bell’s cost model as the

¹⁷ *At&T Communications Of California, Inc., Plaintiff, V. Pacific Bell, Et Al., Defendants*, No. C 97-0080 SI. Heard in the United States District Court For The Northern District Of California. Decided May 11, 1998; Filed May 13, 1998. 1998 U.S. Dist. LEXIS 10103. At p. 14. (Footnotes removed from citation)

basis for setting prices, and determined that the model allowed for Pacific Bell to recoup its costs plus a reasonable profit. The CPUC erred when it allowed for other amounts to be imposed in addition to these costs.”¹⁸

175. The Court went on to find that the pricing standard mandated under §252 of the Act does not allow ILECs to assess charges to subsidize universal service.

176. With this principle in mind, we turn to the common cost markup proposals advocated by the various parties. First, NEXTLINK has proposed a uniform common cost markup of approximately 10 percent above TELRIC costs, based on the 8 percent to 15 percent markup authorized by other state commissions. The cost studies submitted in these dockets highlight why great caution must be exercised when looking at pricing decisions of other jurisdictions. For example, for GTE we have been presented with three studies: BCPM, Hatfield, and LCM. These studies make different assumptions about which costs can be either directly or indirectly assigned to network elements. The markup for GTE’s LCM model must be higher than for the Hatfield Model because, where GTE assumes that certain costs are common, the Hatfield Model developers contend that these same costs can be directly attributable to elements. It follows that the mere fact that another Commission adopted a particular markup is of little or no relevance unless a showing can be made that the methodology used in the other state to identify direct and common costs is the same as we have employed in this proceeding.

Markup to RLCAP Loop Cost Estimate

177. Regarding U S WEST’s request for a common cost markup of 4.05 percent, no party presented any evidence that the Company’s request was unreasonable or in violation of the FCC’s pricing rules.

178. For U S WEST’s RLCAP model we accept U S WEST’s proposed 4.05 percent common cost factor. We note that U S WEST’s attributed cost factor is already included in RLCAP. See paragraph 135, above.

179. As for U S WEST’s proposed markup to recover what it refers to as non-attributable common costs, further examination indicates that this proposal is a variation on Staff’s parity pricing proposal. Given the FCC’s explicit language stating that retail costs may not be used in setting rates, the Commission finds that U S WEST’s proposed markup is contrary to federal law and denies the proposed markup.

¹⁸ *Id.* at p. 14. (Footnotes removed from citation)

Markup to Hatfield Cost Estimates

180. For the HAI model, the Commission notes that to date no party has provided compelling evidence in support of its favored HAI overhead factor. TRACER's response to Bench Request No. 116 demonstrates how the HAI 10.4 percent overhead factor was derived. The Hatfield Model sponsors conducted a statistical analysis of the relationship between the size of an ILEC and its expenditures on corporate overhead functions. This study concluded that for the incumbent local exchange carriers included in the study, corporate overhead expenses were approximately 13 percent of the firms' direct expenses. Bench Request No. 116.

181. The Hatfield proponents argue that the 13 percent value only indicates that overhead costs are not fixed. They do not believe that the 13 percent value is reflective of the operations of an efficient firm. Therefore, they relied on some publicly available data for AT&T's 1994 operations. The AT&T data suggests, according to TRACER, that a 10.4 percent loading factor is more appropriate. Bench Request No. 116; Tr. at 690.

182. We find that the calculations made by the Hatfield Model sponsors are unreasonable. The Hatfield sponsors have included in AT&T's direct costs the expenses associated with international settlements and access charges. Bench Request No. 116, U S WEST's Brief at 28. Local exchange carriers do not pay international settlement charges and their access payments are a smaller percentage of their direct expenses than those of an interexchange firm such as AT&T. Therefore, the AT&T operations data that was used to derive the 10.4 percent factor, as represented in Bench Request No. 116, is a poor indicator of the common cost expense ratio of a local exchange carrier.

183. Accordingly, for HAI, the Commission will adopt the 12.5 percent overhead factor it adopted in its *Tenth Supplemental Order Establishing Costs*, Docket No. UT-980311(a), at paragraph 315. The Commission points out that this number compares favorably to the 13 percent value found in AT&T's study showing that overheads varied with the size of the local exchange company.

BCPM Markup

184. The Benchmark Cost Proxy Model (BCPM) was sponsored by Sprint. Sprint submitted the model in Phase I of this proceeding and did not submit additional testimony in Phase II.

185. The Phase I testimony of Sprint identified \$5.70 as the monthly per line expense of a loop. In Phase II, only U S WEST addressed the input values sponsored by Sprint.

186. In Phase I, Sprint submitted an input value of zero for general and administrative expenses (account 6720). U S WEST contends that for account 6720 an input value of \$2.15 per month per access line should be used. U S WEST response to Bench Request No. 104; Sprint's Response to Bench Request to the Developers of the Benchmark Cost Proxy Model Test Runs Using GTE and U S WEST Actual Loop Lengths Data, submitted November 21, 1997.

187. No party submitted testimony in support of why one value, \$2.15, or another value, zero, should be used in this proceeding.

188. \$2.15 is the national default value for account 6720 in BCPM. See, paragraph 280 of the Commission's *Tenth Supplemental Order Establishing Costs*, In the Matter of Determining Costs for Universal Service, Docket No. UT-980311(a). In the USF proceeding, Sprint sponsored a value of \$4.14 for this input. (*Id.* at ¶280) Account 6720 summarizes the contents of accounts 6721 through 6728. The following types of expenses are recorded in these accounts: providing accounting and financial services (6721); external relations (6722); human resources (6723); information management (6724); legal (6725); procurement (6726); research and development (6727); and other miscellaneous expenses (6728).

189. We find the value proposed by Sprint for account 6720, zero, to be unreasonable in light of the activities associated with this account.

190. For the limited purpose of this proceeding, we will accept as reasonable the U S WEST sponsored value of \$2.15. As in prior proceedings, we note that this value is based on a proprietary study undertaken by local exchange companies. This Commission has repeatedly expressed its preference to use data that is in the public domain. See, *e.g.*, paragraphs 239, 297, 363, and 449 of the 8TH ORDER, and paragraph 67 of the 10TH ORDER.

191. For account 6710, executive and planning, U S WEST has proposed a BCPM input value of \$0.14 per line per month. U S WEST response to Bench Request No. 104. Here, too, Sprint proposed a value of zero for this account. Sprint's Response to Bench Request to the Developers of the Benchmark Cost Proxy Model Test Runs Using GTE and U S WEST Actual Loop Lengths Data, submitted November 21, 1997.

192. As with account 6720, no other party addressed the reasonableness of the BCPM input value for account 6710.

193. We find the BCPM input value proposed by U S WEST to be more reasonable than the Sprint value and will use it for that limited purpose in this proceeding.

194. The following table provides the BCPM per line monthly operating expenses that have been incorporated into the Commission's analysis:

Cost Element	USOAR Account	Amount	Source
Network Support	6110	\$ 0.15	(1)
General Support	6120	\$ 1.20	(1)
COE Switching	6210	\$ -	(1)
Operator Systems	6220	\$ -	(1)
COE Transmission	6230	\$ 0.21	(1)
Information Orig/Term	6310	\$ -	(1)
Cable and Wire Facilities	6410	\$ 2.76	(1)
Other Property Plant	6510	\$ 0.03	(1)
Network Operations	6530	\$ 1.33	(1)
Access	6540	\$ -	(1)
Marketing	6610	\$ -	(1)
Services	6620	\$ -	(1)
Executive and Planning	6710	\$ 0.14	(2)
General and Administrative	6720	\$ 2.15	(2)
Uncollectibles	6790		(1)
Total Expense		\$ 7.97	

Sources:

(1) Sprint's Response to Bench Request to the Developers of the Benchmark Cost Proxy Model Test Runs Using GTE and U S WEST Actual Loop Lengths Data, submitted November 21, 1997.

(2) U S WEST response to Bench Request No. 104.

195. As we noted in our 9TH ORDER, the prior runs of the BCPM included operating expenses of \$4.50 and \$4.87 per line for GTE and U S WEST, respectively. Appendix, "Changes Made to BCPM Model for Washington Arbitration Proceedings." The different input values are due to input errors that were discussed in the section "Monthly Operating Costs." Whereas we have found in this Order that the per line monthly expense value that should be \$7.97, we are adding \$3.47 (\$7.97 - \$4.50) and \$3.10 (\$7.97 - \$4.87) to our prior BCPM cost estimates for the unbundled loop for GTE and U S WEST, respectively.

GTE's Pricing Proposals

196. Given the arguments presented in paragraphs 120-125 and in paragraphs 146-150 above, this Commission finds that GTE's proposed Interim Universal Service Fund surcharge and its proposed Competitive Transition Charge are inappropriate and contrary to federal law. GTE's request to levy these charges is denied.

197. The foundation of GTE's common cost pricing proposal is the proposition that whatever revenues and profits are being recovered from retail services should be recovered in the price of unbundled network elements. GTE claims that it is entitled to recover the same revenues in a wholesale and retail environment because it uses the same physical network to provide both services and UNEs.

198. GTE also proposed "a surcharge applicable to certain UNEs to ensure consistency between its wholesale and retail rate structure." GTE avers that "[i]f *wholesale* prices are not adjusted to reflect existing *retail* prices, then significant arbitrage opportunities will be created for CLECs and GTE will not have the opportunity to recover its costs, let alone the 'reasonable profit' permitted in section 252(d)(1)." GTE witness Lee adds that "no incumbent company in any industry could survive if competitors were afforded such arbitrage opportunities." *Id.* at 21-22.

199. We find GTE's concern about arbitrage to be speculative and without factual foundation. GTE has been operating with interim UNE rates for at least two years, and the Company produced no evidence that would suggest that it has been unable to recover its costs, much less survive, due to arbitrage.¹⁹

200. Furthermore, strikingly absent in GTE's testimony is any data on its actual rate of return subsequent to the passage of the Act. We find the lack of data on this issue paradoxical in light of GTE's testimony that the degree to which it ought to be compensated is "an empirical matter" that "cannot be determined by an *ex ante* theoretical analysis." Ex. 697 at 3.

201. GTE has used the Company's ARMIS report as an input to its estimate of stranded costs caused by the Act. Ex. 693 at footnote 10. The following Table shows GTE's rate of return on its embedded investment since passage of the Act. The data reported in the Table is from GTE's ARMIS report for its regulated operations.²⁰ These

¹⁹Notably, the interim loop rate was lower than the average loop rate established in this proceeding.

²⁰Since the report only calculates the return on interstate investment, the Commission has applied the same methodology to the intrastate investment figures on the report to calculate the intrastate return for Washington.

numbers have not been subjected to the type of scrutiny that occurs in a Commission general rate-case proceeding; nevertheless, we believe that the Company's ARMIS report does provide useful information regarding the degree to which the firm is earning a profit. The Table shows that from 1996 to 1998, GTE has earned a rate-of-return on its embedded investments which is, on average, 5.18 percent greater than the 9.759 percent rate-of-return used in the Company's stranded cost study. Ex. 693 at 35. Given this analysis, the Commission is not persuaded by GTE's claim that it will be unable to earn a fair return on the actual cost of its historic investments unless it is able to impose a Competitive Transition Charge on CLECs. GTE's request for such a charge is, therefore, denied.

Row Title	Regulated 1996	Regulated 1997	Regulated 1998
Total Operating Revenues	563,024	587,365	614,806
Total Operating Expenses	355,166	362,893	380,057
Other Operating Income/Losses	957	1,179	550
Total Non-operating Items (Exp)	-28,442	-32,869	-8,779
Total Other Taxes	50,729	29,195	46,123
Federal Income Taxes (Exp)	42,400	57,370	34,873
Total Plant In-Service	1,897,500	1,985,082	2,099,362
Total Other Investments	95,102	132,813	80,321
Total Reserves	983,907	1,014,958	1,089,141
Average Net Investment	1,008,695	1,102,937	1,090,542
Net Return	144,128	171,955	163,082
Rate of Return	14.29%	15.59%	14.95%

202. The Commission noted above, at paragraphs 172-173, that the FCC has determined that states may not consider certain factors in setting rates, including embedded or historical costs, retail costs, opportunity costs, or revenues used to subsidize other services. In addition, at paragraphs 147-176 above, we noted that GTE's argument that the Act mandates the recovery of its actual costs has been found by the federal courts to lack merit. Accordingly, the Commission finds that GTE's common cost study is flawed, contrary to federal law, and should be rejected because GTE's analysis relies on historical, embedded numbers, and not on forward-looking costs and because GTE seeks to use its common cost methodology as a means to recover its actual costs.

203. Accordingly, the Commission denies GTE's proposed common cost markup factor of 55 percent. While GTE has the burden of proving the magnitude of its common costs, it would not be appropriate to simply state that GTE failed to meet its burden and prohibit recovery of any common costs. For the appropriate common cost markup, the data provided by U S WEST are reasonable proxies. Since this is the best

data available, the Commission will apply U S WEST's 19.62 percent attributed cost factor and its 4.05 percent common cost factor to GTE. The compound effect of the 19.62 percent and 4.05 percent values is a markup factor of 24.47 percent.²¹ As shown in the following Table, most of the cost categories that GTE has classified as common have been treated as attributable in the U S WEST study.

Account	U S WEST	GTE
Accounting and Finance (6721)	Attributable	Common
Human Resources (6723)	Attributable	Common
Computers (6124)	Attributable	Common
Information Management (6724)	Attributable	Common
Research and Development (6727)	Attributable	Common
Other General and Administration (6728)	Attributable	Common
Engineering (6535)	Attributable	Common
Network Administration (6532)	Attributable	Common
Plant Operations Administration(6534)	Attributable	Common
Garage Equipment (6115)	Attributable	Common
Motor Vehicle (6112)	Attributable	Common
Other Work Equipment (6116)	Attributable	Common
Furniture (6122.1)	Attributable	Common
Office Expense (6123)	Attributable	Common
Land and Building (6121)	Attributable	Common
Executive and Planning (6710)	Common	Common

²¹The 19.62 percent comes from U S WEST's response to Bench Request No. 104. The Commission notes that this is the actual factor that U S WEST filed with its work papers. The 20 percent factor which has been discussed by parties in this proceeding is merely a round-up of the 19.62 percent factor found in U S WEST's work papers. It is the 19.62 percent which the Commission will utilize here.

External Relations (6722)	Common	Common
Legal (6725)	Common	Common
Procurement (6726)	Common	Common

204. There are certain accounts which U S WEST treats as direct or administrative expenses but GTE includes in its common cost factor: special purpose vehicle expenses (account 6114); provisioning expense (6512);²² testing (6533); product management (6611); sales (6612); and product advertising (6613). Based on the data provided by U S WEST, these costs constitute a small proportion of the cost of providing a loop. We will take these costs into account by increasing the markup from 24.47 percent to 24.75 percent.

²² The 1995 ARMIS data, as reported in the Hatfield Model, indicates a zero value for this account

Loop Summary

205. Based on the discussion above, we establish the following permanent unbundled loop rates for GTE and U S WEST:

U S WEST Unbundled Loop: TELRIC + Common

	Hatfield	BCPM	RLCAP	Average
Model Run	13.53	15.72	13.76	
Commission Adjustment per 8TH ORDER	\$2.31	\$0.75	\$2.68	
Cost Floor	\$15.84	\$16.47	\$16.44	\$16.25
Phase II Additive	12.5%	\$3.10	4.05%	
TELRIC + Common	\$17.82	\$19.57	\$17.10	\$18.16

GTE Unbundled Loop: TELRIC + Common

	Hatfield	BCPM	LCM	Average
Model Run	15.73	21.81	25.03	
Commission Adjustment per 8TH ORDER	\$1.40	\$0.50	-\$3.57	
Cost Floor	\$17.13	\$22.31	\$21.46	\$20.30
Phase II Additive	12.5%	\$3.47	24.75%	
TELRIC + Common	\$19.27	\$25.78	\$26.77	\$23.94

Common Cost Markup for Other Rate Elements

206. In paragraphs 116 through 167, we reviewed the parties' positions on the appropriate levels of markup over cost. The parties' arguments on the appropriate levels of markup addressed all rate elements, not just the local loop. Therefore, with one exception, our findings regarding the appropriate markup for the loop apply equally to the other network elements. That single exception is the markup for the BCPM output. Sprint, the party sponsoring BCPM, proposed that the model only be used to establish the cost of the local loop. Therefore, in determining the markup for other network elements, we will apply, where applicable, a markup of 12.5 percent, 4.05 percent, and 24.75 percent to the Hatfield, U S WEST, and GTE cost estimates, respectively.

207. At paragraph 320 and footnote 39 of the 8TH ORDER, we used an annual charge factor of 22.95 percent for converting switching investment to an annual cost. We noted that the 22.95 percent excluded common costs. For the port and per minute cost of a switch, we will increase the cost estimates by 4.05 percent in order to reflect the common cost additive identified by U S WEST.

208. GTE and U S WEST are ordered to make a compliance rate filing that reflects our findings in this proceeding. Where parties have proposed a markup for common costs, this will involve applying a 4.05 percent common cost factor to U S WEST cost estimates, 12.5 percent to Hatfield cost estimates, and 24.75 percent to GTE's cost estimates.

209. We require GTE and U S WEST to include a table in their compliance submission that contains the following headings: Rate Element; Cost Estimate(s); Record Citation (for the Cost Estimate); Markup; and Price. For example, the following Table illustrates the type of filing the two parties are required to submit:

Rate Element	Cost Estimate USWest	Cost Estimate Hatfield 3.1	Record Citation USWest*	Record Citation Hatfield 3.1*	Mark-Up USWest	Mark-Up Hatfield 3.1	Price
Tandem Switching	\$.001338	\$.00127	9 th Supp. Ord. Par. 36	9 th Supp. Ord. Par. 36	4.5%	12.5%	(.001338* 1.045 + .00127* 1.125) / 2 = .001413
SCP	N.A.	\$.00131		14 th Supp. Ord. Par. 59		12.5%	.00131*1.125 = .001474

Rate Element	Cost Estimate GTE	Cost Estimate Hatfield 3.1	Record Citation GTE	Record Citation Hatfield 3.1*	Mark-Up GTE	Mark-Up Hatfield 3.1	Price
Tandem Switched Local Transport - Termination	\$.000061 1	\$.00029	14 th Supp. Ord. Par. 48	14 th Supp. Ord. Par. 48	24.75%	12.5%	(.0000611 * 1.2475 + .00029 * 1.125) / 2 = .000201
SCP	N.A.	\$.0015		14 th Supp. Ord. Par. 59		12.5%	.0015 * 1.125 = .001688

* For the Record Citation, please either provide the Supplemental Order and paragraph numbers, or the Exhibit Number and page reference.

LOOP CONDITIONING COSTS

I. PARTY POSITIONS

U S WEST

210. U S WEST notes that in the 8TH ORDER, at paragraphs 150-153, the Commission required U S WEST to rerun its loop conditioning cost study with the following adjusted inputs: reducing technician work time at splice locations from 160 to 120 minutes; reducing plant engineering design time from 3 hours to 60 minutes; removing common costs; and changing the assumption of bridge tap removal at 3 locations to 1 location. U S WEST states that it has modified its cost study in conformity with these requirements. U S WEST submits that its recalculated loop conditioning costs are:

- A non-recurring charge of \$304.12 for load coil removal. This charge is based on a TELRIC of \$292.28 for the cost of removing load coils for a 25 pair binder group plus a common cost of \$11.84; and
- A non-recurring charge of \$147.34 for bridge tap removal, based on a TELRIC of \$141.63 for bridge tap removal at a single location direct and attributed costs plus a common cost of \$5.74.

211. U S WEST takes issue with the contention, made by some of the parties, that the costs of loop unloading are already recovered in U S WEST's maintenance factor. U S WEST asserts that the only unloading activity recovered in the maintenance factor is the historic unloading activity that would have taken place in isolated instances in the single-provider, non-digital network. U S WEST goes on to asseverate that the

loop unloading costs contained in the Company's nonrecurring cost study identify activities in addition to the historic levels of activity. Therefore, the Company maintains that the loop unloading costs which may be required to meet future CLEC requests are not covered by the maintenance factor and are more properly recovered in a separate charge.

GTE

212. Pending the Commission's approval of GTE's new load coil removal cost study, GTE proposes an interim non-recurring rate of \$65.00 to be applied on a per service order basis when a field technician is dispatched to remove load coils. GTE maintains that this figure is based on the Loop Facility Charge contained in GTE's original cost filing and would cover the cost of "unloading" all loops ordered at a specific customer location. Brief at 37.

213. GTE makes the claim that the Commission's work time adjustments for GTE's non-recurring cost study, imposed by the 8TH ORDER, lowered the cost associated with the Loop Facility Charge to \$0.00. Brief at 37. GTE avers that these adjustments are unreasonable, since costs are incurred each time a technician and a truck are dispatched to remove or install a loop and/or remove load coils.

214. GTE takes issue with Murray and Starr's contention that the cost of removing load coils does not belong in recurring or non-recurring rate elements developed under forward-looking cost principles because load coils themselves are not forward-looking technology.²³ GTE makes the point that, while a forward-looking network might not contain load coils, GTE's current network does. Therefore, GTE goes on to assert that it will incur load coil removal costs on those occasions when a CLEC requests removal in order to condition the loop to carry a digital signal. GTE points out that paragraph 155 of the 8TH ORDER acknowledges this possibility and allows GTE to recover these costs.

COMMISSION STAFF

215. Staff acknowledges that U S WEST's study related to its load coil unloading and bridge tap removal costs is in compliance with the 8TH ORDER.

216. As regards GTE's loop conditioning costs, Staff notes that GTE has requested that the Commission allow the filing of an additional cost study. Until such time as that study is filed and accepted, Staff recommends that the interim charge for GTE's loop conditioning be set at 50 percent of GTE's retail nonrecurring rate. If an equivalent nonrecurring rate is not available, Staff recommends that the interim charge

²³ Mr. Murray and Ms. Starr were witnesses for COVAD and AT&T, respectively.

be set at zero. Brief at 20.

PUBLIC COUNSEL

217. Public Counsel does not address the loop conditioning issue.

MCI

218. MCI posits that the loop conditioning charges proposed by U S WEST and GTE should be rejected as being in violation of the FCC's pricing rules and the Commission's 8TH ORDER in this proceeding.

219. MCI argues that "[t]he FCC's pricing rules require that recurring costs shall be recovered through recurring charges, unless an incumbent LEC proves to a state commission that such recurring costs are de minimus." Brief at 7. MCI goes on to aver that both U S WEST and GTE are effectively not charging themselves anything for a DSL-capable loop. In addition, MCI continues to assert, "U S WEST's and GTE's pricing proposals for DSL-capable loops fail to reflect forward-looking costs, as required by the FCC's pricing rules." Brief at 7.

220. It is MCI's opinion that U S WEST and GTE have failed to demonstrate that loading coils and bridge taps would be used in a forward-looking network. MCI further contends that, in the event GTE wins a conditioned loop customer back, GTE benefits from the loop conditioning at the expense of the CLEC that initially requested the conditioning. MCI argues that this is not fair, just, or reasonable. Brief at 8.

221. MCI also avers that U S WEST's charge of \$304 for load coil removal can hardly be considered actual in light of the \$65 charge proposed by GTE.

AT&T

222. AT&T argues that U S WEST has admitted in subsequent proceedings in other states that loop conditioning costs are included in the maintenance costs used in the development of U S WEST's maintenance factor. Brief at 32. AT&T argues that loop conditioning costs are already being recovered in the recurring rate for the unbundled loop. AT&T further argues that the imposition of an additional non-recurring charge to recover these costs is a case of double recovery and is not permissible under the FCC's pricing guidelines.

NEXTLINK

223. NEXTLINK concurs with the criticisms of U S WEST's and GTE's loop conditioning costs made by other parties and opposes any recovery of these costs in unbundled loop rates. It is also NEXTLINK's position that, because loop conditioning

costs are not forward-looking, the ILEC's are not entitled to recover them as part of the charges for an unbundled loop.

COVAD

224. It is COVAD's position that "U S WEST and GTE should not be permitted to impose any additional charges for loop conditioning, since such charges are inconsistent with proper TELRIC costing and pricing. If any additional charges are imposed, they should be treated as recurring." Brief at 3.

225. COVAD argues that U S WEST's and GTE's proposed charges for loop conditioning fail to comply with the Act, the FCC's pricing rules, and the Commission's Phase I Order in this docket for the following reasons:

- Both companies effectively do not charge themselves anything for a DSL-capable loop;
- The proposed charges are discriminatory: By charging competitors all of the costs for loop conditioning on a 25-pair binder group, irrespective of the number of DSL-capable loops ordered from that binder group, the ILECs are then capable of using the extra unloaded loops for their own retail DSL services at no extra cost;
- Inclusion of loop conditioning costs results in pricing proposals for DSL-capable loops which fail to reflect forward-looking costs as required by the FCC's pricing rules, and;
- The imposition of loop conditioning charges on some loops impose a barrier to entry because only the ILECs know where, and how many, loops will require conditioning. This will make it difficult for new entrants to do accurate costing, forecasting, and business and market planning.

226. COVAD's other arguments in opposition to the loop conditioning charges proposed by GTE and U S WEST repeat those already put forth by AT&T and MCI.

TRACER

227. TRACER did not address this issue.

II. COMMISSION DECISION

CONDITIONING

228. Some of the parties, in their briefs on this issue, have voiced the opinion that because loop conditioning costs are not forward-looking costs, the ILECS are not entitled to recover them. As a response to this argument, the Commission would point out that the FCC, at paragraph 382 of its *First Report and Order* on local competition, stated:

Our definition of loops will in some instances require the incumbent LEC to take affirmative steps to condition existing loop facilities to enable requesting carriers to provide services not currently provided over such facilities. For example, if a competitor seeks to provide a digital loop functionality, such as ADSL, and the loop is not currently conditioned to carry digital signals, but it is technically feasible to condition the facility, the incumbent LEC must condition the loop to permit the transmission of digital signals. Thus, we reject BellSouth's position that requesting carriers "take the LEC networks as they find them" with respect to unbundled network elements. As discussed above, some modification of incumbent LEC facilities, such as loop conditioning, is encompassed within the duty imposed by section 251(c)(3). The requesting carrier would, however, bear the cost of compensating the incumbent LEC for such conditioning. (Footnotes omitted from quote; emphasis added.)

229. As a further response to this argument, the Commission directs the parties to its own 8TH ORDER, where we state, at paragraph 155:

Load coils are not a forward-looking technology and therefore they should be excluded from a loop model that is estimating forward-looking recurring costs. On the other hand, in the near-term, there will be occasions where a CLEC will request that load coils or a bridge tap be removed from existing facilities. Load coils or a bridge tap are removed to satisfy the requirements of a particular end-user. We believe that it is appropriate to recover these customer specific costs from the cost-causer.

230. AT&T has stated that U S WEST's testimony in other state proceedings indicates that deloading costs are included in the maintenance costs used to develop U S WEST's maintenance factor. Concerning this allegation, the Commission finds:

(1) There is no citation in the record in this proceeding to support this position; and

(2) The cost of deloading would be included in the expense estimates generated by the Hatfield Model; the Hatfield Model takes ARMIS expense, divides by ARMIS investment, and then multiplies that quotient against the estimated current level of investment. 8TH ORDER at ¶228. The need for deloading is likely growing over time due to the needs of firms that want to provide high-speed data services. Therefore, the expenses that were incurred at the time of the study, 1995 for Hatfield 3.1, are not good indicators of what will be incurred prospectively.

231. Given the Commission's findings in the paragraph above, the Commission concurs with U S WEST's position in paragraph 211 above, that loop unloading costs which may be required to meet future CLEC requests are not adequately covered by the maintenance factor and are more properly recovered in a separate charge.

232. Staff has acknowledged that U S WEST's study complies with the 8TH ORDER. Accordingly, the Commission adopts U S WEST's TELRIC of \$292.28 for the cost of the removal of load coils for a 25-binder group, and its TELRIC of \$141.63 for a bridge tap removal at a single location. The Commission finds that using the 4.05 percent markup factor we have authorized adds common costs of \$11.84 to the cost of load coil removal and \$5.74 to the cost of bridge tap removal.

233. GTE initially proposed an interim non-recurring charge of \$65.00 based on the Loop Facility Charge contained in its original filing. Ex. 575 at 34-35. GTE filed a new NRC study in August 1998 that addressed the cost of loop conditioning in its proposed Outside Facility Charge. However, GTE did not separately identify the costs associated with load coil removal. Staff recommended that GTE separately identify the costs associated with load coil removal and propose a charge that is in compliance with the Commission's 8TH ORDER. Ex. C-660 at 6-7.

234. GTE accepted Staff's recommendation to separately identify the costs of load coil removal and made a commitment to file a new study in mid-February, 1999. Ex. 586 at 19-20.

235. On February 19, 1999, GTE filed a new outside facility connect charge study. The Commission determined that this study could not be considered in Phase II because parties had not been provided an opportunity to review the study. March 9, 1999 Commission letter to GTE. Since the Commission lacks cost information for GTE, and an interim price of \$0.00 would not be appropriate, the Commission will use U S WEST's costs as a proxy and set GTE's interim rate equal to the interim rate for U S WEST.

236. In Phase III of this proceeding, parties are asked to provide testimony on the reasonableness of the GTE outside facility connect charge cost study. As part of their testimony, we ask parties to also address the rate structure that should be used to recover the cost of load coil and bridge tap removal. Should the cost be recovered only from the CLEC that has requested the deloading or removal of the bridge tap, or should the cost be recovered from all UNE loops? If the latter approach is adopted, it results in a lower price but, on the other hand, the charge is assessed against all UNE loops.

237. U S WEST has proposed that the deloading and bridge tap removal be recovered from the party that requests the activity. In Phase III, we ask the parties to address whether the Commission should establish a pricing structure that spreads the cost of deloading to all loops or whether the cost should be recovered only from the party that requests the activity.

238. The deloading costs the Commission has adopted for U S WEST above will be applied in the manner described at paragraphs 147-148 of the 8TH ORDER. That is, deloading costs will be recovered from the loops for which the deloading was requested. For example, loops are typically loaded in 25-pair binder groups, and have load coils or bridged taps to enable or enhance voice-grade communications on long copper loops. If the rate for unloading is \$304.12 for the 25 pairs, and four pairs require the unloading, the cost should be recovered from all four pairs in such a manner that the total charge equals \$304.12.

239. COVAD has expressed concern, above at paragraph 225, that the Commission's decision as to application of deloading costs will enable ILECS to use the extra deloaded loops for their own retail DSL services at no extra cost by charging competitors all of the costs for loop conditioning on a 25-pair binder group, irrespective of the number of DSL-capable loops ordered. In response to this concern, the Commission points out that U S WEST witness Reynolds has testified that not all pairs in a binder group would be simultaneously deloaded when a CLEC deloading request is made. Reynolds stated that maintaining voice grade service on the other lines in the binder group not covered by the CLEC request would necessitate that those lines remain loaded. Tr. at 653-654.

GROOMING

240. The parties also dispute the appropriateness of charging CLECs for the cost of splitting out the unbundled loops prior to their entry into the switch (grooming). For example, ELI and NEXTLINK contend that the cost of grooming would not be incurred on an efficiently designed network, and, therefore, this is not a cost that can be recovered from the CLECs. Brief at 17.

241. U S WEST asserts that under the Act it is entitled to recover all reasonable costs associated with preparing its network and operations to allow for access to its unbundled network elements. Brief at 23, 34.

242. ELI and NEXTLINK also contend that the Commission should give no consideration to the GTE grooming cost study since it failed to timely present sufficient evidence to demonstrate that it will incur these costs. Brief at 29.

243. We concur with ELI and NEXTLINK that GTE failed to provide timely data on the cost of grooming. Cost data on this issue should have been presented in Phase I, and, therefore, we dismiss GTE's request to enter into the record a late-filed cost study.

244. With regards to U S WEST, in order to recover costs from the cost-causer, as with the removal of load coils, we find it appropriate to recover from the requesting CLEC the cost of unbundling loops served by integrated digital loop carrier. This costing principle was reflected in the derivation of our loop cost estimate for U S WEST in Phase I of this proceeding. 8TH ORDER at paragraphs 163-164.

245. When the 8TH ORDER was entered, the Eighth Circuit Court had held that the federal rule that required ILECs to combine network elements for CLECs violated the Act. *Iowa Utilities Board v. Federal Communications Commission*. Subsequently the Supreme Court reversed the Eighth Circuit's decision. 67 U.S.L.W. at 4111-12.

246. The Supreme Court also remanded to the FCC the issue of which unbundled network elements satisfy the "necessary and impair" standards of Section 251(d)(2) of the Act -- conditions that must be met when requiring an ILEC to provide network elements. 67 U.S.L.W. AT 4110-11. If the FCC determines that the loop and a switching port are network elements, CLECs will be entitled to obtain these bundled network elements. Even if the FCC does not require ILECs to provide ports, this Commission may want to do so under its own authority. Where CLECs obtain the bundled network elements from an ILEC, there will no longer be a need to groom the loops. This in turn lowers the cost of providing the loop.²⁴ 8TH ORDER at ¶161.

²⁴ The ILECs have assumed that the provisioning and dispatch activities for a loop or a port are "not analogous to a retail process." See, for example, GTE Non-Recurring Cost Study, pages 3-WA 10-11. Ex. C565. The ILECs have assumed that the work flow process involves more manual work for unbundled network elements than for retail services. This assumption was based on the belief that an ILEC was not obligated to provided bundled network elements. When network elements are unbundled, some of the automated testing and provisioning processes are less accessible. Consequently, the cost estimates of implementing an order for unbundled network elements are much greater than for the resale of retail services.

The assumption about automated processing and flow-through may have been reasonable prior to the Supreme Court's decision of January 1999. In January 1999, the Supreme Court upheld the FCC's rule 315(b) which forbids an incumbent to

247. In the 14TH ORDER, we added \$1.65 to the U S WEST RLCAP cost estimate to reflect the cost of grooming. 14TH ORDER at 12-13. If a CLEC requests a bundled loop and port, the estimated cost declines by approximately $\$1.65 / 3$, or \$0.55. The value of three reflects that in determining the cost of the loop, we gave equal weight to BCPM, Hatfield, and RLCAP.

248. After taking into account the common cost additive of 4.05 percent, this reduces the price of U S WEST's loop to \$17.59. This lower value only applies where a CLEC orders a bundled loop and port.

AVOIDED COST DISCOUNT (OS & DA)

249. The Commission determined in the 8TH ORDER that it was appropriate to establish separate avoided cost wholesale discounts for Operator Services ("OS") and Directory Assistance ("DA"), and directed U S WEST and GTE to file studies consistent with the Order. ORDER at paragraph 407.

250. GTE filed a study which indicated that a 0.6 percent avoided cost for OS/DA services. Ex. 575 at 36; Ex. 579.

251. Staff concurs in GTE's request for a 0.6 percent OS/DA discount, which reflects that uncollectibles will be 100 percent avoided for the service and that none of the other typically avoidable costs associated with these services, such as advertising, were included in the OS/DA costs. Ex. 511 at 2.

252. U S WEST also filed a study in compliance with the Commission's Order, requesting a discount of 6.9 percent. Ex. 509 at 3; Ex. 510. Staff recommends a 7.97 percent discount for U S WEST, which reflects avoided costs divided by revenues, instead of dividing by costs. Ex. 511 at 3. Staff opposes U S WEST's proposal to use costs as the denominator in the discount calculation to account for revenue erosion. Ex. 509 at 11. Staff observed that OS/DA revenues have been less than costs since 1995, that costs have declined as revenues have declined, and that using costs as the denominator would produce a wholesale discount lower than what would have been obtained had revenues been used as the denominator using either 1995 or 1997 data. Ex. 511 at 4.

separate already-combined network elements before leasing them to a competitor. Consequently, depending on the outcome of the FCC's Second Further Notice of Proposed Rulemaking in CC Docket No. 96-98 and 95-185, GTE and U S WEST may need to file revised cost studies that reflect the cost savings that can be achieved through the provisioning of already-combined network elements.

253. Staff also noted that in the 8TH ORDER the Commission ordered that revenues be used as the appropriate denominator in calculating wholesale discounts. ORDER at paragraph 405.

254. We approve the use of the 0.6 percent avoided cost factor for GTE's OS/DA services. For U S WEST, we maintain our view that revenues should be used as the appropriate denominator in calculating wholesale discounts. Therefore, we find that the avoided cost factor for U S WEST's OS/DA services is 7.97 percent.

COLLOCATION

I. OVERVIEW

255. "Collocation is a method of accessing unbundled network elements, or interconnecting the facilities and equipment of telecommunications carriers, that allows competing carriers to place, or direct the local exchange carrier to place, network equipment dedicated to their use on the premises of a local exchange carrier. See 47 U.S.C. §151(c)(6). Collocation may be provided through physical collocation, in which the competing carrier purchases, places, and maintains the equipment on the LEC's premises, or may be provided through virtual collocation, in which the competing carrier purchases equipment and the LEC places and maintains it for the competing carrier's benefit on the LEC's premises. Physical collocation has traditionally been accomplished using 'collocation cages,' typically chain link-type fencing which separates the competitor's equipment from the ILEC's. Other forms of collocation are now emerging, i.e., cageless collocation and common or shared collocation, that may lower the cost and delay of implementing collocation with cages." Staff Brief at 45.

II. POLICY ISSUES

Concerning the Need for a Phase III Proceeding on Collocation

256. The Commission notes that the majority of the parties support opening a new phase of this proceeding in order to address new cost studies being developed by GTE and U S WEST, or to open a separate proceeding concerning collocation. Staff Brief at 44; NEXTLINK/ELI Brief at 34; COVAD Brief at 36; MCI Brief at 34; GTE Brief at 70.

257. U S WEST notes that "the Commission clearly stated in the 8th Supplemental Order, and reiterated in the 15th Supplemental Order, that it does not wish to start a separate proceeding, or to reopen the record to receive testimony and arguments that should have been submitted in Phase I." Brief at 54.

III. COMMISSION DECISION

258. The Commission finds that a Phase III proceeding on the cost and pricing of collocation is appropriate. Over time, more and more CLECs have alleged that collocation is acting as an impediment to the competitive development and deployment of new services, such as ADSL, and acting as a block to competition in more traditional voice and data markets.²⁵ At paragraph 40 of the Order, the FCC states that “[t]he record is replete, however, with evidence documenting the expense and provisioning delays inherent in the caged collocation process. National rules governing specific collocation arrangements will help solve those problems.” Footnotes omitted.

259. Since the Commission is obligated by state and federal law to ensure that rates are “just, reasonable, and non-discriminatory” (47 U.S.C. §251(c)(6)), there is a need to establish a Phase III proceeding to further investigate and examine the cost and pricing of collocation.

260. Furthermore, paragraph 6 of the aforementioned FCC Order states that one of the intents of the FCC Order is to strengthen existing FCC collocation rules to reduce the costs and delays faced by competitors that seek to collocate equipment in an ILEC's central office. The methods utilized by the FCC in its Order to strengthen its existing collocation rules will obviously have an impact on the Commission's collocation decisions. Since the FCC's Order came after the close of the record in the instant proceedings, no party has had an opportunity to respond to, or Brief, the FCC's Order before the Commission.

261. For the reasons outlined above in paragraphs 258-260, because of the number of parties in this proceeding requesting that the Commission open a new phase of this proceeding, and given the fact that GTE and U S WEST are preparing new collocation cost studies, it is reasonable that the Commission establish a Phase III proceeding for the purpose of determining permanent collocation prices.

262. In the 8TH ORDER, the Commission directed U S WEST and GTE “to submit testimony in Phase II of this proceeding regarding the degree to which their studies comply and are consistent with the [FCC's] *Physical Collocation Order*.” To the extent that the studies are not consistent, the Commission noted it would order the ILECs to modify their studies. 8TH ORDER at ¶¶411-417. This directive to the parties also controls the new studies which GTE and U S WEST will submit in Phase III.

²⁵ It is noteworthy that the FCC, at paragraph 40, has come to similar conclusions in its First Report And Order And Further Notice of Proposed Rulemaking, *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, FCC 99-048; CC Docket No. 98-147 (Adopted: March 18, 1999; Released: March 31, 1999)

263. U S WEST, GTE, and AT&T have questioned the relevancy of the FCC's *Physical Collocation Order* to these proceedings.

264. U S WEST has stated that "[p]aragraph 417 of the 8th Supplemental Order does not require a blind adherence to the FCC's Collocation Order's requirements, when such requirements do not make sense in this proceeding."²⁶ Brief at 72.

265. AT&T suggests that the Supreme Court's decision simplifies this area, asserting that the prices contained in the ILECs' interstate collocation tariffs are not TELRIC compliant and so cannot be the permanent prices. AT&T states that the FCC's pricing rules reinstated by the Supreme Court "require that the Commission either develop prices in accordance with TELRIC or utilize proxy prices until it is able to do so." Brief at 67.

266. In response to the above contentions, the Commission would note that the FCC's *First Report and Order on Interconnection*, CC Docket No. 96-96, at paragraph 565, states:

We conclude that we should adopt the existing Expanded Interconnection requirements, with some modifications, as the rules applicable for collocation under section 251. Those rules were established on the basis of an extensive record in the Expanded Interconnection proceeding, and are largely consistent with the requirements of section 251(c)(6). Adoption of those requirements for purposes of collocation under section 251, moreover, has substantial support in the record of this proceeding. Thus, the standards established for physical and virtual collocation in our Expanded Interconnection proceeding will generally apply to collocation under section 251. The most significant requirements of Expanded Interconnection are specifically set out in rules we adopt here. We address pricing and rate structure issues separately, in section VII below. (Footnotes omitted.)

The Commission also notes the FCC's rule §51.509(g) states:

²⁶ U S WEST makes this statement in reference to the fact that the studies that the FCC reviewed in issuing its Collocation Order were TSLRIC studies, while U S WEST's studies in this proceeding are TELRIC studies.

“Collocation. Collocation costs shall be recovered consistent with the rate structure policies established in the *Expanded Interconnection* proceeding, CC Docket No. 91-141.”²⁷

267. Regarding rate structure for collocation elements, the FCC’s *First Report and Order on Interconnection*, CC Docket No. 96-96, at paragraph 826, states:

We have established rate structure rules for collocation elements in connection with our Expanded Interconnection proceeding. Many collocation elements established under section 251(c)(6) are likely to represent the same facilities, and should have the same cost characteristics, as existing interstate expanded interconnection services, and therefore we require states to use the same rate structure rules for those collocation elements that we established in the Expanded Interconnection proceeding. As a proxy ceiling, states may use the rates the LEC has in effect in its federal expanded interconnection tariff for the equivalent services. Expanded interconnection services are subject to the new services test, which, as discussed above, uses a forward-looking methodology. Although LECs have filed expanded interconnection tariffs, we have not yet completed our investigation into those tariffs. Any price for unbundled collocation elements set based on LEC expanded interconnection tariffs would therefore be subject to any modification of those tariffs that results from our pending investigation, and any state-imposed prices based on those tariffs will need to be adjusted accordingly. (Footnotes omitted.)

268. Given the FCC’s position on the relevance of its expanded interconnection requirements and their applicability to collocation under section 251 of the Act, the Commission finds that use of the FCC’s prior collocation orders is consistent with the Act, notwithstanding the fact that the FCC in its *Physical Collocation Order* dealt with studies submitted prior to the Act.

²⁷ The reference to the Expanded Interconnection Proceeding refers to *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369, 7398 (1992) (“*Special Access Expanded Interconnection Order*”).

COLLOCATION CAGES

OVERVIEW

269. ILECs typically require that physically collocated equipment be placed inside a collocation cage within the incumbent LEC facility. Such cages are intended to separate physically the competitors' facilities from those of the incumbent and to prevent access by unauthorized personnel to any party's equipment. Such cages frequently add considerably to the cost of establishing physical collocation at a particular LEC premises and could constitute a barrier to entry in certain circumstances.

PARTY POSITIONS

270. U S WEST states that it submitted evidence on three methods for physical collocation: (1) the use of a secure collocation cage; (2) cageless physical collocation; and (3) a CLEC option to use U S WEST's SPOT frame to combine UNEs without collocating any equipment. U S WEST notes that the Commission, in Docket Nos. UT-960323, *et al.*, determined that U S WEST is not required to offer cageless collocation. Brief at 54-55.

271. GTE states that collocation cages are necessary to ensure the security and integrity of GTE's network. Brief at 68.

272. Staff states its belief that a "unilateral requirement for cages imposes unnecessary costs on the ILECs' competitors and is an inefficient use of space, which in some offices will be at a premium." Brief at 46.

273. Staff also recalls the Commission's recent decision in Docket Nos. UT-960323, *et al.*, which found that U S WEST could deny a request for physical collocation of equipment without a caged enclosure.

274. COVAD advocates for what it calls "true" cageless collocation. By this COVAD "means the ability to collocate its equipment in the same racks and bays as the ILEC locates its equipment. In such circumstances, the space, power cabling, and other requirements become minimal, compared to cage-based collocation." Brief at 29. COVAD goes on to assert that under this arrangement it would only use about four square feet, the space necessary for two 23 inch bays, instead of the 100 or more square feet required for cage-based collocation. Brief at 29.

275. COVAD asserts that "true cageless collocation avoids the need to build, condition, equip, and cable to a completely separate space. By substantially reducing the amount of work needed to prepare a collocation space, the CLEC not only saves money, it can enter a central office and begin to provide service much more quickly." Brief at 30.

276. COVAD notes that U S WEST and COVAD have entered into “a modified agreement regarding cageless collocation that moves toward the COVAD concept of ‘true’ cageless collocation.” Brief at 30.

COMMISSION DECISION

277. The Commission has previously ruled that ILECs are not required to provide cageless collocation. However, the FCC, in Order No. FCC 99-048, adopted new rules concerning the collocation arrangements which must be made available to requesting carriers. First Report and Order and Further Notice of Proposed Rulemaking *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, FCC 99-048; CC Docket No. 98-147. (FCC 99-048) In this First Report and Order, at ¶40. The FCC reasons that it has chosen to adopt additional national rules on collocation because of the evidence documenting the expense and provisioning delays inherent in the caged collocation process and because it feels that national rules governing specific collocation arrangements will help solve those problems.

278. Order No. FCC 99-048 states further that ILECs must make each of the following collocation arrangements available to competitors “as soon as possible, without waiting until a competing carrier requests a particular arrangement, so that competitors will have a variety of collocation options from which to choose.” These arrangements are:

- (I) ILECs must make shared collocation cages available to new entrants;
- (II) ILECs must make cageless collocation arrangements available to requesting carriers;
- (III) ILECs must ensure that cageless collocation arrangements do not place unreasonable minimum space requirements on collocating carriers, and;²⁶
- (IV) ILECs are required “when space is legitimately exhausted in a particular LEC premises, to permit collocation in adjacent controlled environmental vaults or similar structures to the extent technically feasible.”²⁷

²⁶ The FCC states here that “[w]e require incumbent LECs to make collocation space available in single-bay increments, meaning that a competing carrier can purchase space in increments small enough to collocate a single rack, or bay, of equipment.” *Id.* at ¶43.

²⁷ These arrangements are expanded upon in greater detail at paragraphs 41-44. *Id.* at ¶44.

279. At paragraph 45 of Order No. FCC 99-048, the FCC went on to assert that “we now conclude that the deployment by any incumbent LEC of a collocation arrangement gives rise to a rebuttable presumption in favor of a competitive LEC seeking collocation in any incumbent LEC premises that such an arrangement is technically feasible.”

280. Based on our reading of the collocation arrangements outlined in the FCC CC Docket 99-048 order, we tentatively conclude that our previous position -- that ILECs could not be required to provide cageless collocation -- is no longer tenable and needs to be revisited. In Phase III, parties will be asked to comment on the significance of the FCC’s ruling on the provision of collocation arrangements in the state of Washington.

281. Furthermore, the Commission directs U S WEST and GTE to submit testimony in Phase III of this proceeding regarding the degree to which their studies comply and are consistent with the FCC’s ruling, as well as with those aspects of the FCC’s *Physical Collocation Order* not superseded by FCC 99-048. We require both U S WEST and GTE to submit cageless collocation studies in Phase III.

COST RECOVERY FOR COLLOCATION EXPENSES

OVERVIEW

282. In the FCC’s Second Report and Order in CC Docket No. 93-162, released June 13, 1997 FCC 97-208, at paragraph 45, the FCC found:

LECs recover common construction costs by (1) initially charging the first interconnection for all common construction costs through a nonrecurring charge; (2) initially charging the first interconnection for all common construction costs through recurring charges; or (3) charging the first interconnection a portion of common construction costs based on total estimated demand of central office space by interconnectors. We find that these common construction cost recovery mechanisms are not unreasonable, provided that such costs are equitably shared by all interconnectors benefitting from shared facilities.

283. However, we note that FCC Order No. 99-048 states:

We conclude, based on the record, that incumbent LECs must allocate space preparation, security measures, and other collocation charges on a pro-rated basis so the first collocater in a particular incumbent premises will not be

responsible for the entire cost of site preparation. For example, if an incumbent LEC implements cageless collocation arrangements in a particular central office that requires air conditioning and power upgrades, the incumbent may not require the first collocating party to pay the entire cost of site preparation. In order to ensure that the first entrant into an incumbent's premises does not bear the entire cost of site preparation, the incumbent must develop a system of partitioning the cost by comparing, for example, the amount of conditioned space actually occupied by the new entrant with the overall space conditioning expenses. We expect state commissions will determine the proper pricing methodology to ensure that incumbent LECs properly allocate site preparation costs among new entrants. We also conclude that these standards will serve as minimum requirements, and that states should continue to have flexibility to adopt additional collocation requirements, consistent with the Act.²⁸

COMMISSION DECISION

284. Based on our initial reading of FCC Order No. 99-048, we tentatively conclude that the above quoted paragraph is binding on the Commission. Given this tentative conclusion, it would appear that ILECs, such as GTE and U S WEST, may not recover the entire start-up costs for collocation from the first entrant requesting collocation. The Commission seeks further comment on this issue by the parties in Phase III.

USE OF OUTSIDE CONTRACTORS FOR SITE PREPARATION

PARTY POSITIONS

285. The parties addressed the question of whether to give a CLEC the option of obtaining site preparation work at the tariffed rate or putting it out for a competitive bid. GTE opposes providing CLECs with this option. GTE is concerned that a CLEC would use an outside contractor for inexpensive work, and only select GTE when the cost of construction was high. GTE claims that whereas the tariff rate reflects the cost of both high-cost and low-cost undertakings, and GTE would only be used for high-cost

²⁸ *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, First Report And Order And Further Notice of Proposed Rulemaking, FCC 99- 048; CC Docket No. 98-147, Adopted: March 18, 1999; Released: March 31, 1999 at ¶51.

work, the Company would end up providing site preparation work at a loss. Brief at 69.

286. U S WEST states that it is willing to “allow collocators to contract with U S WEST approved contractors for construction of collocation cages.” The Company is not willing to permit collocators to contract for work outside the physical cage. U S WEST avers that construction work outside the cage would constitute a taking to which U S WEST is entitled compensation. Brief at 69-70.

287. Staff believes that the appropriate method for setting rates for site preparation is through approved cost studies, rather than self-provisioning. Brief at 54.

288. NEXTLINK and ELI assert that, to be in compliance with 47 U.S.C. §251(c)(6), the Commission must “authorize CLECs to construct and install, or arrange for mutually acceptable contractors to construct and install, collocation site preparation and related facilities.” Brief at 51. NEXTLINK and ELI go on to aver that, in most cases, the contractors performing this work would be the same as those used by the ILECs. Brief at 52.

289. COVAD concurs with NEXTLINK and ELI on the issue of third party provisioning.

290. The Commission believes that the FCC’s *First Report and Order on Interconnection*, at paragraph 598, provides guidance on the question of third party provisioning:

Based on the comments in this proceeding and our previous experience with physical collocation in the Expanded Interconnection docket, we will continue to permit LECs to require reasonable security arrangements to separate an entrant’s collocation space from the incumbent LEC’s facilities. The physical security arrangements around the collocation space protect both the LEC’s and competitor’s equipment from interference by unauthorized parties. We reject the suggestion of ALTS and MCI that security measures be provided only at the request of the entrant since LECs have legitimate security concerns about having competitors’ personnel on their premises as well. We conclude that the physical separation provided by the collocation cage adequately addresses these concerns. At the same time, we recognize that the construction costs of physical security arrangements could serve as a significant barrier to entry, particularly for smaller competitors. We also conclude that LECs have both an incentive and the capability to impose higher construction costs than the new

entrant might need to incur. We therefore conclude that collocating parties should have the right to subcontract the construction of the physical collocation arrangements with contractors approved by the incumbent LEC. Incumbent LECs shall not unreasonably withhold such approval of contractors. Approval by incumbent LECs of such contractors should be based on the same criteria as such LECs use for approving contractors for their own purposes. We decline, however, to require that competitive entrants' personnel be subject to minimum training and proficiency requirements as suggested by GVNW. We find that such concerns are better resolved through negotiation and arbitration.

The Commission further notes that the FCC's Interconnection rules at §51.323(h)(2) state that "[a]n incumbent LEC is not required to permit collocating telecommunications carriers to place their own connecting transmission facilities within the incumbent LEC's premises outside of the actual physical collocation space."

291. Given the guidance provided by the FCC on this issue, the Commission finds that collocating parties do have the right to subcontract for the provision of physical collocation arrangements, provided those contractors are approved by the ILECs. The Commission agrees with U S WEST that collocators are not permitted to contract for work performed in ILEC offices outside the physical cage. However, given the FCC's ruling of March 31, 1999, and the augmented national collocation rules contained therein, the Commission seeks comment from the parties in Phase III as to the impact of these new rules on the scope of third party provisioning of collocation in light of the FCC's finding that cageless collocation must be provided by ILECs.

SEPARATE CLEC ENTRANCE FACILITIES

292. GTE requires modification of its central office buildings to provide CLECs requesting non-virtual collocation with dedicated access to their equipment 24 hours per day. This entails the construction of separate entrance facilities, doors, and security systems to allow CLEC technicians access to CLEC equipment. Charges for these facilities, among others, are recovered through GTE's Building Modification Charge. Brief at 71.

293. NEXTLINK and ELI take the position that a cage enclosure, where requested, that is accessible by a common, existing, entrance facility to the central office, offers more than adequate separation. These Companies point out that U S WEST requires no more than that and also offers cageless collocation. Brief at 48.

294. At paragraph 42 of Order No. FCC 99-048, the FCC states that “incumbent LECs may require competitors to use a central entrance to the incumbent's building, but may not require construction of a new entrance for competitors' use, and once inside the building, incumbent LECs must permit competitors to have direct access to their equipment.” (Footnote omitted.)

295. The Commission's reading of Order No. FCC 99-048 leads us to conclude that GTE's practice of requiring the construction of separate entrance facilities in its central offices for the use of collocating CLEC personnel is not allowable under current FCC regulations. In addition, the Commission believes that separate entrance facilities are an unreasonable barrier to entry. GTE is therefore directed to remove all attendant costs related to the provision of this item from the collocation cost studies it will submit in Phase III.

IV. INTERIM PRICING ISSUES

296. Having found above at paragraph 261 that another phase of this proceeding is necessary in order to establish permanent collocation prices, it remains for us to establish interim collocation prices.

INTERIM RATES FOR GTE

PARTY POSITIONS

297. GTE's collocation cost study filed with the Commission is the basis for its FCC tariff rates. Staff Brief at 52. GTE suggests that the Commission set interim collocation prices for GTE in accordance with this cost study until such time as the Commission opens a new proceeding to establish permanent rates based on a new GTE collocation cost study. GTE Brief at 70.

298. Staff supports GTE's interim price proposal with certain modifications. One of Staff's proposed modifications, which involves two offsetting changes to the building modification nonrecurring charge, is supported by GTE.²⁹ The other Staff

²⁹ “In Phase II, GTE made two adjustments to its collocation study to conform it to the Physical Collocation Order. In Phase I, GTE elected to recover all of its building modification costs through a non-recurring rate element. Exh. 593:11 (Langley). GTE has since removed a portion of the recurring costs of building modifications from the non-recurring collocation costs, and added a reasonable portion of common overhead costs to the remaining non-recurring collocation costs. (Lee, Exh. 584:4). The net result of these adjustments was to decrease total collocation costs from levels significantly higher than GTE's proposed rates to levels slightly below those rates. Exh. 584:4 (Lee).” GTE Brief at 70.

recommended modification is that “the cost of the collocation cages and other security measures be recovered from all ILEC customers, unless a CLEC specifically requests a cage or specific security measures.” Brief at 53.

299. AT&T states that, with the exception of the building modification charge, GTE’s rates for collocation appear to be reasonable. Brief at 68.

300. NEXTLINK and ELI likewise are not averse to the Commission adopting GTE’s tariff rates for collocation with noted exceptions. Brief at 44. NEXTLINK and ELI find fault with GTE’s proposed Building Modification charge, stating that GTE’s proposed cost to construct a separate enclosed space for CLECS, with its own entrance and security features, is vastly overstated, and that no such charge is warranted. Brief at 48-49. These Companies note that U S WEST requires no more than a cage enclosure accessible by a common, existing entrance facility to the central office, and that U S WEST even offers “cageless” collocation. Brief at 48. NEXTLINK and ELI also assert that the Commission should disallow charges for Overhead Superstructure and for heating, ventilation, and air conditioning (HVAC). These Companies assert that GTE’s current collocation pricing proposal provides these two elements pursuant to individual case basis (ICB) pricing in violation of the FCC’s *Physical Collocation Order*. These Companies further asseverate that such pricing is in violation of the Act as it improperly delegates pricing authority over bottleneck facilities to the incumbent monopoly provider. Brief at 49.

301. COVAD states that any interim collocation prices levied on CLECs should be subject to refund in the event that the Commission establishes permanent rates which are lower than interim rates.

COMMISSION DECISION

302. The Commission accepts GTE’s proposed prices for use on an interim basis. The Commission also accepts the offsetting changes to the building modifications nonrecurring charge proposed by Staff, and agreed to by GTE, at paragraph 298 above. We make no findings regarding Staff’s recommendation that the cost of collocation cages and other security measures be recovered from all ILEC customers. The permanent resolution of collocation pricing issues is deferred to Phase III.

303. The Commission does not find merit in COVAD’s recommendation for a true-up. The Commission’s general approach is to establish interim prices, and then move forward with permanent prices developed on a proper record. There is no reason to treat collocation charges in a different manner.

304. With regard to the concerns raised by some parties over GTE’s Building Modification and HVAC charges, the Commission notes that GTE’s practice of requiring

the construction of separate entrance facilities in its central offices for the use of collocating CLEC personnel is not allowable under current FCC regulations. See, ¶42 of Order No. FCC 99-048. GTE is, therefore, directed to remove all costs related to the construction of separate personnel entrance facilities from its proposed Building Modification Charge. GTE is directed to file within thirty days an interim Building Modification Charge that excludes the aforementioned separate entrance facility costs.

INTERIM RATES FOR U S WEST

PARTY POSITIONS

305. U S WEST asserts that its collocation cost estimates are based on TELRIC principles and are in compliance with paragraph 417 of the Commission's 8TH ORDER. Brief at 55, 72. U S WEST further asserts that no other party has presented TELRIC-based costs of collocation in U S WEST's central offices other than itself. Brief at 55. Finally, U S WEST urges that the collocation prices it has derived from its costs are fair, just, reasonable, and nondiscriminatory. Brief at 57.

306. U S WEST contends that allegations that its cost studies are not based on a "forward-looking central office" are outside the scope of this proceeding and are incorrect. U S WEST points out that the Commission's Fifteenth Supplemental Order stated that the issue in the pricing phase of the proceeding is whether U S WEST's filings comply with the FCC's *Physical Collocation Order*. U S WEST asserts that the *Physical Collocation Order* does not require that collocation cost estimates be derived on the basis that the central office is rebuilt in its entirety. Brief at 55.

307. Staff does not believe that U S WEST has fully complied with paragraph 417 of the 8TH ORDER. Brief at 46. Staff points out that U S WEST has filed two separate cost studies concerning collocation elements -- an EICT recurring cost study and a Physical and Virtual Collocation cost study. Staff opines that, while the EICT study may be used, with some modification, on an interim basis, U S WEST's Physical and Virtual Collocation cost study must be recalculated and resubmitted. Brief at 47.

308. Staff has overall methodological concerns, as well as specific concerns related to costs and prices, with U S WEST's Physical and Virtual Collocation cost study. Staff is particularly concerned with the prices U S WEST proposes for collocation cages, fiber entrance facilities, and power cabling. Staff notes that U S WEST's cost study appears to be suffering from the same computational problems and inconsistencies noted in the FCC's *Physical Collocation Order*. Staff particularly notes the fact that U S WEST's study contains no site preparation, or building modification, costs and is also missing backup costs for floor space used to house collocation equipment. Brief at 48.

309. AT&T notes that U S WEST does not have a federal tariff for physical collocation. Therefore, AT&T advocates the adoption of GTE's collocation rates, with the exception noted previously at paragraph 300 above, as interim rates for U S WEST as well. Brief at 68.

310. MCI states that U S WEST's cost study contains two areas which result in the significant over-statement of collocation costs: the inefficiencies stemming from U S WEST's inclusion of embedded costs and equipment inconsistent with an efficient central office layout, and best planning practices. Brief at 33.

311. NEXTLINK and ELI state that U S WEST's cost study "even fails its own standards for evaluating cost estimates by failing to offer any 'reality checks' to validate the outputs of its collocation models." Brief at 37. NEXTLINK/ELI argue that a comparison of GTE's pricing demonstrates that U S WEST's costs are overstated. Brief at 37.

312. NEXTLINK/ELI join with Staff in noting that U S WEST has offered no evidence of the cost of constructing a cage enclosure or of site preparation costs for the establishment of a collocation cage. These Companies further claim that U S WEST only offers this element under ICB pricing, in violation of the Act and the FCC's *Physical Collocation Order*. Brief at 38.

313. NEXTLINK/ELI also take issue with U S WEST's proposed charges for its fiber entrance facilities, and the fiber splicing costs which attend that element. They claim that U S WEST's proposed charges for this element are more than fifteen times higher than GTE's rate for the same element. Brief at 38. NEXTLINK/ELI contend that the source of this discrepancy is U S WEST's assumption that "the pathway and related facilities used to bring the fiber from the CLEC network to the collocation space is dedicated exclusively to three CLECs using 12 fibers each." Brief at 39.

314. NEXTLINK and ELI argue that U S WEST's proposed DC Power Cable Installation costs are more than six times higher than U S WEST's tariff rate for virtual collocation, and GTE's proposed rate, for the same element. Brief at 39. NEXTLINK and ELI represent that one of the principal reasons for this disparity is that U S WEST's DC Power Cable Installation costs are not based on Washington-specific costs, but on an average of costs incurred in five central offices in different states. NEXTLINK and ELI state that none of the central offices in the study are representative of the majority of Washington State's central offices. For example, these Companies maintain that the typical Washington State central office only requires that DC power be brought from the basement to the first floor, while the offices used in the U S WEST study require that DC power be brought as high as the eighth floor, thereby overstating the costs for DC power installation in the typical Washington State central office. Brief at 40.

315. NEXTLINK and ELI are not averse to the Commission adopting GTE's tariff rates for U S WEST's collocation prices, with one additional exception to those already mentioned at paragraph 300, above. NEXTLINK and ELI advocate setting the Expanded Interconnection Channel Termination (EICT) charge at U S WEST's latest TELRIC estimate instead of utilizing GTE's EICT charge.³⁰ Brief at 44.

COMMISSION DECISION

316. The disparity between GTE's and U S WEST's entrance facility rates is due to U S WEST's assumption that outside of its offices, at the point of interconnection manhole (POI), a separate manhole will be constructed for the CLECs. U S WEST states that the CLECs require a new manhole because there is too much congestion in the U S WEST manhole outside the central office. Ex. 602 at 11; Ex. 621 at 5-6. GTE, on the other hand, does not require the construction of a separate manhole for the CLECs -- it is willing to share its entrance facility with the CLECs.

317. In Phase III we require U S WEST to submit cost studies that reflect sharing of entrance facilities. We find the assumption that there is congestion in all U S WEST entrance facilities implausible. The assumption that all existing U S WEST facilities are congested strikes us as an example of an ILEC using the cost and provisioning process to create a barrier to entry.

318. We do not rule out the possibility that in certain areas of U S WEST's territory the manholes will be congested and there will be a need to construct a new manhole. Later in the instant Order, in our ruling on SPOT frames, we determine that where U S WEST can show that it is using comparable intermediate frames for its own operations, the cost of SPOT frames can be charged to CLECs.³¹

319. As to entrance facilities, if U S WEST can demonstrate that its first manhole is congested, it can require the CLECs to use a separate manhole and recover the cost from the CLECs. Where U S WEST claims that a manhole is congested, it must provide access to the manhole so that the CLECs can verify that claim.

320. We find U S WEST's proposed rates to be unreasonable. We conclude that U S WEST has failed to explain why its proposed rates are out-of-line with its own

³⁰ NEXTLINK and ELI note that U S WEST modified its EICT recurring cost study in response to concerns raised by other parties and that the resulting estimates were substantially lower than U S WEST's original estimates and GTE's proposed rates.

³¹U S WEST can not charge for the SPOT frame until the Commission has approved a tariff for this facility

federal tariff rates and GTE's proposed rates. Neither has U S WEST shown that its studies adequately comply with the FCC's *Physical Collocation Order*.

321. On an interim basis, the Commission will adopt GTE's collocation tariff rates, as modified by us at paragraphs 302-304, above, as surrogate rates for U S WEST in place of those collocation rates proposed by U S WEST itself.

NEXTLINK'S MARKET PRICE PROPOSAL

PARTY POSITIONS

322. As an alternative to the ILEC's proposals, NEXTLINK has put forth what it calls a market price proposal for the elements of physical collocation based on bids submitted by various contractors for the provision of those elements. Brief at 49. NEXTLINK claims that the collocation prices derived from this analysis are generally comparable to the rates in the GTE's interstate collocation tariff, and substantially lower than the collocation prices proposed by U S WEST. Brief at 50.

323. U S WEST claims to have found flaws with NEXTLINK's study. For example, there is no substantial evidence that the NEXTLINK study is truly market based as two-thirds of the prices were derived from unidentified contractors. Also, the study failed to identify under what conditions the indicated prices would be honored. Brief at 61.

324. U S WEST also contests the NEXTLINK study because it assumes non-existent CLEC demand for some elements. As an example, U S WEST points out that the NEXTLINK study assumes that the cost of the fiber entrance facility "would be spread on a per-fiber basis over 230 fibers. Yet the CLECs would use a tiny fraction of this number of fibers, and would pay for the entrance facility only on a per fiber basis." Brief at 61.

325. U S WEST also suggests that the "NEXTLINK prices for other elements are based on clearly erroneous and unsupported assumptions about the assignment of cost. Mr. Sobieski divided by ten the total costs for a configuration of ten collocators located contiguously. (Tr. 1873). Mr. Sobieski justified this approach by claiming that collocation costs were linear as a mathematical function of the floor space area used for collocation. (Ex. 677 at 15). However, he provided no empirical or mathematical proof of this linear relationship, although he admitted that whether such a linear relationship exists can be tested. (Tr. 1874)." Brief at 63.

326. U S WEST observes that NEXTLINK used this linear cost assumption for cage construction, HVAC cost, DC power cable cost, grounding, and racking. U S WEST states that "[t]here is reason to question the NextLink assumption of linearity of cost. The FCC's Collocation Order, paragraph 60, found that DC power cost is not

linear with collocation square footage. DC power cable cost is linear with distance as long as the cable gauge stays unchanged. (Tr. 1284-1285). A cage builder incurs fixed costs (Tr. 1873) which will result in higher costs per square foot for a smaller than a larger size cage.” Brief at 63.

327. U S WEST also urges that “the Commission should reject the NEXTLINK study because it omits certain costs for collocation. Of the fourteen categories of direct cost in paragraph 63 of the FCC’s Collocation Order, NextLink’s witness did not know whether he included costs for common construction project management and construction provisioning. (Collocation Order & 63(4)(a), (2); Tr. 1872, 1864). NextLink included no costs at all for security, cross connection provisioning circuit design, and interconnection-specific construction for cage lighting. All of these are FCC approved cost categories. (Collocation Order & 63(11, 12, 5, 3); Tr. 1872, 1868, 1864). Exhibits 674 and 678 omit several categories of collocation direct cost in addition to the foregoing, such as common construction lighting and floor reconditioning (Collocation Order & 63(4)(b)), and riser. (Collocation Order & 63(14)). The NextLink study does not include costs for cable duct, holes within the central office, and firestop, which the U S WEST study treats as shared among three collocators and includes in the overall per foot cost. (Ex. C-617, Att. A at 6-10). NextLink has failed to account for all reasonable direct costs.” Brief at 65.

328. GTE joins U S WEST in faulting NEXTLINK’s study. GTE’s analysis of the study on pages 72-76 of its Brief describes methodological flaws similar in nature to those described by U S WEST in its analysis and outlined in the preceding paragraphs.

329. Staff also questions the merits of NEXTLINK’s study and therefore does not believe that the study should be used to impose a market price cap on ILEC collocation rates. Brief at 53-54.

COMMISSION DECISION

330. Based on our review of the record on this issue, the Commission finds NEXTLINK’s Market Price Proposal to be seriously flawed. NEXTLINK’s Market Price Proposal is, therefore, rejected.

U S WEST’S SPOT FRAME PROPOSAL

I. PARTY POSITIONS

U S WEST

331. U S WEST states that the issue of SPOT frames was beyond the scope of issues in Phase II, and, therefore, it did not introduce prices, costs, or direct

testimony on this issue. Brief at 58. Because other parties chose to raise and discuss the issue,

U S WEST submitted responsive testimony explaining the SPOT frame and how its use insures efficient network operation.

332. U S WEST believes that its SPOT frame concept is consistent “with the proper operation of a network, and is also wholly consistent with U S WEST’s rights and obligations to manage the space and equipment in its central offices.” U S WEST represents that a SPOT frame is nothing more than an intermediate connecting frame, and, as such, are typically used in U S WEST’s own network. Brief at 59.

COMMISSION STAFF

333. Commission Staff argues that a SPOT frame is not technically necessary or required for interconnection. Furthermore, requiring a SPOT frame introduces an extra interconnection arrangement, thereby creating additional work and costs for U S WEST’s competitors. Staff contends that it would be more efficient to have a direct connection between the main distribution frame and the CLECs collocation cage. Staff accepts that under extraordinary circumstances, when there is significant congestion in the central office, a SPOT frame may be required.

AT&T

334. AT&T requests that the Commission consider the following information:

The FCC Rule 315(b) is one of the implementing regulations adopted by the FCC relating to the unbundling of network elements. 47 C.F.R. §51.315(b). Rule 315(b) provides, “[e]xcept upon request, an incumbent LEC shall not separate requested network elements that the incumbent LEC currently combines.” *Id.* The Supreme Court reinstated this rule, holding that the rule “is entirely rational, finding its basis in § 251(c)(3)’s nondiscrimination requirement.” The Court reasoned that in the absence of Rule 315(b) “incumbents could impose wasteful costs” on carriers who request network elements, even if carriers do not seek access to the incumbent LECs’ entire pre-assembled networks, and that the FCC is well within its bounds to prevent such an “anticompetitive practice.” *Iowa Utils. Bd. III*, 1999 WL 24568, *13. Brief at 66-67.

335. AT&T contends that when the Supreme Court reinstated Rule 315(b), it “explicitly rejected anticompetitive practices like the SPOT frame.” AT&T states that CLECs are “entitled to obtain access to unseparated network elements, with no SPOT frame and no additional, wasteful charges.” Brief at 15.

336. AT&T urges that U S WEST's arguments justifying the requirement of SPOT frames have been "rejected by the Iowa, Colorado, Oregon, and New Mexico Commissions as well as in the ALJ's recommended decision in Minnesota as discriminatory and inefficient." Brief at 67.

OTHER PARTIES

337. MCI, NEXTLINK, and ELI contend that the SPOT frame is illegal because it fails to provide the CLECs with nondiscriminatory access to unbundled network elements. MCI Brief at 34; NEXTLINK/ELI Brief at 44-47.

II. COMMISSION DECISION

338. The Commission notes that the parties' comments on the SPOT frame issue were focused on whether or not the SPOT frame fails the 251(c)(3) nondiscriminatory access requirement. Quality of access is not at issue before the Commission in this proceeding. This is a pricing proceeding, and since U S WEST has not submitted a pricing proposal for the SPOT frame, the Commission will not factor SPOT frame costs into collocation prices at this time. This should in no way be interpreted as condoning a general U S WEST requirement that CLECs use and pay for a SPOT frame in order to obtain access to UNEs. U S WEST may not levy a general charge for SPOT frames until it has submitted the appropriate rate request and supporting cost studies to the Commission for review and approval. If U S WEST asserts that a SPOT frame is necessary in a particular location, the parties must resort to the alternative dispute resolution provision of their interconnection agreement to verify the need for, and the cost and price of, this and any other intermediate interconnection arrangement.

339. The Commission notes the recent FCC Order which held that "[i]ncumbent LECs may not require competitors to use an intermediate interconnection arrangement in lieu of direct connection to the incumbent's network if technically feasible, because such intermediate points of interconnection simply increase collocation costs without a concomitant benefit to incumbents."³²

340. If a CLEC has requested a SPOT frame for the bundling of unbundled network elements, U S WEST may recover the costs of the SPOT frame from the CLEC.

³² First Report And Order And Further Notice of Proposed Rulemaking *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, FCC 99- 048; CC Docket No. 98-147 (Adopted: March 18, 1999; Released: March 31, 1999) at ¶42.

INTERIM LOCAL NUMBER PORTABILITY

I. OVERVIEW

341. The Commission addressed the pricing of interim number portability in its interconnection proceeding. *Fourth Supplemental Order Rejecting Tariff Filings and Ordering Refiling: Granting Complaints, in Part*, Docket Nos. UT-941464, *et al.* (October 31, 1995). In that Order the Commission determined that the price for interim local number portability (ILNP) should be equal to the incremental cost of service. The Commission added that whereas “[i]nterim number portability is a stopgap measure until permanent number portability can be established[,] there is no reason for USWC to recover common costs from this service.” Order at 57.

342. In the instant Order, we adopt a different pricing standard in recognition of the passage of the Telecommunications Act of 1996. As we state in paragraph 369, *supra*, the FCC has “interpreted Congress’s competitive neutrality mandate to require the Commission to depart from cost-causation principles when doing so is necessary to ensure ‘that the cost of number portability borne by each carrier does not affect significantly any carrier’s ability to compete with other carriers for customers in the marketplace.’” *Third Report and Order on Number Portability* at ¶41. We find in light of the pricing mandate established by Congress, as subsequently interpreted by the FCC, it would be inappropriate to recover the cost from the carrier that is requesting the ported number.

343. In the 8TH ORDER, at paragraph 435, the Commission invited parties to address cost recovery issues associated with ILNP in Phase II of this proceeding. At paragraphs 436 and 535 of that Order, the Commission found that the monthly per path cost for providing ILNP is \$1.50.

344. At this juncture, the Commission has two viable cost recovery mechanisms which it can implement for ILNP: First, the mechanism outlined by AT&T at paragraphs 360 through 363, *supra*, which the FCC has adopted for permanent local number portability; second, the “New York” method described in paragraphs 365 and 372 through 376, *supra*. This is one of the methods that the FCC approved for ILNP cost recovery in its *First Report and Order on Telephone Number Portability*.

345. The Commission has previously mandated the use of the “New York” cost recovery mechanism for ILNP in an earlier decision concerning the interconnection agreement between MCI and U S WEST. The United States District Court For The Western District Of Washington, Seattle Division, in a decision filed July 21, 1998, upheld the Commission’s adoption of the New York method for ILNP cost recovery. Given that this mechanism has been utilized by the Commission previously, and that its use has been upheld by the Federal Court upon review, it seems sensible to adopt this

mechanism in this docket as well.

II. PARTY POSITIONS

U S WEST

346. U S WEST claims that “[t]he Commission did not specify whether its cost estimate for ILNP included attributed or common costs.” Brief at 31. U S WEST posits that, because the Commission specifically ruled that common costs were a Phase II issue, common costs were likely not included in the Commission’s \$1.50 ILNP cost.

347. U S WEST applied its standard attributed and common cost factors to the Commission’s ILNP rate in a manner consistent with its treatment of other U S WEST cost results, as set forth in exhibit 699. U S WEST believes that the resultant price of \$2.20 is the proper rate for ILNP. Brief at 31.

348. U S WEST maintains that ILNP is little more than call forwarding from the ILEC’s switch to the CLEC’s switch, and that initially most numbers will be ported from ILEC to CLEC switches with ILECs incurring the costs for call forwarding and transport. Brief at 38. U S WEST’s position is that, because CLECs required to port numbers to ILECs would be entitled to similar cost recovery for ILNP, U S WEST’s ILNP proposal meets the standards of competitive neutrality.

349. U S WEST takes issue with the ILNP cost recovery methods put forth by AT&T and TCG which suggest that ILNP costs be allocated among providers, along the lines suggested by the FCC for permanent local number portability (LNP). It is U S WEST’s position that the implementation of LNP, and its associated cost recovery mechanism, is very different from the processes required for the implementation of ILNP. Brief at 39. U S WEST points out that the LNP process is an industry-wide initiative involving the creation of processes and products which will be used by, and benefit, the entire industry and, therefore, allocating the cost among various industry participants is appropriate. Brief at 39.

350. According to U S WEST, ILNP, by contrast, is merely the process of routing a call from the switch that previously served the customer to the switch that currently serves the customer. Therefore, U S WEST believes the most appropriate method of cost recovery is for the company that incurs the cost of the call transfer to recover that cost. Brief at 39.

351. U S WEST also disagrees with Staff’s recommendation that U S WEST’s nonrecurring charge for ILNP be reduced by 50 percent, believing that Staff incorrectly interpreted the Commission’s 8TH ORDER at paragraph 533. U S WEST reads the Order to require the 50 percent avoided cost discount for retail nonrecurring activities,

not for wholesale nonrecurring activities such as ILNP.³³ Brief at 39.

GTE

352. GTE applies its cost plus a fixed allocator approach to the Commission ILNP costs to determine the rate for ILNP.³⁴ GTE asserts that this approach is consistent with sound economic principles requiring costs to be assigned to the appropriate cost causer. GTE believes that relative market share methods are impractical as GTE has no means by which to accumulate the data required to determine each CLEC's share of the ILNP cost. Such a scheme would necessitate that the Commission, or some other entity, act as a clearinghouse for this information, thereby increasing administrative costs. Brief at 63.

STAFF

353. Staff has proposed recurring charges for U S WEST and GTE based on the assumption that the \$1.50 cost ordered by the Commission includes attributed and common costs. "As such, Staff proposed that only an appropriate markup be added to the base \$1.50 cost, resulting in a \$1.77 per month charge for U S WEST and a \$1.80 per month charge for GTE." Brief at 36. Staff notes that while both GTE and U S WEST contest that the Commission's cost includes attributed and common costs, U S WEST did concede that it would support Staff's proposal in the event that the Commission had included attributed and common costs in its \$1.50 cost for ILNP.

354. Staff notes that its proposed reduction of GTE's 55 percent "fixed allocator" to a 20 percent markup was intended to make GTE's markup consistent with U S WEST's 18 percent markup. However, given the Supreme Court's decision, Staff argues that recurring charges for ILNP should be based on the TELRIC floor, plus common costs. Brief at 37.

355. Staff does not believe that U S WEST's proposed nonrecurring charge for ILNP is supportable. Staff's recommendation "that U S WEST use 50 percent of its current nonrecurring tariff rate for call forwarding as the nonrecurring charge for ILNP on an interim basis" is consistent with paragraph 533 of the 8TH ORDER. Brief at 37. Staff cautions that, given the Supreme Court's ruling, "the Commission must consider whether the costs U S WEST claims are appropriate, and add only a reasonable

³³ Paragraph 533 of the 8TH ORDER reads: "U S WEST and GTE must file, and the Commission must approve, avoided cost studies for nonrecurring activities. Until such avoided cost studies are approved, the Commission orders that a 50 percent avoided cost discount applies to retail nonrecurring activities."

³⁴ This cost may be found at paragraph 535 of the 8TH ORDER.

allocation of common costs.” Brief at 37.

356. Staff also takes issue with GTE’s nonrecurring charge for ILNP. In particular, “Staff does not agree with GTE’s time estimates and method of calculating costs related to ILNP connect, disconnect, and change orders.” Brief at 37. Staff notes that “[i]n reviewing GTE’s calculations for the time per unit, or ‘touch’ on an order, Staff could not replicate GTE’s result and, therefore, adjusted the time per touch based on Staff’s calculations. Staff therefore recommends nonrecurring charges of \$14.44 for a new order, and \$7.64 for a change order.” Brief at 38.

357. Staff believes its recommended NRC charges for GTE are reasonable as within the range of GTE’s current retail nonrecurring charges for remote call forwarding, which Staff feels is the functional equivalent of ILNP. Brief at 38. In response to the assertion that a comparison between wholesale nonrecurring charges and related tariff rates is inappropriate, Staff points out that “the Act requires State Commissions to ‘determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.’” Brief at 38.

358. On the issue of cost recovery for ILNP, Staff directs the Commission’s attention to 47 U.S.C. § 251(e)(2) which states that “[t]he cost of establishing . . . number portability shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission.” Brief at 38. Staff points out that the FCC, in its *First Report and Order in the Matter of Telephone Number Portability* at paragraph 138, determined that “requiring new entrants to bear all of the costs, measured on the basis of incremental costs of currently available number portability methods . . . would contravene the statutory mandate that all carriers share the cost of number portability.”

359. Staff states that, in keeping with the FCC Order cited above, it is recommending that ILNP prices be shared among all carriers. In addition, Staff recommends that all ILNP charges be eliminated after February, 1, 1999, in those MSAs equipped with long-term number portability in order to facilitate the move from ILNP to long-term number portability. Staff further recommends that ILNP charges be eliminated in areas outside MSAs as soon as long-term number portability is established. Brief at 39.

AT&T

360. AT&T/TCG filed ILNP cost recovery testimony which suggests that the costs for ILNP be allocated among providers. They propose an allocation based on the FCC’s methodology for allocating the cost of regional databases and functions related to permanent number portability. Brief at 49.

361. In direct testimony, at page 18, AT&T/TCG witness Montgomery provides the following summary of the FCC's cost allocation method for permanent number portability:

The FCC defined an allocator by which the LNP costs would be spread among all telecommunications carriers in an area. This allocator is defined as the ratio of the sum of the intrastate, interstate, and international end-user telecommunications revenues that such telecommunications carrier derives from providing telecommunications service in an area; to the sum of the intrastate, interstate, and international end-user telecommunications revenues that all telecommunications carriers derive from providing telecommunications service in the area.

362. AT&T/TCG indicate that a nearly identical end-user revenue allocator is currently being used by the Washington Exchange Carrier Association to spread the cost of number portability in Washington State. Mr. Montgomery suggests that the Commission use the same percentage or proportional allocator derived from all service providers' end user revenues in Washington that are used to derive the LNP cost allocation factor. Alternatively, the revenue allocator could be based only on intrastate revenues, as a reasonable way of adjusting the FCC method for conditions in this state.

363. AT&T/TCG recommend that the Commission adopt the cost allocation method used by the FCC to distribute ILNP cost among the various carriers. They believe that, at this juncture, ILNP costs will be so small that the Commission may not have to establish a specific cost recovery rule such as an all end-user surcharge. It should allow U S WEST and GTE, as well as CLECs to recover the cost in any just and reasonable manner. Recovery for a particular ILEC might also be limited to specific services, classes of customers, or particular geographical area of the state, and, to the extent that the ILECs remain subject to cost and price regulation, that ILECs' cost recovery be consistent with other cost-of-service or pricing rules.

NEXTLINK & ELI

364. NEXTLINK and ELI believe that the best method for recovering ILNP costs is the method adopted by the New York Public Service Commission specifically spreading the costs among "all carriers based on each local exchange carrier's relative number of active telephone numbers." Brief at 30. NEXTLINK and ELI support the TCG proposal "to establish a cost recovery mechanism based on the mechanism used to compensate carriers for their costs to participate in the permanent number portability solution currently being deployed in Washington." Brief at 30.

365. However, NEXTLINK and ELI also suggest that the Commission could adopt an alternative to the New York method. The alternative NEXTLINK and ELI support is “the language TCG Seattle and U S WEST negotiated in their arbitrated interconnection agreement that reflects the fourth mechanism approved by the FCC -- that each carrier is responsible for its own costs of interim local number portability.” Brief at 30. NEXTLINK and ELI assert that either of these options would be consistent with the Act and the FCC's Number Portability Orders.

366. NEXTLINK and ELI state that either of the ILNP methods suggested above should be augmented to require any “carrier porting away a telephone number to remit 85 percent of the access charges it collects on, or imputes to its own provisioning of, interexchange calls routed to that number.” Brief at 30.

III. COMMISSION DECISION

367. In response to the apparent confusion as to whether or not the Commission's \$1.50 monthly per path cost for providing ILNP contains attributed and common costs, the Commission confirms that the \$1.50 cost contains attributed costs. It does not, however, contain common costs.

368. In response to arguments made by U S WEST and GTE that ILNP costs are more appropriately assigned to the cost causer, the Commission reminds those parties that the FCC has “interpreted Congress's competitive neutrality mandate to require the Commission to depart from cost-causation principles when doing so is necessary to ensure ‘that the cost of number portability borne by each carrier does not affect significantly any carrier's ability to compete with other carriers for customers in the marketplace.’” *Third Report and Order on Number Portability* at ¶41.

369. The FCC has also stated that “requiring the new entrants to bear all of the costs, measured on the basis of incremental costs of currently available number portability methods, would not comply with the statutory requirements of section 251(e)(2). Imposing the full incremental cost of number portability solely on new entrants would contravene the statutory mandate that all carriers share the cost of number portability. Moreover, as discussed above, incremental cost-based charges would not meet the first criterion for “competitive neutrality” because a new facilities-based carrier would be placed at an appreciable, incremental cost disadvantage relative to another service provider, when competing for the same customer. Rates for interim number portability would also not meet the second criterion if they approximate the retail price of local service. New entrants may effectively be precluded from entering the local exchange market if they are required to bear all the costs of currently available number portability measures. Retail rates for call forwarding, to the extent they are set above incremental costs, would also not meet the principles of competitive neutrality for the same reasons that incremental cost-based rates would not. Finally, placing the full cost burden of number portability on new

entrants would also deter customers of incumbent carriers from transferring to a new service provider to the extent that the entrant passes on the cost of currently available number portability, in the form of higher prices for customers. In addition, if incumbent LECs were not required to bear a portion of the incremental costs of currently available number portability measures, they would have an incentive to delay implementation of a long-term number portability method." *First Report and Order on Number Portability* at ¶138.

370. The FCC has established a two part test for competitive neutrality with regard to the recovery of the incremental costs of interim number portability: First, the costs of interim number portability not place any one carrier at an appreciable, incremental cost disadvantage when competing for a subscriber; and, second, the costs of interim number portability not disparately affect the ability of competing carriers to earn a normal return. *Third Report and Order on Number Portability* at ¶¶43-44.

371. The FCC has determined that at least four allocation mechanisms would meet this two-part test: "(a) assessing an annual charge based upon each carrier's number of ported telephone numbers, (b) allocating number portability costs based upon number of lines, (c) assessing a uniform percentage of carriers' gross revenues that do not include charges they pay to other carriers, and (d) requiring each carrier to pay its own costs." *Id.* at ¶45.

372. This Commission has chosen to adopt the "New York" method recommended by AT&T, NEXTLINK, and ELI. Under this method, the total costs of implementing interim number portability are allocated to each carrier based upon the ratio of working lines serviced by each carrier to total working lines, option (b) in paragraph 371 above.

373. The Commission notes that it has previously chosen this method of ILNP cost recovery in its decision concerning the interconnection agreement between MCI and U S WEST. The Commission also notes that this decision has been upheld on appeal. See, *MCI Telecommunications Corp., et al., Plaintiff, v. U S WEST Communications, Inc., et al., Defendants*. Case No. C97-1508R, 1998 U.S. Dist. LEXIS 21585 (Consolidated).

374. In that decision, the Court stated:

U S WEST contends that the MCI agreement fails to compensate it for the costs of providing interim number portability. It is incorrect because the agreement is consistent with the Act and with binding FCC orders.

U S WEST says that the WUTC erred by allocating the costs of number portability in the MCI agreement based on the amount of

active local numbers each carrier has rather than on the number of calls actually forwarded. The FCC explicitly authorized allocation of cost recovery based on the number of active lines. Telephone Number Portability, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 8352, at P 136 (1996). It specifically rejected the kind of plan proposed by U S WEST because it would impose the full cost[*30] of number portability on new entrants. *Id.* at P 138; see also TCG Seattle, slip op. at 9 (rejecting same U S WEST contentions). (*MCI Telecommunications Corp., et al., Plaintiff, v. U S WEST Communications, Inc., et al., Defendants.* Case No. C97-1508R, 1998 U.S. Dist. LEXIS 21585 (Consolidated). United States District Court for the Western District of Washington, Seattle Division. Decided, July 21, 1998, filed July 21, 1998. Section H)

375. The Commission recalls that GTE objects to the “New York” method on the grounds that it has no means by which to accumulate the data necessary to make a determination of each CLEC’s share of the ILNP cost. GTE has further stated that the method is impractical as it would necessitate the Commission, or some other entity, acting as a clearinghouse for this information, thereby increasing administrative costs. Brief at 63.

376. The Commission does not believe that either of these concerns are major obstacles to successful implementation of the “New York” plan. First, in order to minimize the administrative cost of measuring the costs associated with ILNP, an ILEC can use its per ported number cost estimates established in this proceeding.³⁵ With regard to data on the number of working lines, if the CLECs are unwilling to provide this information, other proxies may be substituted, such as revenue.

377. The Commission notes that any proposal it adopts is temporary in nature as the FCC, in its *Third Report and Order on Telephone Number Portability*, has asserted its authority over both the interstate and intrastate jurisdictions in the recovery of long-term number portability costs.³⁶

378. With respect to the common cost markup, we select a value of 15 percent. This value falls in the range established for the unbundled loops. Hence, the price for

³⁵ The per ported number cost plus common cost would be multiplied by the number of ported numbers.

³⁶ *In the Matter of Telephone Number Portability, Third Report and Order*, CC Docket No. 95-116 28-29 (FCC 98-82, May 12, 1998) (“Third Report and Order on Number Portability”).

interim local number portability is \$1.73.

379. The Commission agrees with Staff's recommendation, stated at paragraph 357 *infra*, concerning nonrecurring charges for new orders and change orders to be levied by GTE on CLECs. Accordingly, the Commission sets these GTE nonrecurring charges at \$14.44 for a new order, and \$7.64 for a change order.

380. The Commission also finds merit in Staff's suggestion, stated at paragraph 359 *infra*, that all ILNP charges be eliminated after February, 1, 1999, in those MSAs equipped with long-term number portability and that ILNP charges be eliminated in areas outside those MSAs as soon as long-term number portability is established. Accordingly, the Commission orders ILNP charges to be eliminated in those areas equipped with long-term number portability. The Commission further directs that all ILNP charges shall be eliminated in an area as soon as long-term number portability is established.

SHARED TRANSPORT

I. OVERVIEW

381. Shared Transport has been defined by the FCC "as transmission facilities shared by more than one carrier, including the incumbent LEC, between end office switches, between end office switches and tandem switches, and between tandem switches, in the incumbent LEC's network." 47 C.F.R. §51.319(d)(1)(ii).

382. The FCC has "concluded that 'shared transport,' as required by the *Local Competition Order* encompasses a facility that is shared by multiple carriers, including the incumbent LEC." *Third Order On Reconsideration And Further Notice Of Proposed Rulemaking*, CC Docket Nos. 96-98 and 95-185 ("Third Order"), at ¶22. The FCC has also stated that "the *Local Competition Order* requires incumbent LECs to offer requesting carriers access, on a shared basis, to the same interoffice transport facilities that the incumbent uses for its own traffic." *Ibid.*

II. PARTY POSITIONS

U S WEST

383. U S WEST notes that the Supreme Court's ruling has vacated Rule 51.319, which included the obligation to provide shared transport. U S WEST states that, even though it is not obligated to provide shared transport under FCC rules currently in force, it has, nevertheless, created a shared transport offering and rate schedule to comply with the Commission's Order. U S WEST reminds the Commission that it will have to revisit this issue if the FCC determines, on remand, that ILECs are

not required to provide shared transport.

384. The FCC's determination that a shared transport facility will be used by multiple carriers introduces the possibility of congestion on that facility. U S WEST is concerned about the possibility of congestion in its shared transport network impairing service to its retail customers. The Company believes that the rate structure adopted by the Commission should encourage CLECs to bear the costs of under or over estimating the demand for shared transport. U S WEST argues that do otherwise allows CLECs to enjoy the benefits of being a facilities-based provider, without bearing the concomitant risks. Furthermore, U S WEST urges that failure to do so would have the effect of shifting the CLECs' risk to U S WEST. Accordingly, U S WEST's rate proposal requires a CLEC to forecast its use of the shared transport network, and to bear the risks of investing in too much or too little capacity. Brief at 81-82 and 89.

385. In order to encourage CLECs to accurately forecast their shared transport capacity requirements, U S WEST proposes to assess each CLEC a premium charge, the standard rate times two, for any traffic which exceeds the capacity that has been purchased. In the event that usage is below the committed level, U S WEST proposes that a CLEC be required to pay for the capacity it requested. U S WEST proposes to offer CLECs a six-month grace period during which time premium charges will not apply for under-forecasting. The grace period would not begin until U S WEST has developed the necessary usage reports which will enable the CLECs to accurately determine their trunking requirements based on their usage patterns. The grace period will be applied on an office-by-office basis. Brief at 88-89.

386. U S WEST states that the loop, switching, and interoffice transport are the basic components of its retail exchange services. The proposed Shared Transport rate element bundles the components of interoffice transport with unbundled switching into a macro network element that constitutes a majority of the functionality of retail exchange service. Brief at 90. U S WEST maintains that "[t]he relatively simple connection of an unbundled loop to this macro element completes a service for the CLECs that in most respects is the functional equivalent of U S WEST's residential and business exchange services." Brief at 90-91.

387. U S WEST believes that in order to avoid an arbitrage opportunity, there must be a link between the rates for UNEs, which comprise its retail exchange services, and the revenues generated from those exchange services.³⁷ Brief at 91. The

³⁷U S WEST believes that without the recombination charge an arbitrage opportunity exists because CLECs would be able to purchase virtually complete services, including subsidy-laden vertical services such as toll, access and features, at rates substantially lower than the wholesale retail rate available to resellers. (Ex. 595 at 29).

Company proposes assessing CLECs a recombination charge which it feels “recognizes the relative similarity between functionality for bundled resold services and the combination of unbundled loops, unbundled switching, and shared transport.” Brief at 91.

388. The starting point for the development of the recombination charge was to compare the sum of the unbundled network element prices (*i.e.*, loops, switching, and shared transport) with the price of a resold retail residence or business exchange service and its accompanying average vertical service revenue streams. Because shared transport does not represent a total bundling of the UNEs required to provide the retail services, U S WEST proposes that the recombination charge be set at one-half the difference between the average resale and unbundled element revenue streams. Brief at 91-92.

GTE

389. GTE developed its prices for shared transport based upon TELRIC plus an equal percentage markup to recover common costs. Brief at 59. GTE did not propose any rate penalties for those instances where actual demand was greater or less than forecasted demand.

STAFF

390. The recent Supreme Court ruling in AT&T Corp. vs. Iowa Utilities Bd. does not require the Commission to put its generic cost and pricing proceeding on hold while the FCC reevaluates which network elements an ILEC must provide on an unbundled basis. Brief on S.C. Ruling at 8. Staff urges that “[a]s the Supreme Court noted, a CLEC requesting access to network elements may petition state commissions, who may require that additional elements be made available on a case-by-case basis. 67 U.S.L.W. at 4110, citing 47 C.F.R. §51.317.” Brief on S.C. Ruling at 8. Staff believes that even though the Court has vacated Rule 319, which identifies those elements that must be provided on an unbundled basis, the states still have authority to determine whether certain network elements may be provided on an unbundled basis. The Commission could make UNE determinations under the federal statutory standard of paragraph 251(d)(2), or based on state law under RCW 80.36.140.

391. Staff argues that the Supreme Court’s decision reinstating the FCC’s pricing rules need not necessarily affect the Commission’s consideration of rate structure proposals for shared transport in the pricing phase of the proceeding. Brief at 55. Staff supports Commission flexibility under the FCC’s rules in setting rates for shared transport by noting that paragraph 757 of the *First Report and Order* states that “states may use either usage-sensitive rates or flat capacity-based rates for shared facilities, if a state finds that such rates reasonably reflect the costs imposed by the various users.” Brief at 55-56.

392. Staff supports U S WEST's proposed capacity-based rate structure for shared transport, with certain conditions. Staff believes that requiring CLECs to forecast their capacity needs places an appropriate risk on CLECs to use the network efficiently. However, Staff believes that CLECs should have the flexibility to transfer unused capacity to other CLECs who may have underestimated capacity. Staff is also concerned that U S WEST's proposal does not include any sanction or penalty for U S WEST if its own forecasting proves inadequate and results in call blockages or, alternatively, that U S WEST would provide a rebate to CLECs who suffered from poor service. Brief at 57.

393. Regarding U S WEST's proposed recombination charge, U S WEST witness Reynolds, in response to questions by Staff, "acknowledged that U S WEST's proposed recombination charge is really a misnomer, as no unbundling, combining, or recombining actually takes place to create shared transport. Tr. at 1207 (Reynolds). In fact, Mr. Reynolds described the charge as 'more of a linkage to the wholesale rate for resold services.'" Brief at 57. Staff notes that it did not initially object to the recombination charge. However, Staff now contends that the recent Supreme Court decision renders any charge in addition to the TELRIC floor, plus a reasonable markup for common cost, is inappropriate. Brief at 58.

394. For GTE, Staff recommends that the Commission adopt a flat capacity-based rate structure, rather than the Company's proposed minute-of-use based rate structure.

AT&T

395. AT&T points out that § 51.507 of the FCC rules states: "The costs of shared facilities shall be recovered in a manner that efficiently apportions costs among users. Costs of shared facilities may be apportioned either through usage-sensitive charges or capacity-based flat-rated charges, if the state commission finds that such rates reasonably reflect the costs imposed by the various users." AT&T states that it used the U S WEST cost study to calculate a per-minute rate. AT&T adds that the "remainder of the surcharges and penalties proposed by U S WEST for this element are readily dismissed as inconsistent with and prohibited by the TELRIC pricing methodology." Brief at 70.

III. COMMISSION DECISION

396. The Commission acknowledges that on June 1, 1999, the Supreme Court remanded the issue of shared transport as a UNE to the FCC for reconsideration. Our decision in this proceeding regarding shared transport pricing is therefore contingent on the FCC again finding that shared transport is a network element. The Commission makes no finding in this Order concerning the issue of whether shared transport should constitute an unbundled network element.

397. The Commission agrees with U S WEST that CLECs ought properly to bear the costs of over or under-estimating demand for shared transport on U S WEST's network. We therefore adopt U S WEST's proposed capacity based pricing structure.

398. Adopting this pricing structure will require U S WEST to develop the necessary usage reports enabling CLECs to accurately determine their trunking requirements based on their usage patterns. U S WEST must offer CLECs a six-month grace period during which time premium charges will not apply for under-forecasting, and the grace period will not commence until such time as U S WEST has developed the requisite usage reports and the CLECs have accepted their validity, as U S WEST has committed to do. See, U S WEST Brief at 88-89. Until U S WEST has developed its CLEC trunking usage reports, CLECs are exempt from paying any premium charges related to shared transport usage.

399. The Commission shares the concerns expressed by Staff at paragraph 393 above. The Commission acknowledges U S WEST's apparent willingness to address Staff's concerns and appreciates U S WEST's cooperative stance on these issues. We find that CLECs ought to have the flexibility to transfer unused capacity to other CLECs who may have underestimated capacity. U S WEST is therefore directed to permit CLECs to combine their shared transport usage, where traffic can be placed on the same route, before any penalties are imposed. U S WEST is also directed to develop a rebate plan to compensate any CLECs who experience service quality deterioration due to shared transport network congestion resulting from inaccurate forecasting by U S WEST as to its projected trunking needs.

400. With regard to U S WEST's recombination charge, the Commission believes the following testimony of its witness Mr. Reynolds is instructive:

- Q. [I]sn't the transport network already combined for U S WEST's use, and no unbundling, combining, or recombining actually takes place in order to create shared transport?
- A. That's correct. In fact, I would be the first to admit that I think the recombination charge is probably a misnomer. I think it's as I explained it, is that it is truly more of a linkage to the wholesale rate for resold services.
- Q. So if I asked you what has to take place to actually be considered recombining, you'd have the same response, that it's really not an apt description; it's more of a comparison to the wholesale rate?
- A. That's correct.

Tr. 1207. Mr. Reynolds also states that “as my testimony explained, the recombination charge is intended to reflect the fact that you are very close to a resold service. And the calculation that I go through actually adds up the prices of the unbundled UNEs and compares that with the revenues from a resold service and takes half the differential between the resold service revenue level and the unbundled UNE prices, and that’s how we established the recombination charge.” Tr. 1206.

401. Under the FCC’s pricing rules, prices for UNEs may not exceed TELRIC plus a reasonable allocation of forward-looking common costs. 47 C.F.R. § 51.505(a). Per 47 C.F.R. § 51.505(b)(1), the TELRIC of an element is “the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC’s provision of other elements.” Furthermore, at 47 C.F.R. § 51.505(d)(3), the FCC prohibits the use of opportunity costs in calculating the forward-looking cost of an element. Opportunity costs are defined as including the revenues that the incumbent LEC would have received for the sale of telecommunications services, in the absence of competition from the telecommunications carriers that purchase network elements.

402. Given Mr. Reynolds’ testimony on the development of U S WEST’s proposed recombination charge, and guidance by the FCC on the appropriate pricing of UNEs, the Commission finds U S WEST’s proposed recombination charge to be inappropriate and in violation of the reinstated FCC pricing standards. U S WEST’s request for a recombination charge is denied.

403. Another issue of concern to the Commission is the flawed nature of U S WEST’s DS0 shared transport cost study. In the study originally submitted to the Commission, U S WEST assumes that all of the DS0 traffic would flow to the tandem, whereas its witness Mr. Fleming testified that U S WEST routes only 14 percent of DS0 traffic through tandems. The assumption that all DS0 traffic would go through the tandem greatly increases the estimated cost-of-service. Tr. 1388.

404. To address this concern, the Commission issued a bench request asking U S WEST to recalculate the DS0 costs to reflect U S WEST’s actual network configuration. U S WEST acknowledges that it routes all shared transport traffic in the same manner as it routes its own local traffic. Brief at 84. The Commission adopts the DS0 cost recalculated by U S WEST, in response to Bench Request #04-125, as the appropriate rate for that element.

405. The Company on brief does not reflect the revised shared transport cost calculation. For example, where the study previously showed a direct cost of \$15.96, the new study shows a direct cost of \$4.72. Compare Ex. 607 and Response to Bench Request #125, *Map to Rate Worksheet*. The new shared transport local trunk DS0 rate is \$5.87. This rate is determined increasing the direct cost by the attributed and

common cost factors: TELRIC plus attributed plus common costs is equal to $\$4.72(1+0.1962)(1+0.0405) = \5.87 . U S WEST is ordered, as part of its compliance filing, to show that its shared transport rates, including the charge for unforecasted local trunk DS0, comply with our adoption of the costs submitted in response to Bench Request #04-125.

406. Staff has argued, in paragraph 391 above, that the FCC's pricing rules for shared transport grant the Commission flexibility to establish either usage-sensitive rates or flat capacity-based rate structures for shared transport. In support of its position, Staff cites the FCC's *First Report and Order*. We note that, subsequent to the release of that Order the FCC has entered a *Third Order on Reconsideration and Further Notice of Proposed Rulemaking*, which clarifies its position regarding the obligation of ILECs to provide unbundled access to interoffice transport facilities on a shared basis. At paragraph 30 of its *Third Order*, the FCC states:

Finally, we note that, traditionally, shared facilities are priced on a usage-sensitive basis, and dedicated facilities are priced on a flat-rated basis. We believe that this usage-sensitive pricing mechanism provides a reasonable and fair allocation of cost between the users of shared transport facilities. For example, in the Access Charge Reform Order, specifically the sections dealing with rate structure issues for interstate access charges, we required that the cost of switching, a shared facility, be recovered on a per minute of use basis, while the cost of entrance facilities, which are dedicated to a single interexchange carrier, be recovered on a flat-rated basis. We note that several state commissions, in proceedings conducted pursuant to section 252 of the Act, have required incumbent LECs to offer shared transport priced on a usage-sensitive basis. We acknowledge that, under the Eighth Circuit's decision, we may not establish pricing rules for shared transport. However, in situations where the Commission is required to arbitrate interconnection agreements pursuant to subsection 252(e)(5), we intend to establish usage-sensitive rates for recovery of shared transport costs unless parties demonstrate otherwise. (Footnotes omitted.)

407. We agree with Staff that the Commission has the flexibility to establish either usage-sensitive rates or flat capacity-based rates as the rate structure for shared transport, and find that a per-minute usage rate should be an available option. The Commission requires U S WEST to file and support a per-minute rate as part of its compliance filing.

TRANSPORT & TERMINATION PRICING

I. OVERVIEW

408. One of the issues the Commission must resolve in this proceeding is what specific rates, including the rate structure, will apply when companies cannot agree on a reciprocal compensation method, *i.e.*, a mechanism for compensating each other for the exchange of traffic under interconnection agreements.

409. At paragraph 443 of the 8TH ORDER, the Commission encouraged the parties to address the appropriateness of relying on bill-and-keep arrangements or some other mechanism.

II. PARTY POSITIONS

410. TCG advocates the establishment of a flat-rate capacity charge. The Company contends that a flat-rate capacity charge reflects the manner in which telecommunications traffic sensitive equipment is designed and therefore is a more efficient price structure than a minute of use charge that applies during all hours of the day:

Flat rate capacity charges provide the strongest efficiency incentives. Such charges have been typically reflected in trunk pricing, like PBX or special access lines. The number of trunks or lines needed to maintain a consistent grade of service during the peak usage period reflects the capacity cost. If more peak traffic occurs, more trunks must be added. Thus the number of trunks reflects that carrier's usage at the peak period. Ex. 642 at 9 and 10-11.

411. TCG submitted "illustrative" capacity charges. Ex. 642 at 14. The proposed rates are not based on cost data or usage assumptions developed in Phase I. Ex. 643; Tr. 1668.

412. Staff recommends that the Commission allow companies to negotiate the issue of reciprocal compensation and establish a default rate that applies unless companies agree to some alternative. Staff believes that the default rate should be a capacity charge because such a price would encourage efficient use of the traffic sensitive portions of the network. Ex. 554 at 2-5; Brief at 34.

413. Staff proposes that the capacity cost be developed by multiplying the per minute cost by the monthly usage. It suggests that the cost per minute of tandem and end office switching be obtained "from the per-minute costs submitted by the companies." Staff endorses TCG's proposal of 5,000 minutes per month for line-to-

trunk connections, and 9,000 minutes per month for trunk-to-trunk connections.” Brief at 34-35.

414. Electric Lightwave and NEXTLINK contend that more than one compensation arrangement, including bill-and-keep, measured rates, and capacity charges, are appropriate, and that carriers should be able to negotiate and, if necessary, arbitrate this issue. Brief at 23.

415. These parties disagree with Staff’s proposal to adopt a capacity charge as the default interconnection rate:

Staff's proposal . . . conflicts with past Commission orders and other state commission determinations and would lead to absurd consequences. No carrier has negotiated, requested, or arbitrated a flat-rated form of reciprocal compensation, nor has the FCC or any other state commission imposed flat-rated compensation for the exchange of telecommunications traffic or concluded that such compensation is the only or even most accurate cost-based form of compensation. See, *Local Competition Order* at ¶¶1056-64. Staff, however, would have the Commission impose such compensation on carriers that do not agree on this issue even if neither carrier wants flat-rated compensation. Such a proposal is flatly inconsistent with the Commission's "baseball" style arbitration procedures, see *In re Implementation of Certain Provisions of the Telecommunications Act of 1996*, Docket No. UT-960269, Interpretive and Policy Statement (June 28, 1996), and would function as a penalty for disagreement, rather than a resolution of a disputed issue. If for example, the carriers could not agree on bill-and-keep versus measured compensation, the proper resolution in an arbitration is to determine whether the traffic exchanged or to be exchanged between the carriers is sufficiently balanced to justify bill-and-keep, not to reject both Parties' proposals and impose an unrelated compensation mechanism. Brief at 25.

416. MCI shares the views of ELI and NEXTLINK that the Commission should not impose a particular pricing plan. Rather, carriers should have the freedom to choose a compensation structure that is most appropriate for their circumstances. MCI supports per-minute-of-use reciprocal compensation, within which carriers would operate under bill-and-keep³⁸ unless traffic studies indicate that traffic is out of balance. In that situation, carriers would pay each other at the specified rate. MCI Brief at 10-12.

³⁸Bill-and-keep is a usage based agreement whereby each party terminates local traffic for the other at no charge. GTE Brief at 59.

417. GTE generally does not object to bill-and-keep arrangements for interconnection agreements. However, it cautions the Commission not to adopt it as the only approved form of reciprocal compensation. Instead, GTE advocates that the Commission sanction multiple compensation mechanisms with the understanding that the parties are free to negotiate appropriate arrangements within the requirements of the Act. Brief at 60.

418. GTE contends that the flat-rate capacity charge proposal is “neither necessary or appropriate in many circumstances, such as between parties who are exchanging roughly the same levels of local traffic.” Brief at 60. It adds that the calculation of the capacity costs are flawed. GTE states that the implicit monthly usage underlying GTE’s TELRIC for transport termination is 16,611 minutes per month. GTE states that if a flat-rate capacity charge is adopted by the Commission, the data used to establish the rate should be validated and be consistent with the usage data that was used to derive the per-minute costs developed in Phase I of this proceeding. Ex. 599 at 7; Tr. 919-920.

419. U S WEST supports the maintenance of its existing rate structure, arguing that it already provides CLECs with both usage and capacity charges. It therefore finds little need to consider the flat-rate capacity charge proposal. Brief at 37-38.

420. Staff, responding to U S WEST’s argument, notes that the Company’s flat-rate per circuit charge is for direct-trunked transport facilities, not for termination. Brief at 34-35.

III. COMMISSION DECISION

421. We concur with Staff and TCG that a flat-rate capacity charge would better reflect the cost structure of the telecommunications network. Therefore, we accept, in principle, the proposal supported by Staff and TCG.

422. We do not agree with Staff that the companies’ per-minute costs should be used to establish the switching capacity costs. The Commission has previously rejected the companies’ switching cost estimates. See, *e.g.*, 8TH ORDER at ¶¶288-307. Also, the Commission has used both the Hatfield and ILEC models to estimate the cost of tandem switching. See, *e.g.*, 9TH ORDER at ¶36.

423. Furthermore, the calculation of the capacity charge should be done in a manner that is consistent with the development of the unit costs. We share GTE's concern that the minutes of use utilized in the *approved* cost study should also be used to calculate the rates.³⁹ Staff is directed to work with other interested parties to develop a compliance capacity charge filing. The parties must demonstrate that the proposed rates reflect Commission findings in this proceeding. We suggest, for example, that the parties consider how both the cost and usage data reported at paragraphs 318-320 of the 8TH ORDER can be incorporated into the development of a capacity charge.

424. Neither do we accept Staff's proposal that the capacity charge be mandated whenever parties are unable jointly to reach agreement. We concur with ELI, NEXTLINK, and MCI that the Commission, to the greatest extent possible, should arbitrate disputed issues and, where feasible, adopt a rate structure that is proposed by one of the parties.⁴⁰

NON-RECURRING CHARGES

I. OVERVIEW

425. Non-recurring costs are one-time costs that are incurred for specific work activities required to order, provision, or install network elements. The non-recurring costs are largely labor-related costs which are typically incurred when connecting or disconnecting a service. By definition, a "non-recurring" cost is a cost incurred only once, and a "non-recurring" charge is a charge assessed only once.

426. Both U S WEST and GTE filed Non-Recurring Cost (NRC) studies in Phase I of this proceeding. The Commission subsequently ordered both U S WEST and GTE to resubmit NRC studies in Phase II to reflect adjustments required by the Commission's 8TH ORDER. 8TH ORDER at ¶¶474, 478. One of the adjustments we required was that GTE and U S WEST file cost studies that separate the costs for connect from disconnect activities. See, *e.g.*, 8TH ORDER at ¶¶519, 537.

427. Subsequent to the 8TH ORDER, GTE requested and was granted permission to file a new NRC study. See, 10TH ORDER at ¶¶56, 57.

³⁹The minutes of use data used in the cost studies that were not accepted by the Commission are not relevant.

⁴⁰Where the public interest or prevailing law requires, we may adopt a rate structure that is not sponsored by either party.

II. COST STUDY COMPLIANCE WITH THE COMMISSION'S ORDERS

U S WEST'S STUDY

PARTY POSITIONS

428. U S WEST asserts that its NRC studies are fully compliant with Commission Orders. Brief at 15. U S WEST claims that Staff's review and analysis of the Company's compliance filing found U S WEST's NRC studies to be in full compliance with the Commission's 8TH ORDER. Brief at 16.

429. U S WEST states that only AT&T challenged U S WEST's NRC studies. It is U S WEST's contention that AT&T's challenges are without merit as they are "simply a series of allegations without proof." Brief at 16. As an example, U S WEST notes that AT&T witness Starr suggested that U S WEST's NRC studies overstate cost due to reliance on manual entry even though U S WEST had, following the Commission's Order, reduced manual order processing time from 45 to 6 minutes. Brief at 17.

430. U S WEST further states that "AT&T's criticism about the use of 'manual processes' ignores the Commission's Eighth Supplemental Order at paragraph 482, which states clearly that the cost findings in the order do not yet reflect the transactional efficiencies that may be achieved through computer links between ILEC and CLEC systems. U S WEST has committed, and the Commission has approved, that studies will be revised to reflect these efficiencies when the systems are in operation." Brief at 17.

431. Staff maintains that U S WEST's refiled NRC study has been revised in compliance with the Commission's Order, and recommends that it be accepted by the Commission. Brief at 13.

432. AT&T states that the non-recurring costs for U S WEST established in Phase I of these proceedings do not comply with FCC rules. AT&T claims that "[t]he Commission did not specifically find -- because it could not -- that the U S WEST study complied with TELRIC. To the contrary, the findings in the Order establish that the study does not reflect least-cost technology and efficient practices currently available. Further, the Order finds that U S WEST is denying to the CLECs the efficiencies of electronic interfaces for access to OSS as required by the FCC. Thus, the cost estimates were not based upon the required TELRIC methodology and cannot be utilized for pricing UNEs." Brief at 21.

433. NEXTLINK and ELI "concur in the criticisms of the ILEC nonrecurring studies made in Phase I, as well as the evaluations by AT&T, TCG Seattle, and Commission Staff of U S WEST's and GTE's latest studies." Brief at 15-16. NEXTLINK

and ELI urge the Commission not to base any non-recurring prices on the ILECs' current cost estimates. Instead, NEXTLINK and ELI suggest that the Commission leave current interim non-recurring charges in place. Brief at 16.

434. NEXTLINK and ELI further recommend that the Commission "establish future interim charges at the ILEC retail nonrecurring charge for comparable service (*i.e.*, basic business exchange service as roughly equivalent to providing an unbundled loop), less the avoided cost discount, until such time as U S WEST, GTE, or other interested Parties are able to provide adequately supported and accurate TELRIC-based nonrecurring charges." Brief at 16.

COMMISSION DECISION

435. Based on Staff's review of U S WEST's NRC compliance filing, and the lack of compelling evidence to the contrary, the Commission accepts U S WEST's NRC compliance filing. Furthermore, we accept U S WEST's proposal to increase the NRC cost by 19.65 percent for attributed and 4.05 percent for common costs.

436. However, we do not accept the price structure proposed by U S WEST. First, as noted above in our discussion of OSS, U S WEST is directed to make a compliance filing in which it proposes rates for manual ordering and for EDI (electronic ordering). Furthermore, as discussed at paragraph 471 *supra*, we require that U S WEST establish separate NRCs for connection and disconnection. The compliance filing would have the following format:

	Connection	Disconnection
Electronic		
	OSS	OSS
	NRC	NRC
Non-Electronic (e.g., IMA)		
	OSS	OSS
	NRC	NRC

437. A connection rate should recover the non-recurring costs associated with connecting the customer to the network and appropriate OSS costs. The level of these costs varies and is dependent upon whether the order is placed electronically, using EDI, or manually, using facsimile or IMA. Similarly, a rate for disconnection should recover the non-recurring costs associated with disconnecting the customer and the

appropriate OSS costs.

GTE'S COST STUDY

PARTY POSITIONS

438. GTE asserts that its non-recurring cost study fully complies with the TELRIC standard and accurately estimates volume sensitive costs and shared and fixed costs. Brief at 22-27.

439. GTE disagrees with Staff's suggestion that GTE's work time activity be adjusted to reflect the assumption that all CLEC orders will be handled electronically, arguing that this suggestion ignores the current state of the industry. GTE notes that Staff witness Roth admitted that if a CLEC chooses to place an order manually, GTE will incur costs for the placement of that order, and the CLEC should pay the costs of processing that order no matter how it was done. Brief at 28.

440. GTE also rejects Staff's adjustment of GTE's work times for "I" order entry to conform with paragraph 473 of the 8TH ORDER. GTE argues that this and other Staff adjustments to GTE's task times "ignores the reality that GTE and U S WEST are distinct and unique companies and use different order processes." Brief at 28. GTE claims that "[n]o one produced any evidence to suggest U S WEST's processes were more efficient than GTE's." Brief at 28. GTE also claims that "any comparison between GTE's non-recurring charges and those of another company is meaningless. The systems and processes used by GTE -- as detailed in the testimony of its witness Mr. Langley -- differ from those used by U S WEST. The charges imposed by any other ILEC are therefore irrelevant to the charges necessary to recover GTE's costs to receive and fulfill CLEC orders." Brief at footnote 17.

441. Staff's proposed 50 percent reduction of GTE's wholesale non-recurring costs is based on the erroneous assumption that "it was appropriate to look to corresponding retail charges, and to cut those charges in half to yield a wholesale charge." Brief at 28. GTE argues that this approach is nonsensical as the ordering processes for wholesale and retail are different and there is no evidence that a wholesale activity will be performed faster than a retail activity.

442. Staff's assumption that GTE's non-recurring costs related to the NID (network interface device) represent the investment in the NID itself likewise is in erroneous. GTE's "non-recurring charges for the NID only represent the non-recurring activity associated with receiving and fulfilling a CLEC order for the NID itself." Brief at 28-29. GTE points out that the FCC's Rule 319 requires that the NID be offered as a separate UNE; therefore, the FCC must have assumed that some CLECs would want the opportunity to lease a NID by itself.

443. Staff contends that GTE's studies are not in compliance with Commission Order because they do not include the Commission-ordered adjustments. Staff also faults GTE's study for not fully meeting the standards of modeling forward-looking, efficient technology, and for not adhering to cost causation principles. Brief at 13-14. Staff recommends that the Commission reject GTE's studies, order GTE to re-file them, and, as an interim measure, utilize GTE's retail non-recurring charges, set at 50 percent of retail rates, as ordered by the Commission in Phase I. Brief at 14. As an alternative, Staff asks the Commission to order GTE to change its studies as recommended by Staff and other parties. Brief at 14.

444. "Specifically, Staff recommends that GTE's studies be modified to: (1) reduce service order times for various activities; (2) change the cost of money to reflect the Commission authorized rate of return of 9.76 percent;⁴¹ (3) exclude NID costs from the proposed NRCs; and (4) reflect that shared costs and forecasting data used in the studies cannot be verified." Brief at 14.

445. Staff asserts that TELRIC principles require that estimated costs reflect the least cost, most forward-looking technology. Staff contends that, because it calculates a weighted average service ordering cost using time estimates from both manual and electronic processing, GTE's study violates TELRIC principles. Brief at 15. The GTE time estimates for order processing should be adjusted to reflect that no manual entry orders will be received in the future. Brief at 15. Staff also recommends that certain other task times be adjusted downward to reflect the adjustments the Commission ordered at paragraphs, 467, 468, and 473 of the 8TH ORDER. The same time standards which were applied to U S WEST should be applied to GTE as there is no basis for assuming that a GTE representative will be slower than U S WEST representative at processing orders. Brief at 15.

446. Staff found it very difficult to identify the portion of costs related to disconnection that GTE proposes for provisioning, dispatching, and installation. The Commission ordered U S WEST and GTE to file separate costs for connect and disconnect activities; Staff asserts that GTE's studies do not comply with Commission Order. Brief at 16.

447. Staff also asserts that in its non-recurring cost studies GTE included costs which should more properly be treated as recurring costs. Brief at 16. In addition, Staff believes that the cost of the NID ought to be excluded from GTE's non-recurring costs because that this cost is already included in the recurring cost of the loop. Brief at 16.

⁴¹ In responsive testimony, GTE agreed to use the Commission's cost of capital figure and refiled certain pages of its studies to reflect the adjustment. Ex. 568 at 2-3.

448. Finally, due to insufficient information concerning shared costs for wholesale ordering and provisioning, Staff could not determine the reasonableness of the forecasted orders on which GTE based the Washington share of its total costs. Brief at 17.

449. AT&T cites two fundamental problems with GTE's non-recurring cost study which should cause the Commission to reject it: (1) the study does not comply with TELRIC methodology, and; 2) the study completely lacks any independent verification. Brief at 23. As to the first allegation, AT&T states that GTE's methodology, a two month snapshot study of its activities, does not, and cannot, take into account the time and cost savings associated with process improvements which GTE -- in other proceedings in other states -- claims are under development. Brief at 24. As to the second allegation, AT&T points out that there are several methods by which GTE could have submitted the assumptions of its study to independent verification. Brief at 25-26.

450. AT&T finds other problems with GTE's study, "such as overstated work times, how the company calculated touches per order and misapplication of the effective number of orders over which costs were spread." Brief at 23.

451. NEXTLINK and ELI apply their disagreements with U S WEST's non-recurring cost studies, described at paragraphs 433-434 above, to GTE's study as well.

COMMISSION DECISION

452. The Commission accepts GTE's current non-recurring cost study with the modifications outlined in the following paragraphs.

453. In order to address the parties' concerns, which this Commission shares, regarding the blending of costs for manual and electronic order entry, GTE, similar to our requirement of U S WEST at paragraph 436 above, is directed to make a compliance filing where it separately identifies rates for manual ordering and electronic ordering. For example, the cost of the average NOMC time per phone call calculation (Exh. C565, 2-WA-85) would be developed separately for a manual and an electronic order. No longer would the time be a weighted average of the two activities. Rather, there would be one value for a manual order and a second value, which may be zero, for an electronic order.

454. The Commission shares Staff's concern that GTE's work time activity estimates are unreasonable and inflated and could prevent competitive market entry. We therefore adopt Staff's suggestion, made at paragraph 447 above, that the task time adjustments applied to U S WEST at paragraphs 468, 469, and 473 of the 8TH ORDER ought to be applied to GTE as well. We adopt these times for GTE because we have concluded that an efficient firm should be able to achieve the installation times adopted in our 8TH ORDER. Accordingly, GTE is ordered to make a compliance filing adjusting its non-recurring cost study to conform with paragraphs 468, 469, and 473 of

the 8TH ORDER. These adjustments should be made in a manner consistent with Staff witness Roth's study, as explained in response to Bench Request No. 128. GTE is also directed, in its compliance filing, to make the following adjustments as outlined in Response to Bench Request No. 128:

- Reduce the time estimates for "Due Date Assignment" and "Provide LSC to CLECs" by 50 percent;
- Utilize Staff's proposed time adjustments in Exhibit JYR-5 relating to INP, as detailed in Section B of Bench Request No.128, and;
- Utilize Staff's proposed changes as detailed in Section C of Bench Request No.128.

455. Furthermore, we find the assumed LSR and error rejection rates to be unreasonable. GTE has made no showing that the reported error rates are due to mistakes made by the CLEC, or the proxy for CLECs, interexchange carriers (see, for example, Exh. C565 2-WA-79). We do not think it is reasonable to require CLECs to pay for high error rates for which they are not responsible. Therefore, we require GTE to file new cost studies that have LSR and error rejection rates that are 50% lower than the rates assumed in the current study.

III. CUSTOMER TRANSFER CHARGE

OVERVIEW

456. The Commission directed the parties to address in Phase II the reasonableness of proposed customer transfer charge ("CTC") cost studies, which "identify the cost of transferring an existing customer/account to a local exchange service reseller." 8TH ORDER at ¶41, fn.13; ¶523.

PARTY POSITIONS

457. U S WEST concurs with Staff's recommendation for a new CTC rate structure that utilizes a cost-of-money of 9.63 percent, eliminates the distinction between business and residence customers, and adds separate CTCs for private line and frame relay. Brief at 19; Exh. 540 at 16.

458. U S WEST disagrees with Staff's proposed adjustments excluding the recovery of resale systems start-up costs and reducing the order processing time. U S WEST contends that the time estimates are based on actual representations of ordering and implementation activities and should not be arbitrarily reduced. Brief at 20.

459. U S WEST supports Staff's proposed modifications to the rate structure of

the CTC. U S WEST witness Reynolds testified that “U S WEST supports Staff’s CTC rate restructure and has provided cost documentation that supports the new structure. No other party opposed Staff’s proposed modifications. The new rate design is clearly cost-based and aimed at increased efficiency. Accordingly, the Commission should find in favor of Staff’s modified CTC rate design.” Brief at 34.

460. Staff recommends that the Commission order U S WEST to adjust its CTC rate structure according to Staff’s modifications. Brief at 29.

461. Staff notes, for example at paragraphs 468 and 473 of the 8TH ORDER, that the Commission adjusted the order processing time to six minutes for various U S WEST nonrecurring costs. Staff believes the CTC cost study should also utilize the six minutes for processing time where the tasks are similar. Responsive Testimony of Jing Roth, Ex. C656, at p. 4, and Brief at 18. Staff also recommends that resale OSS system costs be eliminated from the CTC calculation as these costs are already a part of U S WEST’s proposed recovery of its OSS costs. Brief at 18.

462. Staff notes that U S WEST has conceded that “if the Commission intends the reduction in processing times to apply to the CTC, it will make the revision.” Brief at 18. Staff also suggests that U S WEST has acknowledged that “costs for resale systems are included in both its CTC and development and enhancement order charge, and states that it will recover only one or the other.” Brief at 18.

463. AT&T argues that U S WEST’s CTC is duplicative of the Company’s per service order charge, and claims that U S WEST admits this but cannot identify the overlap. Brief at 32. CTC costs do not comply with TELRIC but represent U S WEST’s claimed expenditures. AT&T posits that a general rate case proceeding is the proper forum for consideration of this issue.

COMMISSION’S DECISION

464. The Commission finds that Staff’s proposed adjustments to U S WEST’s CTC rate structure should be adopted. We note that U S WEST has stated, at paragraph 459 above, that it has provided cost documentation that supports the Staff modified CTC rate structure.

465. The Commission finds that Staff’s other recommended changes to U S WEST’s CTC also should be adopted and orders U S WEST to make a compliance filing that utilizes Staff’s recommended six minute order processing time. With respect to AT&T’s concerns, in order to prevent double recovery of resale OSS system costs, we direct U S WEST to submit a compliance filing removing the wholesale OSS costs from its OSS Cost Study.

IV. RATE DESIGN ISSUES

NRC FOR INSTALLATION AND DISCONNECTION

Overview

466. In Phase I, U S WEST submitted cost studies that reported the combined cost of installing and disconnecting customers. AT&T/MCI criticized the bundling of disconnection and connection charges. The Commission found “U S WEST’s inclusion of disconnection costs to be inappropriate, because the study does not take into account the time value of money, nor the likelihood that a UNE would be disconnected.” 8TH ORDER at ¶472.

PARTY POSITIONS

467. U S WEST advocates the continued bundling of disconnection and connection charges into a single non-recurring charge. U S WEST asserts that installation and disconnection charges should continue to be recovered at the time of installation as is the current industry practice. To do otherwise would jeopardize full recovery of its incurred costs. Brief at 33.

468. GTE also favors recovering the disconnection cost at the time of installation because: (1) establishing a disconnection charge would impose the additional administrative cost of a second billing on the Company; and (2) there is the possibility that a CLEC could go out of business by the time service is disconnected, making collection of a separate charge even more unlikely. Brief at 35-36.

469. Staff disagrees with GTE and U S WEST, and is concerned that the collection of disconnect charges up-front would artificially increase the cost to CLECs and, therefore, create a barrier to entry. Staff believes the Commission would not have directed U S WEST and GTE to identify the costs of connection and disconnection separately if it did not intend for there to be separate charges. Brief at 28-29.

470. AT&T/TCG urge that “[c]onsistent with the principles of cost-causation and to avoid creating barriers to entry, [t]here should be separate, cost-based charges for connection and disconnection. Brief at 43.

COMMISSION DECISION

471. The Commission believes that since an ILEC has a commercial relationship with a CLEC which is different in nature from that which it has with its retail customers the cost of disconnection should not be recovered up-front. We adopt this rate structure because reducing the up-front costs of establishing service will reduce a barrier to entry. We see no reason why the CLECs should pay in advance for a service. Consistent with our findings at paragraph 472 of the 8TH ORDER, we order U S WEST

and GTE to submit separate charges for connection and disconnection. U S WEST and GTE also are directed to demonstrate in their compliance filing that the charges from the bifurcated NRC are no greater, with one exception, than the charges for a combined connect/disconnect NRC. The sole exception is the bifurcated connect-disconnect charge: the ILEC's are entitled to include in their cost study two billing charges -- one for the connection and a second for the disconnection.

OTHER ISSUES

472. The Commission's Bench Request #02-133 asked U S WEST "[i]f a CLEC orders multiple loops at a single location, does that generate a service order per loop or is it a per location service order?" U S WEST responded that "when a CLEC orders multiple loops at a single location this results in one service order for each loop." The Company explains its practice: "A service order can contain one and only one UNE: one loop, one switch port. The requirement that UNEs be ordered on separate service orders is a constraint of the billing system." U S WEST witness Reynolds claimed that if this constraint did not exist, the per unit charge would have to be higher in order for the Company to be able to recover its fixed costs. Mr. Reynolds stated that the net effect of the higher unit charge on a lower number of transactions would be revenue neutral. Tr. 541.

473. AT&T states that "U S WEST would impose an additional surcharge of \$17 per 'service order' to recover its claimed \$150 million (and growing) 'transition' costs. Each element requires a separate service order. So, a CLEC ordering a loop, port, transport, and number portability would require multiple orders. Each customer location requires a separate service order, preventing a CLEC from realizing any economies for multiple customers or multiple locations." Brief at 18.

474. Likewise, NEXTLINK and ELI assert that "[c]ontrary to U S WEST's representations of two charges 'per order,' moreover, U S WEST actually proposes multiple charges for each CLEC order of unbundled network elements, Ex. 735 (USWC Response to Record Request No. 13), which would impose a substantial additional financial burden on CLECs' ability to provide service to their customers." Brief at 32.

475. The Commission believes that NRCs are designed to recover, in part, transaction costs, such as the taking of an order, and that only one charge should apply for ordering and billing per customer location, no matter how many UNE's are being ordered for that customer location.⁴² If fewer orders are placed it logically follows that

⁴² The Commission notes that it is appropriate for the ILECs to charge multiple NRCs which are designed to recover the costs of the actual implementation of the order as opposed to the taking of the order. The Commission requires the ILECs to design their rate schedules so that if multiple UNEs are ordered for a customer at one location, there should be one transaction charge for each type of UNE. On the other

fewer resources would be required. We therefore order U S WEST, as part of Phase III, to file evidence that supports its claim that if its billing system could handle multiple UNEs on a single order, the cost-of-service would not change. If there are cost savings that can be achieved through an improved billing system, we conclude that these savings should be reflected in the price of NRCs.

476. Finally, the Commission notes that after the FCC establishes its list of network elements, the Commission may issue a Phase III notice which requires the ILECs to file new NRC studies that apply to that list of elements, as well as bundled elements.

GEOGRAPHIC DEAVERAGING

477. Subsequent to the Commission's Phase II evidentiary hearings, the U.S. Supreme Court overturned, on jurisdictional grounds, the Eighth Circuit Court's voidance of the FCC's pricing rules. The Eighth Circuit Court is now reconsidering those rules on their merits. While the FCC's rules include guidelines on deaveraging, it is not clear whether these guidelines will be part of the Eighth Circuit Court's review, nor is any legal guidance on this issue to be found in the Supreme Court's ruling, which made no mention of deaveraging.

478. On May 7, 1999, the FCC issued a *sua sponte* stay of the effectiveness of section 51.507(f) of its rules. Section 51.507(f) requires state commissions to establish at least three geographic rate zones for unbundled network elements and interconnection. In its Stay Order, the FCC stated that "[t]he stay shall remain in effect until six months after the Commission issues its order in CC Docket No. 96-45 finalizing and ordering implementation of high-cost universal service support for non-rural local exchange carriers (LECs) under section 254 of the Communication Act of 1934, as amended." *Stay Order*, FCC 99-086, in CC Docket 96-98, released May 7, 1999, at ¶1.

479. In previous Orders, we have taken the position that we did not want to order deaveraging until a state universal fund program had been established. In Phase I of this proceeding, the Commission received information on the cost of providing service in different density zones. Since the Commission decided, pursuant to Staff's recommendation, not to deaverage at this time, no deaveraged pricing recommendations were requested of the parties in Phase II. 8TH ORDER at ¶¶274, 496.

480. Given the recent Supreme Court ruling and the FCC stay Order concerning deaveraging, and the fact that no deaveraged pricing recommendations

hand, it is appropriate for there to be multiple NRCs for implementing the order at one location.

were submitted in the instant pricing phase of this proceeding, the Commission has decided to initiate a Phase III proceeding in which interested parties may submit proposals for deaveraging the statewide loop prices we establish in the instant Order.

481. In the Phase III proceeding, the Commission will ask the parties to make deaveraged pricing proposals that result in an average price for the loop that is equal to the statewide loop prices we establish in the instant Order. The parties should not take this as an opportunity to re-argue the merits of the statewide loop prices we establish in the instant order. The Commission makes clear to the parties that in Phase III the statewide average loop price will not be at issue -- the Commission will consider only the relative prices in different geographic zones contained in the deaveraging price proposals put forth by the parties.

482. The Commission has determined that deaveraged prices for interconnection and unbundled network elements (UNEs) should be established. Therefore, the current interim rates for interconnection and UNEs which were approved by the Commission in agreements filed pursuant to the arbitration and negotiation provisions of the Act will remain in effect pending the outcome of Phase III.

FINDINGS OF FACT

Having discussed above in detail the written testimony and the documentary evidence concerning all material matters, and having stated our findings of fact and conclusions of law in the text of the Order, the Commission now makes the following abridged summary of those comprehensive determinations. Those portions of the preceding detailed findings and conclusions pertaining to the Commission's ultimate findings and conclusions in this matter are incorporated by this reference.

483. The cost of a four-wire loop for U S WEST is 85 percent more than the cost of a two-wire loop.

484. U S WEST and GTE did not provide adequate documentation of their OSS costs.

485. U S WEST's common cost factor for the RLCAP model of 4.05 percent should be accepted; it's proposed "non-attributable" common cost factor should be rejected.

486. GTE's common cost factor of 55 percent should be rejected.

487. The U S WEST revised loop conditioning cost study complies with the 8TH ORDER. The total element long-run incremental cost of load coil removal on a 25-pair binder group is \$292.28, and the total element long-run incremental cost of bridge tap removal at a single location is \$141.63.

488. The GTE loop conditioning cost study was neither timely filed nor adequate to determine prices for service. The best surrogate cost information available to the Commission is cost information from the U S WEST loop conditioning cost study.

489. GTE did not timely file adequate cost information on grooming loops.

490. Grooming is not necessary when a local exchange company orders a bundled loop and port. Without grooming, the total element long-run incremental cost of a loop for U S WEST declines by \$0.55 from the figure the Commission adopted in the 14TH ORDER.

491. Revenue, not cost, is the proper denominator in calculating wholesale discounts. The OS/DA avoided cost discount for GTE is 0.6 percent and the avoided cost discount for U S WEST is 7.97 percent.

492. U S WEST and GTE should file new collocation cost studies in Phase III consistent with the FCC's physical collocation order.

493. NEXTLINK's market price proposal contains serious flaws as described in the text of the instant Order and should be rejected.

494. U S WEST's existing collocation cost study contains the unrealistic assumption that all of its offices suffer from congestion to the point where a separate point of interconnection manhole, as a general requirement, will be necessary.

495. U S WEST did not show in this proceeding that all of its offices suffer from congestion to the point where a SPOT frame, as a general requirement, will be necessary.

496. The \$1.50 interim local number portability monthly per-path cost figure in the Commission's 8TH ORDER contains attributed costs, but not common costs. A common cost additive of 15 percent falls within the reasonable range for unbundled loops.

497. The transport rate element already is combined for U S WEST's use, and its proposed "recombination" charge is a misnomer. The effect of the charge would be to link the shared transport element cost to U S WEST's wholesale rates. U S WEST's shared transport study assumes that 100 percent of traffic flows through a tandem switch; the actual percentage is only 14 percent. The result of modifying this cost study input reduces the direct cost from \$15.96 to \$4.72.

498. A capacity charge for transport and termination better reflects the cost structure of the telecommunications network.

499. The GTE non-recurring cost study does not include adjustments that the Commission required in the 8TH ORDER.

500. The U S WEST customer transfer cost study includes OSS costs which the Company also includes its OSS cost study.

501. U S WEST failed to provide adequate factual support for its assertion that reducing the number of service orders by combining unbundled network elements for a single customer location onto a single order would not result in a cost savings.

CONCLUSIONS OF LAW

502. The price of a four-wire loop for U S WEST should be 85 percent more than the price of a two-wire loop. The price for a four-wire loop for GTE should be 50 percent more than the price for a two-wire loop.

503. Interconnecting competitive local exchange companies should pay reasonable costs of modifying OSS to support a competitive environment. For U S WEST, this includes the IMA interface. U S WEST and GTE should be required to file new OSS cost studies for review by the Commission no later than January 31, 2000. Both U S WEST and GTE should file interim prices for both manual and electronic interfaces pursuant to the terms of the instant Order.

504. For U S WEST's loop cost, the Commission should apply a 4.05 percent common cost factor to the RLCAP model cost estimate, a 12.5 percent factor to the Hatfield model estimate, and \$3.47 to the BCPM model estimate. For GTE's loop cost, the Commission should apply a 24.47 percent common cost factor to the GTE model cost estimate, a 12.5 percent factor to the Hatfield model estimate, and \$3.10 to the BCPM model estimate. The Commission rejects proposals for additional markup over cost because they are not consistent with the 1996 Act.

505. The Commission should consider geographic de-averaging in Phase III of this proceeding and design geographic rate zones to produce target revenues equal to the \$18.16 and \$23.94 statewide average loop rates for U S WEST and GTE, respectively.

506. The current interim loop rates approved by the Commission through interconnection agreements filed pursuant to arbitration proceedings conducted under the Act should remain in effect until the Commission has deaveraged rates in Phase III of the instant proceeding.

507. The U S WEST loop conditioning cost study filed in response to the 8TH ORDER should be accepted and the 4.05 percent common cost factor should be applied to establish loop conditioning prices.

508. The Commission cannot set permanent loop conditioning prices for GTE because GTE did not file an adequate cost study early enough in this proceeding to be addressed by the parties and evaluated by the Commission. Pending consideration of GTE's cost study in Phase III of this proceeding, the Commission should use U S WEST's prices as interim prices for GTE.

509. The Commission should not consider GTE's proposed grooming prices because GTE did not timely submit cost data.

510. The price of a bundled loop for U S WEST should be \$17.59 when a CLEC orders a bundled loop and port because grooming is not needed in that situation.

511. The operator service/directory assistance avoided cost discount for GTE should be 0.6 percent and the discount for U S WEST should be 7.97 percent.

512. The Commission should consider collocation policy issues, and the new collocation cost studies being developed by U S WEST and GTE in Phase III of this proceeding.

513. The Commission should reject NEXTLINK's market price proposal.

514. The Commission should order that GTE may not require CLECs to use separate entrance facilities. GTE should remove separate entrance facility costs from its cost studies. With that adjustment, the Commission should adopt GTE's existing collocation cost study as the basis for GTE's interim collocation prices.

515. The Commission should not accept U S WEST's existing collocation cost study as the basis for its interim collocation prices because it contains unreasonable assumptions. The interim prices for U S WEST should be the same as for GTE.

516. U S WEST did not include SPOT frame costs in its collocation cost study, therefore no pricing issue is presented for Commission determination in this proceeding.

517. The Commission should adopt the "New York" method for recovering the cost of interim local number portability. The Commission should approve a common cost rate additive is 15 percent for this service.

518. The Commission should modify and then adopt U S WEST's proposal for a capacity-based pricing structure for shared transport service.

519. A usage-sensitive shared transport pricing option should be available and U S WEST should file, and support, a minutes-of-use rate as part of its compliance filing.

520. The Commission should require the parties to develop a capacity charge pricing structure for transport and termination. The Commission also should provide interconnecting parties with flexibility and resolve interconnection disputes on this pricing issue by adopting one of the parties' proposals.

521. The Commission should adopt U S WEST's non-recurring cost study, including a 19.65 percent additive for attributed costs and a 4.05 percent additive for common costs. The Commission should reject U S WEST's pricing structure and order the Company to file separate rates for manual and electronic ordering, and separate rates for connection and disconnection.

522. For GTE, the Commission should modify inputs to the non-recurring cost study and order GTE to use the same rate structure as ordered for U S WEST.

523. The Commission should adopt Staff's proposed adjustments to U S WEST's customer transfer charge rate structure and should require U S WEST to remove wholesale OSS costs from its OSS cost study.

524. GTE and U S WEST should be required to bill separately for connection and disconnection and should be permitted to bill only one charge for ordering and billing per customer location. U S WEST should be required to submit cost information in Phase III demonstrating whether a billing system which could accommodate multiple unbundled network elements on a single order would produce cost savings.

ORDER

THE COMMISSION ORDERS:

525. The price of a four-wire loop for U S WEST is 85 percent more than the price of a two-wire loop. The price of a four-wire loop for GTE is 50 percent more than the price of a two-wire loop.

526. U S WEST and GTE shall file new OSS cost studies no later than January 31, 2000, pursuant to the terms of this order, for review in Phase III of this proceeding. U S WEST and GTE shall file interim OSS prices for both manual and electronic interfaces pursuant to the terms of the instant Order.

527. U S WEST and GTE shall charge statewide average unbundled loop prices of \$18.16 and \$23.94, respectively, pending a Commission decision on geographically deaveraged prices in Phase III of this proceeding. When an

interconnecting local exchange company orders a bundled loop and port from U S WEST, the statewide average price of the loop shall be \$17.59.

528. Pending the Commission's decision in Phase III on the most appropriate method for generating loop conditioning cost recovery revenues, U S WEST's price for load coil removal on a 25-pair binder group shall be \$304.12 and the price for bridge tap removal at a single location shall be \$147.37. Pending additional consideration in Phase III of GTE's loop conditioning cost study, GTE's interim prices shall be the same as U S WEST's prices.

529. The OS/DA avoided cost discount for GTE shall be 0.6 percent and the discount for U S WEST shall be 7.97 percent.

530. GTE may not require interconnecting local exchange companies to use separate entrance facilities, and GTE must remove separate entrance facility costs from the collocation cost studies it files for Phase III of this proceeding. GTE also must remove separate entrance facility costs from its existing cost studies and file the resulting figures as interim collocation prices pending resolution of collocation issues in Phase III of this proceeding. U S WEST's interim collocation prices shall equal GTE's prices.

531. U S WEST and GTE must file new collocation cost studies in Phase III in compliance with the FCC's physical collocation order.

532. NEXTLINK's market price proposal is rejected.

533. The "New York" method for recovering the cost of interim local number portability is adopted and the monthly per-path price for interim local number portability shall be \$1.73.

534. U S WEST and GTE shall provide shared transport as provided in the instant Order. U S WEST shall file and support a minutes-of-use rate as part of its compliance filing.

535. Staff, in consultation with interested parties, shall develop a capacity charge proposal for transport and termination pricing.

536. U S WEST's nonrecurring charges shall equal the cost study figures plus a 19.65 percent additive for attributed costs and a 4.05 percent additive for common costs. U S WEST shall file separate rates for manual and electronic ordering, and separate rates for connection and disconnection. GTE shall modify its cost study as provided in the instant Order and file the same rate structure as U S WEST.

537. U S WEST shall file a revised customer transfer charge as provided in the instant Order.

538. U S WEST and GTE shall not impose more than one charge for ordering and billing per customer location. U S WEST must submit cost information in Phase III showing whether a billing system with the ability to accommodate multiple unbundled network elements on a single order would result in cost savings.

539. The Commission has determined that deaveraged prices for interconnection and unbundled network elements (UNEs) should be established. Therefore, the current interim rates for interconnection and UNEs which were approved by the Commission in agreements filed pursuant to the arbitration and negotiation provisions of the Act shall remain in effect pending the outcome of Phase III of this proceeding.

540. U S WEST and GTE shall comply with the filing and other requirements as fully described in the body of the instant Order.

NOTICE OF PREHEARING CONFERENCE

(September 23, 1999)

With Phase II of this proceeding completed, the Commission seeks to commence Phase III immediately. The issues to be addressed in Phase III include:

Physical Collocation: Since the Commission is obligated by state and federal law to ensure that rates are "just, reasonable, and non-discriminatory" (47 U.S.C. §251(c)(6)), there is a need to establish a Phase III proceeding to further investigate and examine the cost and pricing of collocation.

Rate Deaveraging: In the Phase III proceeding, the Commission will ask the parties to make deaveraged pricing proposals that result in an average price for the loop that is equal to the statewide loop prices we establish in the instant Order. The parties should not take this as an opportunity to re-argue the merits of the statewide loop prices we establish in the instant order. The Commission makes clear to the parties that in Phase III the statewide average loop price will not be at issue -- the Commission will consider only the relative prices in different geographic zones

contained in the deaveraging price proposals put forth by the parties.

Other Matters: All unresolved cost and pricing issues deferred by the Commission in the instant Order will be considered in Phase III.

NOTICE IS GIVEN That the Commission will convene a prehearing conference to initiate a Phase III of this proceeding at 9:30 a.m., Thursday, September 23, 1999, in the Commission's Hearing Room, Second Floor, Chandler Plaza Building, 1300 S. Evergreen Park Drive S.W., Olympia, Washington.

If any party or person needs an interpreter or other assistance, please complete the form attached to this notice and return it to the Commission.

ANY PARTY WHO FAILS TO ATTEND OR PARTICIPATE IN THE HEARINGS SET HEREIN, OR OTHER STAGE OF THIS PROCEEDING, MAY BE HELD IN DEFAULT IN ACCORDANCE WITH THE TERMS OF RCW 34.05.440.

DATED at Olympia, Washington, and effective this day of August 1999.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

RICHARD HEMSTAD, Commissioner

WILLIAM R. GILLIS, Commissioner