BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

In the Matter of the	)	
	)	
Continued Costing and Pricing of	)	Docket No. UT-003013
Unbundled Network Elements, Transport,	)	
Termination, and Resale	)	
_____	)	

PART A RESPONSE TESTIMONY

OF

ROY LATHROP

On

Behalf of

WORLDCOM, INC.

July 21, 2000

PART 1: INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Roy Lathrop. I am an Economist in the State Regulatory Analysis Section of WorldCom Inc. ("Worldcom"). My business address is 1133 19th Street, NW, Washington DC, 20036.

Q. PLEASE DESCRIBE YOUR QUALIFICATIONS.

A. I am responsible for developing and promoting Worldcom public policy positions before state and federal regulators. These policy positions generally involve encouraging competition by implementing economically efficient costing and pricing. For roughly two of the past three years, my efforts have been focussed primarily on collocation costing and pricing cases, and on obtaining nondiscriminatory terms and conditions for collocation. I have examined the cost studies and tariffs of several incumbent local exchange companies ("ILECs"), assisted in the development of a forward-looking collocation costing model sponsored by Worldcom and AT&T, and I have filed testimony on various collocation issues in California, Michigan, Minnesota, Massachusetts, New Jersey, New York, Pennsylvania and Washington state.

Prior to joining MCIW, I was employed in the Telecommunications section of the Washington Utilities and Transportation Commission ("WUTC"), where I analyzed economic and policy issues involved in developing an alternative form of regulation for US West, and costing and pricing issues related to network unbundling proposals.

Prior to working at the WUTC, I was employed by the California Public Utilities Commission ("CPUC"). My assignments at the CPUC included three years in the Telecommunications Rate Design Branch of the Division of Ratepayer Advocates where I provided analysis and expert testimony on various rate design, cost and tariffing issues, including cases implementing incentive regulation for California local exchange carriers. Subsequently, I served as an advisor to the Commission responsible for economic and policy analysis for the electricity, natural gas and water industries. Prior to working at the CPUC, I was employed as a Research Economist at the Community and Organization Research Institute where I conducted econometric and policy analysis related to water demand. I have a Bachelor of Arts degree in Economics and Environmental Studies, and a Master of Arts degree in Economics from the University of California at Santa Barbara.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to comment on the collocation cost studies filed by US West Communications, Inc. ("USW", now called "Qwest") and GTE Northwest, Incorporated ("GTE", now called Verizon, Northwest, Inc. or "Verizon."). In addition, I comment on OSS cost recovery issues and I address the need for the Commission to require Qwest and Verizon to facilitate line sharing for local exchange service providers serving end users using UNE-P ("unbundled network element – platform").

PART 2: COLLOCATION COSTS

WHAT IS THE PROPER APPROACH TO DEVELOPING COLLOCATION COSTS BASED ON FORWARD-LOOKING COSTING PRINCIPLES?

A. It is axiomatic that a cost component of collocation involves the floor space in which collocation equipment is placed – the central office "rent." Forward looking central office ("CO") space rental costs should be based upon a CO that would be built today using current least-cost technology and best practices space planning. Such a central office would be designed to incorporate a multi-tenant environment, and would include, for example, perimeter corridors and compartmentalized areas (which increase fire safety) that would permit collocators to access their respective areas by relying on electronic card key access without the need for escorts. Forward-looking CO space rental costs would also reflect a fully air-conditioned CO. Because properly developed space rental costs reflect a central office designed to house telecommunications equipment, it is inconsistent to assess an additional, separate charge for "space preparation" or "conditioning". Such additional charges would be duplicative. It follows that CLECs paying a forward-looking space rental charge should not also be required to pay to improve ILEC central offices to meet current standards.

This aspect of forward-looking cost development is particularly

important. ILECs' COs generally were built to accommodate different technological requirements for equipment space and connectivity arrangements than may exist in a CO today. As a result, ILECs' COs may reflect inefficient characteristics. For example, various sized "pockets" of space may be scattered throughout the central office, created by the replacement of analog equipment with more space efficient digital equipment. These "pockets" may be vacant, used by administrative staff, or have unused analog equipment retired in place. There may be lengthy and indirect cable routes caused by congestion in the overhead cable racks as a result of removing previous equipment without removing cables. In addition, there may be multiple voice grade cross-connects using a main distribution frame ("MDF") and various intermediate distribution frames ("IDF") with complex inter-DF tie cable systems resulting in excessive cable lengths and additional points of failure. Under these circumstances, it is tempting to permit the ILECs to recover costs associated with "preparing" the CO to house the CLECs' telecommunications equipment. However, there are a number of reasons why the Commission should not succumb to this temptation.

First, as noted initially, applying forward-looking costing principles in the context of collocation requires an approach in which the goal should be to develop a forward looking CO space rental charge. A forward looking CO space rental charge will be based on a CO already configured with sufficient power, air

conditioning etc, to accommodate a number of different carriers' equipment. To assess a separate "space preparation" or "conditioning" charge is the antithesis of this approach and would permit double recovery of costs.

Second, since the ILEC controls the placement of collocators' equipment in the CO, the ILEC exerts almost total control over the costs its competitors pay for collocation. Moreover, the ILEC has no incentive to minimize the CLECs' collocation costs, and in fact has the opposite incentive. By focussing on the development of an appropriate forward looking space rental charge and denying the ILECs the ability to assess separate "space preparation" charges, the Commission can guard against these incentives that are contrary to the pro-competitive purposes of the Telecommunications Act.

Q. HAVE OTHER STATES ADOPTED A FORWARD-LOOKING APPROACH TO COLLOCATION COSTS?

A. Yes. Recently, the Michigan Commission rejected the Ameritech Michigan costing approach that included proposed "conditioning" charges:

> The Commission concludes that it should not adopt Ameritech Michigan's model, which assumes that the cost of existing central office buildings plus the costs of modifications are a proper basis for determining the forward-looking cost of central office space. Contrary to Ameritech Michigan's argument, TSLRIC principles require the assumption that the location of the buildings remains unchanged, but does not require the assumption that the existing buildings with their current configurations will be used.[1]

[1] Michigan Public Service Commission, Opinion and Order in Case U-11831, November 16, 1999 at pages 30 and 31.

Q. HAS THE FCC PROVIDED A COMPREHENSIVE FORWARD-LOOKING APPROACH TO COLLOCATION COSTING?

A. No. It is worth noting that while the FCC has addressed collocation costs in various orders, it has not specifically and explicitly provided a comprehensive forward-looking approach to collocation costing. This is important because certain FCC pronouncements might, if considered alone, lead to short run incremental costing. For example, in the Advanced Services Order, the FCC discussed recovering "site conditioning" costs on a pro rata basis. While the FCC's discussion addressed the problem of "first in pays", it was not provided within the larger context of a comprehensive collocation costing method. That is, the FCC did not consider the question whether a forward-looking approach to collocation costing includes site conditioning type costs within the per square foot central office floor space costs. The FCC stated:

> …incumbent LECs must allocate space preparation, security measures, and other collocation charges on a pro-rated basis so the first collocator 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 that state commissions will determine the proper pricing methodology to ensure the incumbent LECs properly allocate site

preparation costs among new entrants.[2]

The proper collocation costing and pricing methodology, one that avoids double counting, includes a forward-looking space rental cost and therefore no need to recover "space preparation" costs or to charge for HVAC and power upgrades on an individual case basis ("ICB"), a point I return to below. This approach therefore avoids altogether the "first in pays" problem the FCC addressed in the Advanced Services Order.

Q. HOW DOES THIS ANALYSIS COMPARE WITH THE QWEST'S COST PRESENTATION?

A. It is not clear whether Qwest's cost presentation is consistent with forward-looking principles. Qwest generally took a forward-looking approach to developing a central office space cost. I was unable to determine, however,

[2] FCC Order 99-48, *Advanced Services Order*, ¶ 51, CC Docket No. 98-147, March 31, 1999.

whether any "space preparation" type charges were included in the sample of cageless collocation jobs Qwest used to develop other collocation costs.[3] Qwest also did not state whether space preparation charges were included in its development of caged collocation costs, for which it relied on a team of experts to revise the cost assumptions to account for the cost differences between cageless and caged collocation.[4] ("Space preparation" or "conditioning" charges are frequently assessed through an ICB charge. However, without proposed tariff language and proposed rate sheets, it is difficult to determine whether an ILEC intends to assess an ICB charge, which would not necessarily appear on a list of collocation cost components.)

Qwest's charge for caged collocation, termed "space construction", comprises various cost elements, including engineering, cage construction, a power feed, overhead cable racking and support structure, lighting and HVAC. Qwest's rent charge includes an electrical outlet, and maintenance and repair as well as general housekeeping services. If Qwest did include any space preparation charges in its development of caged collocation costs (for example, as part of any of the cost elements for rent or space construction), they should be removed as duplicative of the forward-looking space rental costs. The Commission should exclude costs associated with demolition, reconstruction and modification activities.

[3] Qwest's sample of collocation jobs were constructed prior to May of 1999. Direct Testimony of Jerrold L. Thompson, February 15, 2000 at p.7, line 20-21.

[4] May 17, 2000 Errata to the Direct Testimony of Jerrold L. Thompson, February 15, 2000.

Q. HOW DOES THE ABOVE ANALYSIS COMPARE WITH THE VERIZON'S COST PRESENTATION?

A. Verizon, like Qwest, generally took a forward-looking approach to developing a central office space cost. Unfortunately, Verizon includes several categories of space preparation-type costs in its cost presentation that are duplicative of forward-looking space rental costs.

Verizon's Space Rental Costs

Verizon developed space rental costs beginning with the land and building investments to construct selected central offices, and indexed the building investment to current values. Verizon deducted 16% of the building investment for HVAC (relying on RS Means, an industry construction text), then added back an "HVAC Shell Cost" based on one ton of HVAC for each 300 sf of floor space. While this approach generally estimates forward-looking central office space costs, the process excludes any economies of scale that would be available by providing HVAC for an entire building, rather than "units" of 300 sf. In addition, it appears that Verizon double counted HVAC investment by adding back some HVAC to its building investment, while separately charging for HVAC based on DC amps. That is, Verizon recovers all necessary HVAC costs based on the number of amps a collocator orders.

Verizon's approach to building investments double-counted costs to the extent that multiple investments (in different periods) in a particular central office were associated with re-configuring or expanding space that involved space preparation activities such as demolition and reconstruction. Indeed, Verizon notes

that its buildings supported mechanical and electronic switching equipment in the past and "have been brought up to date" and now support the digital technology being deployed by Verizon today.

Verizon may also have double-counted cost factors. Verizon's cost development appears to have used the "overhead and profit" column from RS Means, to which Verizon added 15% for "general conditions" and an additional 9% for engineering fees. Verizon also applied its overhead cost factor. At a minimum, Verizon should be required to revise the inputs so as to not use the overhead and profit factor from RS Means.

Verizon's Building Modification Costs

Verizon's "Building Modification" cost element is assessed on a "per occurrence" basis and includes three categories. The category called "Site Modifications" includes "Demolition and Site Work" and "Dust Partition" costs elements that are clearly associated with space preparation activities (remodeling, repairing, and rehabilitating the central office) that are duplicative of forward-looking space rental costs. A third cost element, "Ventilation Ducts" (referred to elsewhere in Verizon's presentation as "Minor HVAC") is also associated with space preparation activities and is duplicative of Verizon's HVAC cost element. Each of these site preparation related cost elements are inconsistent with forward looking space rental costs and should be removed.

Verizon's "Environmental Conditioning" cost component is assessed per 40 amps and is intended to recover the HVAC costs cost associated with dissipating the

heat generated by collocators' telecommunications equipment. While I have no fundamental objection to the general structure of this cost, Verizon would be double recovering if it assessed a charge for Ventilation Ducts (aka, "Minor HVAC") as well.

If the Commission is willing to entertain the concept of space preparation type charges, an approach I do not recommend, it should be circumspect in considering Verizon's (and Qwest's) proposed costs because collocators have no influence over where in the CO their equipment is located and Qwest and Verizon have no incentive to minimize the costs borne by their competitors, two important factors that would otherwise reduce the "actual costs" the ILECs claim the need to recover.

DOES EITHER ILEC REQUEST RECOVERY FOR HVAC OR POWER PLANT ADDITIONS?

I do not believe so. (It is difficult to know without examining proposed tariff language.) If they have, such cost recovery would be discriminatory and inappropriate. Most ILEC collocation cost studies and tariffs I have reviewed have included proposed ICB ("individual case basis") charges for the space preparation type costs I described above. More recently there has been a trend to include such costs explicitly on a flat rated basis. In addition to the "room construction" type charges (demolition and reconstruction), some ILECs have also proposed ICB charges for HVAC and power

plant additions. For example, although Qwest states that it does not seek cost recovery for power plant additions, it does not exclude the possibility.

Permitting Qwest or Verizon to charge collocators for HVAC or power upgrades would be inconsistent with the forward-looking approach to developing space rental charges, discriminatory and should not be allowed. The ILECs charge collocators for the use of a shared power plant, and also recover power costs from retail rates (by applying cost factors). If ILECs were to place equipment to serve end users (for example, DSLAMs) that caused them to expand a power pant, end users would not be charged for the power plant addition, and it would be discriminatory to assess collocators a charge in a similar situation. Furthermore, any ICB charges ILECs assess collocators for HVAC power upgrades are short run incremental costs, unlikely to capture the economies of scale that ILECs realize in their use and operation of the CO HVAC and power systems.

Other Collocation Cost Items

DO YOU HAVE ADDITIONAL COMMENTS ON QWEST'S COST STUDY?

Yes. Qwest assumed specific numbers of collocators per central office in its general inputs for collocation. Given the ever-increasing number of collocation applications, it may be appropriate to revisit this figure prior to the implementation of rates established in this proceeding (through a late-filed exhibit).

Cable Racking Assumptions

Qwest assumes that a significant percentage of collocations require cable

racking and aerial support, which overstates the cable racking costs. For example, Qwest assumes that caged collocation is "generally in a place where no cable racking previously existed"[5] and for cageless collocation, Qwest assumes fully half the central offices will need major racking and support. Indeed, this seems to conflict with Qwest's definition of cageless collocation that "…a CLEC's equipment is placed in the US West central office adjacent to US West or other CLEC equipment..."[6]

If Qwest were placing its own equipment, it would place it close to the devices to which the equipment connects, and in a place where overhead racking exists. The assumed need for additional racking and overhead support likely arises from Qwest's desire to place collocators in a separate room or area. Qwest, which has no incentive to minimize collocators' costs, completely controls the placement of collocators' equipment. CLECs should pay for the use of cable racking and support structure on a capacity basis (that is, the proportionate amount of space their cables consume on the shared overhead cable racks). The amount of cable racking dedicated to any one collocator would be very small if Qwest placed their equipment in the same manner in which it placed its own equipment. CLECs should pay for no more than about 10 feet of dedicated cable racking and overhead support.

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5 Qwest's Response to discovery propounded by Nextlink, et al 01-010.
6 Direct Testimony of Larry B. Brotherson, February 15, 2000 at page 5.

Bay Construction

Qwest assumes end guard costs that actually exceed the cost of the equipment bay. Qwest should be given the opportunity to revise this cost.

Space Rental Cost

Qwest provided materials in response to discovery request MCW 02-015 that include a confidential attachment that indicates flaws in USW's cost development for space rental cost. Qwest develops a "CLEC Rentable/Usable Space Factor (CLEC R/U)," that accounts for the additional space collocation "uses" that is not rentable space (for example, a dedicated hallway). The CLEC R/U is too high, thereby inflating space rental costs.

Qwest developed its factor by averaging several actual collocations (using CO floor plans) and two examples. In one example, four adjacent 100 square foot cages are completely surrounded by a 4-foot aisle space, depicted as a box-within-a-box. The "inner" box is the four 100 square foot cages, hence 20ft by 20 ft, or 400 square feet. The "outer" box adds the 4-foot aisle space to each side and thus the total measures 28 ft by 28 ft. The CLEC R/U factor is calculated as the ratio of the total space to the rented space, that is the 784sf (28ftx28ft) of the total, outer box to the 400sf (20ftx20ft) of the inner box. Thus, the CLEC R/U factor derived in Qwest's example is 1.96 (=784sf/400sf). If Qwest had an incentive to economize on space, and hence collocators' costs, the CLEC R/U factor would not be as high. For example, a CO with perimeter corridors would produce a much smaller CLEC R/U factor. For example, a common aisle separating four 100 sf cages (two on a side)

produces a CLEC R/U factor of 1.375. (Assume a 7.5-foot wide aisle, 20 feet long, for a total of 150sf, which, when added to the 400sf of the four 100sf collocation cages, leads to a total of 550sf. (550sf/400sf = 1.375) Although a CLEC R/U of 1.375 is less than all but one of the factors Qwest used to develop its average, it is achievable, and Qwest should be required to use a CLEC R/U factor of 1.375.

Collocation Space Report

Q. PLEASE DESCRIBE THE REQUIREMENT TO PROVIDE WHAT VERIZON TERMS A "COLLOCATION SPACE REPORT."[7]

A. The FCC's Advanced Services Order states that incumbent LECs must submit to requesting carriers, within ten days of a request, a report indicating the ILEC's available collocation space in a particular premises. "This report must specify the amount of collocation space available at each requested premises, the number of collocators, and any modifications in the use of the space since the last report. The report must also include measures that the incumbent LEC is taking to make additional space available for collocation."[8]

Thus, it is possible such a report would simply show the following:

__ (number) __ square feet of collocation space available.

__ (number) __ collocators.

__ (brief description) __ modifications in the use of the space since the last report.

[7] Qwest's cost study does not appear to include such a report.
[8] FCC's ASO at paragraph 58.

(brief description) measures to make additional collocation space available.

Q. SHOULD THIS INFORMATION BE READILY AVAILABLE TO VERIZON AND QWEST?

A. Yes. Verizon's and Qwest's records, if maintained on an ongoing basis, would include all this information. (Indeed, collocation application fees generally include time for staff to design, prepare engineering records and input data.) Qwest and Verizon know the number of collocators, since they have received applications and submit bills. Qwest and Verizon know the amount of collocation space available because they have floor plans of their premises. Qwest and Verizon know what measures they will take to make additional space available since modification plans are known well in advance. Qwest and Verizon know of any modifications in the use of space since the last report since they would have made or overseen the changes. In other words, in a forward-looking environment, the information needed to generate a Collocation Space Report should merely require accessing existing information since Qwest and Verizon should be keeping their records up to date. (Presumably, this would be important for equipment inventory management and tracking.)

If Qwest or Verizon have not kept their databases current, they should not impose the cost of updating (or keeping records current) on CLECs. Many of the activities needed to produce a space report are capable of being performed by retrieval and updating computer database files. In that case, only about two hours should be required to develop the collocation space report.

PART 3: LINE SHARING

WHAT IS LINE SHARING?

Line sharing is the use of one loop by two different telecommunications carriers that provide service using different frequency ranges.

SHOULD THE COMMISSION REQUIRE QWEST AND VERIZON TO FACILITATE LINE SHARING BETWEEN CLECS?

Yes. Worldcom and other CLECs should be permitted to add advanced services capability to lines provisioned using UNE-P. There are no technical problems to prevent ILECs from supporting CLECs' efforts to provide an advanced service capability over a new or already operating UNE-P line. An ILEC would insert a splitter in the UNE-P loop-port combination and wire the high frequency output of the splitter to the DSL equipment. That is, the physical arrangements necessary for a CLEC providing service using UNE-P to acquire access to the high frequency portion of the loop are nearly identical to that which the ILECs provide for line sharing with data CLECs. See, for example, Qwest's explanation of how line sharing works with data CLECs under alternative network configurations (splitter placement) in the Direct Testimony of Robert J. Hubbard, May 19, 2000 at p.7 and 9.

IS PROVIDING SERVICE USING UNE-P AN IMPORTANT VEHICLE FOR LOCAL EXCHANGE MARKET ENTRANTS?

Yes. UNE-P is the only practical mechanism for mass market entry in the local exchange market (resale and unbundled loops are simply not effective for a mass-market means of serving local customers). Just as ILECs offer xDSL services internally or through an affiliate, and data CLECs may avail themselves of line sharing, Worldcom would like to provide DSL capability to customers it serves using UNE-P, without the need to use a second line.

If ILECs are not required to facilitate CLEC-to-CLEC line sharing, customers will be denied the choice of using <u>one</u> line for data and any other provider but the ILEC for voice service. ILECs should be required to facilitate the choice of a customer that has xDSL service and wishes to switch to a CLEC that provides voice service using UNE-P and relies on a third party's xDSL capabilities. Without ensuring that ILECs facilitate UNE-P line sharing, once an ILEC offers long distance service, the ILEC will be the only provider capable of providing a full complement of local, long distance and data services on one line. In summary, ILECs should be required to enable CLECs to add, modify or remove xDSL capabilities to a new or already operating UNE-P line or to migrate customers who already subscribe to xDSL to UNE-P without loss of the data service (whether the data service is provided by another CLEC through line sharing, the ILEC, or an ILEC data affiliate).

DO YOU AGREE WITH QWEST'S TESTIMONY REGARDING LINE SHARING NETWORK CONFIGURATIONS?

Not entirely. Qwest's description of the line sharing network architecture[9] appears to assume the use of an intermediate distribution frame ("IDF") in all instances, which is not necessary. Interestingly, Qwest admits that a traditional call can be routed "directly from the COSMIC or MDF to the CLEC/DLEC's collocation area."[10] In addition, Qwest noted that IDFs are unnecessary in a Colorado proceeding:

> "…US WEST provides CLECs with the same network connections as US WEST uses to provision services to its own retail customers. CLEC terminations share frame space with US WEST terminations without a requirement to also traverse an intermediate device, such as an ICDF or SPOT (Single Point of Termination) frame. A direct connection between the collocation space and the same digital cross-connect frame terminating similar retail services can be provisioned without a bona fide request."[11]

WHAT IS THE IMPACT OF QWEST ASSUMING THE USE OF AN IDF?

Assuming the use of an IDF will increase costs for line sharing by requiring more cross connects than necessary, as well as introducing additional points of network failure, similar to Qwest's previous attempt to use a SPOT frame in collocation arrangements.

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[9] Direct Testimony of Robert J. Hubbard, May 19, 2000 at pages 6-7.

[10] Direct Testimony of Robert J. Hubbard, May 19, 2000, pages 4-5.

[11] Affidavit of Thomas R. Freeberg, June 27, 2000 at page 27; Colorado Public Utility Commission Docket No. 97I-198T.

WHEN SHOULD THE ISSUE OF CLEC-TO-CLEC LINE SHARING BE RESOLVED?

Either in this phase of the proceeding or in phase B.

PART 4: OSS COSTS

WHAT COST STANDARD SHOULD APPLY TO RECOVERY OF OSS COSTS?

The cost standard that should apply is one that requires costs be forward-looking, reflect efficient operations, and considers the total demand when analyzing the cost of providing nondiscriminatory access to OSS.

ARE QWEST'S AND VERIZON'S PROPOSED OSS COSTS CONSISTENT WITH FORWARD-LOOKING PRINCIPLES?

No. Qwest and Verizon are claiming cost recovery for OSS costs based on "actual" expenditures to modify their OSS systems for a multi-provider environment. The proper forward-looking costs would not be a simple tabulation of current (or recent) expenditures. Instead, the proper cost would be the difference between the cost of developing a forward-looking, efficient OSS system excluding the new features and the cost of developing a forward-looking, efficient OSS system including the new features. The forward-looking per-unit cost is de minimus

because the total cost difference between developing the two OSS systems (with and without the features the ILECs added to their legacy systems) would be relatively small, and because the cost would be shared among (divided by) all users, including the ILECs' retail customers.

CAN THE COST DIFFERENCE YOU DESCRIBE BE QUANTIFIED EASILY FROM THE COST INFORMATION PROVIDED BY QWEST AND VERIZON?

No. The tabulations of costs provided by Qwest and Verizon are basically "time and materials" to modify their existing legacy systems. There is no information that indicates that Qwest and Verizon even began with forward-looking, efficient systems. Even if there was evidence that the ILECs' legacy systems were "up to date" the proper cost is not the cost to modify existing (possibly efficient) systems, but the difference between developing systems with and without the necessary features. In addition, Qwest and Verizon have no particular incentive to minimize costs that they expect not to pay. Hence, it is unlikely that least cost solutions have been obtained. (Even if the tabulation of costs were the "right" costs to examine, the situation is problematic when functions are outsourced, particularly to an affiliated vendor. For example, a vendor may provide deep discounts to entice a customer to purchase a product, recognizing that subsequent work – undiscounted -- will be obtained.)[12]

[12] Qwest's response to discovery request RLI-03-008 (c) indicated that no information was available to Qwest regarding Telcordia's price quote.

Q IS THERE ANY EVIDENCE THAT QWEST AND VERIZON DID NOT HAVE FORWARD-LOOKING, EFFICIENT OSS SYSTEMS TO BEGIN WITH?

A. Possibly**.** Qwest and Verizon indicate increasing expenditures on OSS prior to the "additional" expenditures for which they claim cost recovery now. There is no substantiation that these expenditures were undertaken to bring existing OSS systems up to forward-looking, efficient capabilities. In fact, the expenditures prior to the Act may have modified the OSS systems in a way that complicated (and hence increased the cost) to complete the tasks for which the ILECs claim cost recovery.

Clearly, OSS costs have been included in the ILECs' rates (through the application of overheads and cost factors). If the trend in OSS expenditures on a per unit basis (for example, per-line or per- dollar of revenue) has remained constant, then it is possible that the OSS costs for which the ILECs are claiming cost recovery are in some sense included in existing rates. For example, the new collocation costs were developed by applying the same cost factors.

WHAT HAVE QWEST AND VERIZON PROPOSED FOR OSS COSTS?

A. Qwest has proposed what appear to be a per-order charge of $14.19 (manual) and $9.58 (electronic) for "start up" costs, and "ongoing" charges (presumably per line per month) of $1.76 for manual and $2.02 for electronic. Verizon proposes to

charge $3.27 per order for transition (start-up) costs, and $3.76 per order for transaction costs (until 17.375 million orders are processed). In addition, Verizon plans to charge $4.92 per local service request for the recovery what it refers to as national open market shared/fixed costs.

Q. ARE YOU AWARE OF THE WUTC'S FINDING THAT ILECS' OSS COSTS SHOULD BE PAID FOR BY CLECS?

A. Yes, a finding with which I respectfully disagree, if the Commission intends to permit recovery of the ILECs' claimed costs from CLECs. There are important implications for the prospect of local competition to develop in Washington State if the ILECs' claimed costs are imposed on CLECs. First, the fact that CLECs must bear their own costs results in the respective companies facing unequal cost burdens. Second, a structure in which one set of competitors (CLECs) bears another's (ILECs) costs is undesirable for efficiency reasons since the incentive to minimize costs is not placed with the entity that bears the costs. Third, the absolute level of costs adds a layer of costs that CLECs must pay in addition to existing recurring and nonrecurring costs.

IS IT APPROPRIATE FOR NEW ENTRANTS TO PAY THE ILECS' CLAIMED OSS COSTS?

No. The costs Qwest and Verizon propose to recover were effectively caused by the changes in the law and public policies that were intended to open the local exchange

market to competition. Indeed, one could as easily claim that Congress, rather than new entrants, is the cost causer. Even if the Commission were to entertain permitting the ILECs to recover some significant amount of their claimed OSS costs, the prospects for local competition to develop in Washington State would be brighter if a competitively neutral mechanism were to be used.

New entrants have incurred their own costs for OSS development (including training personnel and building their own side of the gateway). To impose the ILECs' OSS costs on CLECs in addition to CLECs' bearing their own OSS costs would result in CLECs facing a greater cost burden than the ILECs, since the ILECs do not bear any part of CLECs' OSS costs. The simplest competitively neutral cost recovery mechanism would be for each company to bear its own costs for access to OSS (which would ensure the incentive to minimize costs and not shift the burden of enhancing a competitor's OSS system that is not up to date.) Alternatively, the Commission could establish a competitively neutral surcharge, applied to all access lines that would recover the ILECs' costs for developing access (with CLECs also relying on their end users to recover OSS costs). The surcharge would decrease over time as the number of access lines increases each year.

The development of competition in the local exchange market will benefit all customers, including those that choose to remain with the ILEC. Regardless of which provider a customer chooses, the existence of viable choices for customers will force all carriers, including the ILECs, to deploy new technologies more quickly, to develop innovative product offerings, and to control prices. The

competitive discipline will benefit all users. The development of competition, however, will be hindered if new entrants must bear their own OSS costs and those of the ILEC as well.

Q. WILL QWEST AND VERIZON OBTAIN BENEFITS FROM DEVELOPMENT OF THEIR RESPECTIVE OSS SYSTEMS?

A. Yes. Naturally, Qwest will benefit from developing its OSS systems by fulfilling one of the requirements for entry into the long distance market. (Since Qwest is required to provide new entrants with nondiscriminatory access to OSS before it will be granted interLATA authority, any Qwest interLATA ambitions could be seen as making Qwest the "causer" of its OSS costs.)

The modifications to the various ILEC OSS systems will provide some benefit to the ILECs. For the variety of systems changed, it is hard to believe that changes would be restricted to those only benefiting CLECs, while continuing to leave ILECs "no better off." It is more likely that in changing the OSS systems, any opportunity for ILEC improvements that make CLECs no worse off would be taken advantage of. For example, if an ILEC's operations could be made more efficient or flexible while accommodating the CLEC, at little to no incremental effort, one would expect that to occur, rather than to see a clear opportunity for benefit intentionally ignored. Similarly, any possibility for greater integration of ILEC systems, or expansion of their capabilities (perhaps to handle more or

different standards) – while making the CLECs no worse off and at little incremental effort – would be undertaken.

In addition, the ILECs retain the "new and improved" OSS systems which may have value in their own right as intellectual property, as well as enabling the ILECs to have a more efficient, productive means of providing service to their customers.

DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, at this time.