BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

IN THE MATTER OF THE PETITION OF

US WEST COMMUNICATIONS, INC.

FOR COMPETITIVE CLASSIFICATION OF BUSINESS SERVICE IN SPECIFY WIRECENTERS

NO. UT-003013

OPENING BRIEF OF PUBIC COUNSEL (PART A)

I. INTRODUCTION

Public Counsel has not presented its own expert testimony in this phase of the case. Public Counsel believes, however, that this phase of the costing/pricing proceedings presents an important policy and legal issue with regard to reasonable of allocation costs among all services which employ the loop to reach the ultimate consumer.

Accordingly, the focus of this brief is to recommend that the Commission allocate a reasonable portion of cost to line sharing and, as a result, adopt a positive or "non-zero" price for the high-frequency portion of the loop as a UNE (HUNE). This position is based on two related rationale. First, adoption of a zero price would violate the fundamental regulatory principle that the loop is a shared cost, properly supported by all services which require the loop for their provisioning. Second, requiring that line sharing be provided at a zero price would violate the provisions of Section 254(k) of the Telecommunications Act of 1996.

II. LEGAL AND POLICY ISSUES

A. The Loop Is a Shared Cost.

A fundamental principle of appropriate telecommunications pricing is the treatment of the loop as a common or shared cost. It is an input for every service sold in the telecommunications network.

This principle has been explicitly adopted in Washington in this Commission's seminal decision in U S West's 1995 rate case. There the Commission held:

> The Commission finds, consistent with the presentations of Public Counsel/AARP and other parties, that the cost of the local loop is not appropriately included in the incremental cost of local exchange service. The local loop facilities are required for nearly every service provided by the Company to a customer. Neither local services nor in-state long distance service nor interstate long distance, nor vertical features can reach a customer without the local loop. Should USWC cease to provide any one of these services, its need for a local loop to provide the remaining services would remain. The cost of the local loop, therefore, is not incremental to any one service. *It is a shared cost that should be recovered in the rates, but no one service is responsible for that recovery*.[1]

The Commission rejected USWC cost studies in that case which assigned all loop costs to local service because "the local loop is correctly treated as a shared cost." *Id.*, p. 84.[2] The pertinence of this principle in the present docket was noted by Commissioner Hemstad at the hearing. (Tr.

---

[1] *Washington Utilities and Transportation Commission v. U S West Communications Inc.*, UT 950200, Fifteenth Supplemental Order, April 11, 1996, pp. 83-84. The Commission's decision was affirmed on appeal by the Washington Supreme Court and the loop cost portion of the decision was not challenged. *U S West Communications, Inc., v. Washington Utilities and Transportation Commission*, 134 Wn. 2d 74, 83, 99, 949 P.2d 1337 (1997).

[2] *See also*, *Washington Utilities and Transportation Commission v U S West Communications*, Docket UT 941464, Fourth Supplemental Order, p. 39 (re propriety of allocating loop costs to toll and vertical services, rather than 100 % to local service).

548-549).

Other state commissions have likewise endorsed this fundamental pricing principle. *Re U S West Communications, Inc.,* Docket No. RPU-96-9, Iowa Utilities Board, 1998 WL 265370 at 23; *Re Standards and Safeguards for Competitive Services*, Docket M-00950587, Penn. PUC, Order and Opinion, August 6, 1996, p. 162, 1996 WL 944339 ("local loop costs are joint or shared costs since the local loop is jointly utilized to provide a wide array of telecommunications services"); *Re Competitive Telecommunications Environment*, Docket No. 97R-177T, Colorado PUC, Decision No. 98-46, p. 7, 1998 WL 983449 ("We continue to endorse, for present purposes, the allocation of loop costs among all services for which the loop is an input."); *Re U S West Communications, Inc.*, Docket No. 97-049-08, Utah PSC, 183 PUR 4th 382, 444 (1997).

Nor is this principle a recent invention. The policy that the costs of the local telephone network should be shared by all the services that rely upon use found its earliest expression in the landmark United States Supreme Court decision of *Smith v. Illinois Bell Telephone Co.*, 282 U. S. 133; 51 S.Ct. 65, 75 L.Ed. 255 (1930). There the Court held that it was manifestly unreasonable to assign all of the local exchange plant costs to local service when that local plant was also used to provide long distance service. As the Court observed, it is:

> …the indisputable fact that the subscriber's station, and the other facilities of the Illinois Company which are used in connecting with the long distance toll board, are employed in the interstate transmission and reception of messages. While the difficulty of making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential [citations omitted]it is quite another matter to ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden – to what extent is a matter of controversy.[3]

This fundamental cost allocation principle should guide the Commission in this docket as

---

[3] *Smith* 282 U.S. at 150-151 (footnotes and citations omitted).

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
900 4TH AVE, SUITE 2000
SEATTLE, WA 98164-1012
(206) 464-7744

it resolves the line sharing charge issue. A departure from this approach and a conclusion that some services offered over the loop need bear no responsibility for recovery of loop costs creates a damaging precedent that would inevitably expose consumer to upward pricing pressures for basic services. Ratepayers have paid through rates for, and have a right to share in the benefits of, the development of the network which now allows for the provision of competitive services such as line sharing.

B. Adoption Of A Zero Recurring Charge For Line Sharing Would Violate Section 254(k).

Adoption of a zero price for the line sharing UNE would not only be a dramatic departure from sound economic and regulatory policy and precedent, it would run afoul of Section 254(k) of the Telecommunications Act. In enacting this provision, Congress sought to ensure that core telephone services, those included within the definition of universal service, would not be saddled with an undue and excessive burden of cost recovery for all services using the same network facilities. The Act provides:

> A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

The legislative history of the Act further emphasizes Congress' concern that basic services not bear an undue burden of cost by observing that such services could, indeed, permissibly bear "less than a reasonable share" of joint and common costs.[4]

[4] Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 104-458, 104th Cong., 2d Sess., (Jan. 31, 1996), p. 129, 134 (emphasis added).

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
900 4TH AVE, SUITE 2000
SEATTLE, WA 98164-1012
(206) 464-7744

In its order regarding implementation of Section 254(k), the FCC noted the "two dichotomies" in the Act – the prohibition on subsidy of competitive services and the clear prohibition on unreasonable allocation of costs to basic services.[5] Most directly implicated here is the second "dichotomy," the unreasonable allocation of costs. As the FCC notes:

> A telecommunications carrier will typically provide these services [basic telephone services included in the definition of universal service], together with numerous other telecommunications services, over a single network because the total cost of providing these services on shared facilities, under shared management, is less than the combined cost of providing these services on separate facilities particularly under separate management operations. A substantial portion of these costs of shared facilities and operations are joint and common costs; it is difficult, if not impossible, to approximate the actual portion of such costs for which each product or service is responsible. [footnote omitted]. For these types of cost, considerations other than cost causation must prevail in determining how the costs should be allocated among various services.[6]

Section 254(k) therefore requires that this Commission ensure that basic exchange service[7] in Washington bear no more than a reasonable share of the cost of the loop. The loop is required for both basic exchange and Digital Subscriber Line (DSL) service. As the FCC's Line Sharing Order points out "[l]ine sharing generally describes the ability of two different service providers to offer two services over the same line with each provider employing different frequencies to transport voice and data over that line."[8] It would be unreasonable for one service

---

[5] *In the Matterof the Implementation of Section 254(k) of the Communications Act of 1934, As Amended*, FCC 97-163, Order, 12 FCC Rcd. 6415, ¶ 7. (Section 254(k) Order).

[6] *Id.*, ¶ 8.

[7] Inclusion of basic telephone service as part of "universal service" in Washington would not seem a matter of dispute. RCW 80.36.300(7).

[8] *In the Matter of Deployment of Wireline Service s Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third and Fourth Report and Order, CC Docket Nos 98-147 and 96-98, ¶ 17 ("Line Sharing Order"). The FCC has consistently recognized the shared nature of the cost of the loop. *See, e.g*., *Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd. at 15,847("common lines are jointly used for local exchange service and exchange access and interstate interexchange services"); *Jurisdictional Separations Reform*, CC Docket No. 80-286, Notice of Proposed Rulemaking, ¶ 15 (released November 10, 1997)("the cost of a residential loop used to provide traditional telephony services usually is common to local, intrastate toll, and interstate toll services.")

that uses the voice grade frequencies of the loop to pay shared loop costs, while a second service using different frequencies of the same loop pays none of the shared costs.

A decision of the Kansas Court of Appeals illustrates the application of the statute in a case where fully one hundred percent of loop costs were allocated to basic "universal services." The court overturned the allocation, holding:

> Local loop cost is the cost of providing access to the telecommunications network. The loop consists of the wires that connect a customer's premises to the central office serving the customer. The same loop facilities provide all services; for example, local, interstate and advanced services. Approximately 75% of the cost of basic residential service is the cost of the local loop. However, the amount of support to be paid LECs from the KUSF was based on allocating 100% of the loop costs to basic local service.
>
> Section 254(k) of the Federal Act directs the states to establish safeguards and guidelines to ensure that services related to universal service 'bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.' 110 Stat. 75. We believe the KCC orders unduly burden the basic local service consumer with loop cost that are attributable to other services.[9]

The purpose of the first "dichotomy" of Section 254(k), the anti-subsidy prohibition, is to address "the concern that ILECs may attempt to gain an unfair market advantage in competitive markets by allocating to their less competitive services, for which subscribers have no available alternative, an excessive portion of the costs incurred by their competitive operations."[10] In their initial DSL filings ILECs allocated no costs to the HUNE on the theory that these costs were already covered by existing voice grade services. This is precisely the type of allocation that the Act seeks to preclude. The Commission should not ratify this allocation by approval of a zero

---

[9] *Citizens' Utility Ratepayer Board v. Kansas Corporation Commission*, 943 P. 2d 494, 507-508 (Kan. App. 1997), *reversed in part on other grounds,*264 Kan. 363, 956 P.2d 685 (1998)**;** *see also, Re Universal Service Reform*, Cause No. 40785, Indiana Regulatory Commission, October 28, 1998 ("direct assignment of 100 percent of the loop costs to any one service would be violation of the second sentence of Section 254(k)").

[10] FCC 254(k) Order), ¶ 7.

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
900 4TH AVE, SUITE 2000
SEATTLE, WA 98164-1012
(206) 464-7744

price.

C. The FCC Line Sharing Order Does Not Mandate a "Zero Price" For The HUNE.

Parties in this case who advocate a zero recurring charge place heavy reliance on the FCC Line Sharing Order. It is true that the FCC concludes that a "straightforward and practical" approach to HUNE pricing, consistent with the requirements of the Telecommunications Act of 1996, is to set the price at no more than the amount of loop costs the ILEC allocated to its ADSL services when the ILEC established its interstate retail rates.[11] The FCC's position is permissive, however, not mandatory. The Line Sharing Order states that "in arbitrations and in setting interim prices, states *may* require that incumbent LECs charge no more to competitive LECs for access to shared local loops that the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services."[12] Moreover, the FCC acknowledges that its TELRIC methodology does not address the pricing of a shared loop.[13] Indeed, the FCC Line Sharing Order expressly contemplates that states might appropriately assign costs to line sharing that would yield a positive price:

> [T]he TELRIC methodology allows states to include in the price of an unbundled network element a reasonable allocation of forward-looking common costs. We anticipate, therefore, that states will set interim or arbitrated prices for line sharing to include forward-looking common costs as well as the directly-attributable costs discussed above. States should assign forward-looking common costs to this new unbundled network element in the same way that they have assigned such costs to other unbundled network elements.[14]

An additional point is that the allocations used by the ILECs when establishing DSL service

---

[11] Line Sharing Order, ¶ 139
[12] Line Sharing Order, ¶ 139 (emphasis added)
[13] Line Sharing Order, ¶ 138
[14] Line Sharing Order, ¶ 152

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
900 4TH AVE, SUITE 2000
SEATTLE, WA 98164-1012
(206) 464-7744

originally were for the purpose of establishing a price floor. Prices are not required to be at the price floor. Finally, the Act requires that rates be just, reasonable, and non-discriminatory. 47 USC § 251(c)(3). Determinations by state commissions of UNE rates must be based on cost (without reference to rate-of-return), be non-discriminatory, and may include a reasonable profit. 47 USC § 252(d)(1). The Commission, therefore, is not precluded by the FCC Line Sharing Order from adopting a positive rate for the HUNE.

III. LINE SHARING

A. The Commission Should Adopt a Positive Rate for the HUNE.

For the reasons set out above, the Commission should set a positive price for the HUNE in Washington. The record in this docket reasonably supports adoption of a price in the range between Staff's recommendation - $0.96 – at the low end, and Qwest's recommendation of 50 percent of the loop cost at the high end of the range.

As Staff points out in testimony, the basic formula under the 1996 Act for the price of a UNE is based on TELRIC plus a reasonable share of common/overhead costs. Line sharing, now designated as a UNE, must be likewise priced in this fashion. As Staff witness Mr. Spinks testified:

> Line sharing has been determined by the FCC to be a UNE and, therefore, like other UNEs is subject to the "TELRIC plus a reasonable share of common/overhead cost" criteria that is required for pricing UNEs. In developing a charge for this UNE, staff notes that the TELRIC for line sharing is zero; the only question is what is a reasonable share of common and overhead cost to use for line sharing.[15]

Even Dr. Cabe, testifying on behalf of CLECs, conceded on cross-examination that

[15] Ex. T-350. Spinks Direct, pp. 12-13.

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
900 4TH AVE, SUITE 2000
SEATTLE, WA 98164-1012
(206) 464-7744

common costs could be allocated to the high-frequency portion of the loop. After agreeing that the FCC had defined the high-frequency portion of the loop as a UNE, Dr. Cabe was asked:

> Q. [Ms. Anderl] Do you also agree that the pricing principles set forth by the FCC allow TELRIC pricing of unbundled network elements to include all of the direct costs of the elements as well as a reasonable allocation of joint and common costs:
>
> A. [Dr. Cabe] Yes, I do.
>
> Q. We've previously defined common costs as costs that are not incremental to any service or group of services in the Company, is that right?
>
> A. That's correct.
>
> Q. So there are common costs that could be allocated to the loop; is that right? I'm sorry, to the HUNE.
>
> A. *You certainly could do that. I wouldn't recommend it, but you could do it.*

(Tr. 1167-1168 (emphasis added)).

The amount of common costs already included in the UNE loop cost by this Commission is $1.91. Staff's recommendation that a positive price for the HUNE, if adopted, be set at 50% of this amount - $0.96 – is a reasonable minimum price. By setting a "positive" price at least at this level, the Commission remains consistent with the principle that the loop is a shared cost and with legal requirements.

At the high end of the range is the Qwest proposal that the price be based on 50% of the loop cost adopted by the Commission. This represents a reasonable alternative approach to setting a positive price. The rate still constitutes a significant discount from the full price of an

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
900 4TH AVE, SUITE 2000
SEATTLE, WA 98164-1012
(206) 464-7744

unbundled loop. In addition, it makes a reasonable contribution to joint and common costs.[16]

Public Counsel recommends that the Commission require the ILECs to implement an appropriate "tracking" account for revenues from the HUNE.

B. Regulators Have The Means To Prevent A Windfall To The ILECs.

Public Counsel agrees with the parties in this proceeding who express concern about the possibility of windfall profits to incumbent LECs if a positive recurring price is adopted. Part and parcel of adopting a positive recurring charge for line sharing must be the recognition by the Commission of the resulting revenues for ratemaking purposes. In general, the expectation would be that rates for basic services would come down to reflect receipt of the contribution to loop costs from lines sharing. The settlement in the U S West/Qwest merger does not appear to preclude the Commission from addressing this issue as to Qwest. First, the agreement approved by the Commission allows either the Commission Staff or Public Counsel to seek rate changes to accomplish revenue-neutral rate rebalancing.[17] Any action taken to adjust rates based on changes in contributions to loop costs would presumably take place in a revenue neutral fashion. The goal would be to avoid a double recovery of loop costs by "rebalancing" new revenues received from the HUNE recurring charge with reductions in basic voice grade services, rather

---

[16] *Cf., Rulemaking on the Commission's Own Motion To Govern Open Access to Bottleneck Services, Investigation on the Commission's Own Motion Into Open Access and Network Architecture Development of Dominant Carrier Network,* Investigation 93-04-002, Decision 00-09-074, Interim Opinion, September 21, 2000, pp. 15-19 (approving positive price based on arbitrator's adoption of 50 percent formula).

[17] *In re Application of U S West, Inc. And Qwest Communications International, Inc. for An Order Disclaiming Jurisdiction, or in the Alternative Approving the U S West, Inc., - Qwest Communications International Merger*, UT 991358, Appendix A, pp. 9-10. The Verizon merger agreement (GTE/Bell Atlantic) has similar language. *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation For An Order Disclaiming Jurisdiction or In the Alternative Approving the GTE Corporation – Bell Atlantic Merger*, UT 981367, Fourth Supplemental Order, Appendix A, p. 6

than to change overall revenue levels. Second, the limitations of the merger agreement only apply through January 1, 2004. If the Commission adopts a positive recurring charge for the HUNE, and establishes a tracking account, the revenues received from that source could be taken into account on a going forward basis in a future rate case.

Some parties have also suggested that because DSL is treated as an interstate service there is no practicable way for an imputation requirement or other pro-competitive conditions to be imposed on ILECs. This argument is not well taken. First, the FCC Line Sharing Order reaffirms that state commissions have the authority to resolve the pricing issues raised by line sharing. As the FCC states:

> Based on the states' role and our mutual commitment to expeditious and broad-based deployment of advanced services we have established in this order uniform, national rules for the unbundling of the high frequency portion of the loop. These rules include the specifiic parameters, set out in section IV.D.1 above, that incumbents and competitive carriers must follow when providing service on a shared loop. We also announce pricing guidelines that we urge states to apply when they arbitrate modifications to interconnection agreements or adopt permanent prices for this unbundled network element….We believe that the rules and guidelines set out in this order are consistent with Congress' vision of the complementary roles for the Commission and the states with respect to access to unbundled network elements under section 251 of the Act and the deployment of advanced services under section 706 of the 1996 Act.[18]

The FCC goes on to note that "states are free to impose additional, pro-competitive requirements consistent with the national framework established in this [Line Sharing] order." [19] The Line Sharing Order specifically acknowledges the need to avoid a price squeeze by means of imputation, i.e., by "requiring incumbent LECs to provide access to the shared local loops for no more than they allocate to their own xDSL services[.]"[20] Moreover, the order goes on to observe

---

[18] Line Sharing Order, ¶ 158
[19] Line Sharing Order, ¶ 159
[20] Line Sharing Order, ¶ 141

with approval the imputation approach of the Minnesota PUC.[21]

While Public Counsel does not endorse the “zero price” approach permitted by the FCC order, the point to be made here, is that the FCC’s Line Sharing Order makes clear that states to have the necessary authority, as a part of their UNE pricing authority under sections 251 and 252 of the Act, to address the price squeeze question. Moreover, to the extent that states lack authority because interstate services are involved, the FCC has the authority to address the question. (Tr.529-530). The end-result is that imposition of imputation appears to be an available remedy under the existing legal framework.

Finally, Section 254(k) expressly requires the FCC, for interstate services, and the states, for intrastate services, to establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services. The powers granted under this section clearly encompass the ability to of state commissions to take necessary actions in order to avoid unreasonable cost allocations.

Public Counsel therefore recommends that the Commission adopt a “tracking” account to track revenues derived from line sharing for the benefit of ratepayers.

V. CONCLUSION

For the foregoing reasons, Public Counsel recommends that the Commission adopt a positive price for the line sharing HUNE. In conjunction with the positive price the Commission should require the ILECs to establish a tracking account to record revenues received from the HUNE.

---

[21] Line Sharing Order, ¶ 139, n. 326.

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
900 4TH AVE, SUITE 2000
SEATTLE, WA 98164-1012
(206) 464-7744

Finally, the Commission should require ILECs to impute to themselves the recurring charge adopted in this docket.

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
900 4TH AVE, SUITE 2000
SEATTLE, WA 98164-1012
(206) 464-7744

DATED this _____ day of October, 2000.

CHRISTINE GREGOIRE
Attorney General of Washington

____
Simon J. ffitch
Assistant Attorney General
Public Counsel