BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Continued Costing and Pricing of Unbundled Network Elements, Transport, Termination, and Resale.	DOCKET NO. UT-003013 OPENING BRIEF OF COMMISSION STAFF *Part A*

I. INTRODUCTION

1 This docket is a continuation of the Commission's generic costing and pricing proceeding that was initiated to derive the cost methodology and establish prices for interconnection, unbundled network elements, transport and termination, and wholesale services. *See In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale*, Docket Nos. UT-960369 et al., Order Instituting Investigations, at 3 (Nov. 20, 1996). The prices established in Docket Nos. UT-960369 et al., and this docket will be used in current and future interconnection agreements that are arbitrated by the Commission pursuant to the Telecommunications Act of 1996 (Act).[1] In Part A of this docket, the Commission will address the pricing of the high frequency spectrum of an unbundled loop (or "UNE loop"), the recovery of OSS start-up costs, and the proper costs and prices for collocation.

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[1]Pub. L. No. 104-104, 110 Stat. 56 (1996), codified at 47 U.S.C. §§ 151 *et seq.*

II. LEGAL AND POLICY ISSUES

A. Policy Issues

2 The purpose of the Act is to "provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition . . . ." H.R. Conf. Rep. No. 104-458, 104th Cong., 2d Sess. 13 (1996). Congress envisioned that the Act's pro-competitive policies would be accomplished, in large part, by requiring incumbent local exchange companies (ILECs), such as Qwest and Verizon, to open their networks to competitive local exchange companies (CLECs). *See* 47 U.S.C. §§ 251-22.

3 In addition to the policy favoring competition in the telecommunications markets, Congress also intended to make advanced telecommunications services available to everyone:

> The [FCC] and each State commission with regulatory jurisdiction over telecommunications services shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans (including, in particular, elementary and secondary schools and classrooms) by utilizing, in a manner consistent with the public interest, convenience, and necessity, price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment.

Pub. L. 104-104, Title VII, § 706(a), 110 Stat. 153 (Feb. 6, 1996). In essence, advanced services use high-speed, switched, broadband capability that allows users to originate and receive high-quality voice, data, graphics, and video telecommunications using any

technology. *See id.* § 706(c)(1).

4 The state of Washington has legislated a policy favoring local telephone competition. RCW 80.36.300. When the Commission acts to promote competition, it does so to effectuate both state and national policy.

5 In fact, prior to the passage of the Act, this Commission began the process of opening local telecommunications markets to competition. In 1995, the Commission entered an order setting forth the terms and conditions under which competitors for local exchange service will interconnect their networks in order to exchange traffic between their customers. *WUTC v. US West Communications, Inc., et al.*, Docket Nos. UT-941464, -941465, -950146, -950265, Fourth Supplemental Order (Oct. 31, 1995).

B. Legal Issues

1. Requirements of the Telecommunications Act of 1996

6 Among the requirements the Act imposes on ILECs are the obligations to provide CLECs with access to unbundled network elements and to permit CLECs to collocate their equipment on the incumbents' premises. 47 U.S.C. § 251(c)(3), (6). State commissions are authorized to set the prices CLECs must pay for access to unbundled network elements and collocation. *Id.* §§ 251(c)(6), 252(d).

7 Prices for unbundled network elements must be cost-based, nondiscriminatory, and may include a reasonable profit. *Id.* § 252(d)(1). Prices for collocation shall be "just, reasonable, and nondiscriminatory." *Id.* § 251(c)(6).

2. Federal Communications Commission Rules and Federal Court

Review of Those Rules

8 Congress delegated to the Federal Communication Commission (FCC) the task of enacting rules to implement the local competition provisions of the Act, with the caveat that the FCC cannot preempt state access and interconnection regulations that are not inconsistent with the Act. *Id.* § 251(d)(1). In response to this mandate, the FCC promulgated rules that, among other requirements, specified which network elements ILECs must make available to CLECs on an unbundled basis and established a cost methodology for state commissions to follow when setting prices under the Act. *See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (August 8, 1996) ("Local Competition Order"), *aff'd in part and vacated in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff'd in part and rev'd in part and remanded sub nom. AT&T Corp. v. Iowa Utils. Bd.* 525 U.S. 366 (1999); *see also* 47 C.F.R. § 51.319.

9 Many parties petitioned for judicial review of the Local Competition Order. The cases were consolidated in the Eighth Circuit Court of Appeals. The Eighth Circuit affirmed in part, and vacated in part, the FCC's rules. *See Iowa Utils. Bd.*, 120 F.3d 753.

• *UNE Access*

10 One of the network elements the FCC required ILECs to unbundle is their operations support systems (OSS) functions. 47 C.F.R. § 31.319(f). On its review of the Local Competition Order, the Eighth Circuit affirmed the specific unbundling requirements set forth in Rule 319, except to the extent that the rule "establishes a

presumption that a network element must be unbundled if it is technically feasible to do so." *Iowa Utils. Bd.*, 120 F.3d at 819 n.39. The Supreme Court, however, vacated Rule 319 in its entirety and remanded to the FCC for limitations on its definition of the words "necessary" and "impair" as they are used to establish the specific unbundling requirements of 47 U.S.C. § 251(d)(2). *AT&T Corp.*, 525 U.S. at 387-92.

11 On remand, the FCC reaffirmed its decision to require that ILECs provide CLECs with access to their OSSs. Therefore, Qwest and Verizon must make their OSSs available to CLECs on an unbundled basis. *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking ("UNE Remand Order"), 15 FCC Rcd 3696, 3884, ¶ 424 (Nov. 5, 1999).

• *UNE Pricing*

12 In establishing the cost methodology state commissions must use to set prices for unbundled network elements, the FCC determined that a "forward-looking" cost methodology would comply with the pro-competitive purpose of the Act. For unbundled network elements, the FCC adopted a version of "total service long run incremental cost" that it called "total element long run incremental cost" or "TELRIC." *See* Local Competition Order, 11 FCC Rcd at 15844-46, 15850-51, 15857, ¶¶ 672-79, 690-93, 704; 47 C.F.R. §§ 51.501-15. The FCC also decided that the forward-looking pricing methodology should be "based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that the reconstructed local network

will employ the most efficient technology for reasonably foreseeable capacity requirements." Local Competition Order, 11 FCC Rcd at 15848-49, ¶ 685; *see also* 47 C.F.R. § 51.505(b)(1).

13 On its review of the Local Competition Order, the Eighth Circuit vacated the pricing rules because it found that the FCC did not have jurisdiction to set the pricing methodology that states must follow. *Iowa Utils. Bd.*, 120 F.3d at 800. The Supreme Court disagreed, holding that the Act authorized the FCC to enact the pricing rules. *AT&T Corp.*, 525 U.S. at 377-85.

14 On remand, the Eighth Circuit affirmed in part, and vacated in part, the FCC's pricing rules. *Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000). The Eighth Circuit affirmed the use of a forward-looking methodology. *Id.* at 751-53. However, the court vacated the rule requiring that the cost be determined based on a "hypothetical," "most efficient" network configuration. *Id.* at 749-51. The court has stayed its vacatur of this rule pending petitions for certiorari to the Supreme Court.

• *Collocation Requirements*

15 The FCC has promulgated rules regarding an ILEC's obligation to permit the collocation of CLEC equipment on the incumbent's premises. 47 C.F.R. § 51.323. These rules were specifically affirmed by the Eighth Circuit on its review of the Local Competition Order. *Iowa Utils. Bd.*, 120 F.3d at 818. The FCC later refined some of its collocation requirements, including its definitions of "necessary," "physical collocation," and "premises," and imposed a requirement that ILECs must permit cageless collocation

in the FCC's advanced services docket. *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 14 FCC Rcd 4761 (1997) ("Advanced Services Order").

16 Like the Local Competition Order, many parties sought judicial review of the Advanced Services Order. The Advanced Services Order was reviewed by the D.C. Circuit. That court expressly affirmed the FCC's requirement for cageless collocation and its decision permitting adjacent collocation. *GTE Service Corp. v. FCC*, 205 F.3d 416, 424-25 (D.C. Cir. 2000). However, the court invalidated the FCC's expanded definition of equipment "necessary" for collocation as equipment that is "used and useful." *See id.* at 422. The court believed the definition was too broad and would permit the collocation of "any and all" CLEC equipment, which was not what Congress had intended. *Id.* at 423-25. The court also vacated the requirement that CLECs may collocate their equipment in any unused space on the ILECs premises. *Id.* at 426 (vacating requirement set forth in Advanced Services Order, ¶ 42).

• *Collocation Pricing*

17 In the Local Competition Order, the FCC held that the standard for setting prices for collocation should be the same as the pricing standards for interconnection and unbundled network elements. Local Competition Order, 11 FCC Rcd at 15816, ¶ 629. The Act provides that prices for collocation be "just, reasonable, and nondiscriminatory," 47 U.S.C. § 251(c)(6), which is the same standard for setting the prices of interconnection and access to unbundled network elements. 47 U.S.C. § 252(d)(1). Because

interconnection is required in order for CLECs to interconnect or access UNEs, it makes sense that the pricing standards be similar.

18 In the Advanced Services Order the FCC concluded that ILECs must allocate space preparation, security measures, and other collocation charges on a pro-rated basis. Advanced Services Order, 14 FCC Rcd at 4789, ¶ 51. This approach will ensure that the first CLEC to collocate on an ILEC's premises does not bear the entire site preparation costs. *Id.* The FCC authorized state commissions to determine the price methodology for allocating site preparation costs among CLECs. *Id.*

• *Line Sharing Rules*

19 The FCC has determined that the high-frequency spectrum of the loop is an unbundled network element to which ILECs must provide CLECs access. *In the Matters of Deployment of Wireline Service Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 20912, 20926, ¶ 25 (1999) ("Line Sharing Order").

20 In the Line Sharing Order, the FCC noted that there is no longer any dispute that two-carrier line sharing is technically feasible. *Id.* at 20942-43, ¶ 63. The FCC also recognized that while an ILEC's OSSs may need to be modified to accommodate line sharing, such modifications would not require a major undertaking. *Id.* at 20958-62, ¶¶ 97-108.

• *Line Sharing Pricing*

21 The high-frequency spectrum of the loop is a UNE, therefore the price must be based on cost, 47 U.S.C. § 252(d)(1), and comply with the FCC's TELRIC methodology. The FCC established guidelines for state commissions to follow when setting the price for line sharing. Line Sharing Order, 14 FCC Rcd at 20973-91, ¶¶ 131-57.

22 In the Line Sharing Order, the FCC authorized state commissions to price line sharing at "no more . . . than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services." *Id.* at 20975, ¶ 139.

III. LINE SHARING

A. Price of the High-Frequency Spectrum of Loop

23 In this docket, Qwest has proposed a price of $9.08 for sharing an unbundled loop, which is 50 percent of the unbundled loop rate ordered by the Commission. Ex. T-15, at 7. For several reasons, the Commission should reject this proposed price and set the charge for sharing an unbundled loop at zero, or in the alternative, at a price not to exceed $0.96 per line.

24 It is not proper to charge 50 percent of the unbundled loop price for line sharing because many services are provided over the loop and contribute to the cost recovery of the loop. Ex. T-350, at 11 (Spinks, Direct). *See, e.g.*, *WUTC v. US West Communications, Inc.*, Docket No. UT-950200, 15th Supp. Order: Commission Decision and Order Rejecting Tariff Revisions; Requiring Refiling, at 83-84 (April 11, 1996).

When Qwest filed its proposed tariff for MegaBit service in the state of Washington, the Staff had asked the company why the loop costs were not included in the cost support for MegaBit. Ex. T-350, at 12. The company stated that the cost of the loop already was being recovered in the rates for other services. *Id.* Competitors should not be required to pay a charge for the high frequency spectrum of the loop when Qwest charges itself nothing. *Id.*; *see also* Ex. T-190, at 10-14 (Cabe, Direct); Ex. T-182, at 5-6 (Klick, Direct) ("Qwest's proposal would impose a direct (or incremental) cost on the CLECs, even though the ILECs incur no comparable direct or incremental loop cost to provide the HUNE element *or* to provide competing xDSL services over their own loops.") (italics in original).

25 If the Commission decides to set a positive price for the high-frequency spectrum of the loop, that price should not exceed $0.96 per shared loop. This price reflects the common costs that ILECs are allowed to recover when providing access to unbundled network elements. Ex. T-350, at 12-13.

26 The only common cost to consider in setting a price for the high-frequency spectrum of the loop is the common cost associated with the UNE loop. In splitting the high-frequency spectrum from the UNE loop, the CLEC or DLEC will use only the high-frequency spectrum of the loop, it is not purchasing the entire loop. There are no recurring costs associated with the access to the high frequency spectrum of the loop, therefore, the only common costs are those attributable to the UNE loop. *Id.* at 13

27 Because the cost of line sharing is zero, and the only applicable common cost is the common cost of the UNE loop, Qwest should be entitled to recover only one-half the common cost of the UNE loop, if anything. The amount of common cost in the UNE loop is $1.91. *Id.* at 14 and n.9. Therefore, if the Commission decides to set a positive price for the high-frequency spectrum of the loop, the maximum price should be $0.96.

28 Line sharing is a form of sub-loop unbundling.[2] Staff witness Thomas Spinks explained this concept on the record:

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> Sub-loop unbundling is generally thought of in terms of providing access to only the portion of the loop that would be needed by the CLEC given some caveats regarding the feasibility of access. So the framework for discussing unbundling the loop has encompassed using points of access such as the feeder/distribution interface or the drop. The analogy would be to taking a straw and cutting a piece off – maybe at the halfway point or maybe closer to the end – depending on how much you need. Line sharing is like taking the straw and slicing it down the length of the straw. So long as access is feasible, and it is, line sharing is simply a different way of splitting the loop and is a form of sub-loop unbundling. However, unlike costing for other forms of sub-loop unbundling which can rely on relative amounts of investment for each portion of the loop being unbundled, line sharing uses one portion of the loop bandwidth without avoiding the cost of the other portions.

Ex. T-350, at 14-15.

30 The FCC has held that in order to gain access to subloops, competitors are not required to pay for the entire portion of the loop. UNE Remand Order, 15 FCC Rcd at 3791-92, ¶ 212. Likewise, a CLEC should not be required to pay an arbitrarily derived

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[2] "Subloops" are "portions of the loop that can be accessed at terminals in the incumbent's outside plant." UNE Remand Order, 15 FCC Rcd at 3833-34, ¶ 2076. One of the points of access is the main distribution frame in the ILEC's central office. *Id.*

price for access to the high-frequency spectrum of the loop, as Qwest is proposing in this docket. Qwest's proposed price and pricing methodology for the high-frequency spectrum of the loop is excessive and will result in a CLEC paying for a portion of the loop that it will not use.

31 ILECs should not be permitted to charge a positive price for the high frequency spectrum of the loop without making a corresponding reduction in the price of the UNE loop. Any other policy would allow the ILECs to double recover a portion of the UNE loop cost. Ex. T-350, at 11-12.

32 If the ILECs are allowed to impose a charge for line sharing, the Commission should require them to make a corresponding reduction in the retail price of the UNE loop. As set forth in paragraph 49, the merger settlements with Verizon and Qwest do not preclude revenue-neutral rate rebalancing.

33 The Commission should not permit ILECs to include a separate OSS cost recovery charge for line sharing orders. Any allowable OSS costs ILECs incur for line sharing should be added to the total OSS costs incurred by the ILECs and recovered along with the other costs. Ex. T-350, at 15.

IV. OSS COST RECOVERY

A. Sufficiency and Accuracy of OSS Cost Estimates

34 Operational Support Systems (OSS) are the systems, databases, and personnel that an ILEC uses to provision plant, process service orders, manage service connections, disconnections, moves and changes, and track network maintenance. *See In the Matter of*

the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale, Docket Nos. UT-960369 et al., 17th Supp. Order: Interim Order Determining Prices, ¶ 83 (Aug. 30, 1999). OSS is an unbundled network element that ILECs must provide to CLECs.

35 In the 17th Supplemental Order, the Commission determined that Qwest and Verizon are entitled to recover their OSS start-up costs from CLECs. *Id.* at 100-02. However, the Commission also held that neither Qwest nor Verizon had provided adequate documentation of their OSS costs. *Id.* ¶¶ 107-109, 484. The Commission also ordered the ILECs to demonstrate whether their OSS costs have been recovered through their retail rates. *Id.* ¶ 110.

36 Qwest seeks to recover $121.8 million in OSS start-up expenses and $23.5 million of start-up capital. Ex. T-90, at 3 (Million, Direct). Qwest proposes to recover its OSS start-up costs from CLECs through per order service charges. *Id.* at 5. Specifically, Qwest intended to charge $9.58 per order for electronic ordering (EDI) and $14.19 per order for manual ordering (IMA). *Id.* Qwest also proposed an ongoing charge of $1.76 for IMA orders and $2.02 for EDI orders to recover the costs for ongoing maintenance and operation activities associated with its electronic interfaces. *Id.* at 3, 5.[3] The

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[3]In its response to Record Request No. 16, Qwest reran its OSS start-up study using 1999 actual expenses, rather than estimated expenses. Qwest also used a "corrected" cost of money. Ex. 803. From that exercise, Qwest derived an electronic ordering charge of $9.58 and a manual ordering charge of $14.19. This change does not, however, alleviate Staff's concerns over the total amount of OSS start-up costs Qwest seeks to recover or its method of recovery.

Commission Staff disagrees with the amount Qwest seeks to recover, its cost recovery mechanisms, and the application of the ongoing maintenance and operation charges on a service order basis.

37 The amount of OSS start-up costs Qwest intends to recover is excessive. In determining the amount of costs it should recover, Qwest improperly relied on *estimates* of its 1999 expenses, rather than on *actual* 1999 expenses. Ex. 93. The estimated 1999 expense factor for Account 6724 was $979.8 million. However, Qwest's 1999 ARMIS report shows that the company actually booked $623 million to that account in 1999. Ex. T-350, at 3. The company contends that certain software expenses that would have been included in Account 6724 were not reported to that account due to the implementation of Software SOP 98-1, but the company never provided any documentation or breakdown of what it claims to be its actual 1999 OSS expenses. Ex. T-95, at 4-5 (Million, Rebuttal) Therefore, the Commission should not accept Qwest's assertion that it needs to recover $121.8 million in OSS start-up costs.

38 In addition to relying on estimates of 1999 expenses, Qwest's cost study is flawed because the company included certain costs that it claimed were directly attributable to OSS. Ex. 91, Att. A., at 10-17; Ex. T-350, at 3. The categories for these "directly attributable" costs are business fees, product management costs, administrative costs, and attributed costs. These costs significantly increase the amount of claimed expense to be recovered and Staff believes it is improper for the company to include these costs in a

one-time start-up charge. Attributable costs are applicable to the development of non-recurring and recurring costs in cost studies.

39 In testimony, Qwest stated that the Commission already has approved the inclusion of attributable costs in cost studies. Ex. T-95, at 5 (citing *In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale*, Docket Nos. UT-960369 et al., 25th Supp. Order: Order Accepting, Rejecting and Authorizing Refiling of Compliance Filings, ¶ 126 (May 19, 2000)). However, the Commission's ruling addressed the inclusion of these costs in cost studies that were used to determine the direct costs of unbundled network elements, which would be recovered through non-recurring and recurring charges. The determination of the cost of a one-time expense does not require a cost study. For this reason, the Commission Staff does not believe that the Commission ruling in paragraph 126 of the 25th Supplemental Order applies to the one-time expenses of modifying the OSS to provide access to competitors.

40 Qwest also overstates its investment related expense calculations by using a capital recovery factor in its cost study rather than the depreciation rate. During the hearing, the Commission Staff asked the company to provide the source for the capital recovery rate in the cost study. Tr. at 799. Qwest's response to that request shows that the company increased the computer Account 2124 forward-looking depreciation rate of

16.5 percent[4] by applying an equal life group (ELG) weighting to the depreciation calculation and including various expense factors in developing a capital recovery rate. Ex. 804 (Response to Record Req. No. 17). Staff is not aware of any method by which the service life of an asset can be changed due to the use of ELG. The ELG method can result only in a change to the remaining life of an asset. Further, on cross-examination Ms. Million agreed that all costs associated with the purchase and installation of the computer equipment already were included in the amounts capitalized in Account 2124, except for the time value of money. Tr. at 786. The improper capital recovery calculation results in over recovery of Qwest's investment.

41 Another flaw in Qwest's cost recovery proposal is that the company relied on an unverifiable forecast of the number of service orders it expects to process. *See* Ex. 91, Att. B, at 19; *see also* Ex. C-903 (Response to Bench Req. No. 3). The Commission should reject Qwest's service order forecast. In addition, considering that Qwest currently has around 14 million access lines, and that at least two service orders will be generated for each access line switched to a CLEC, the forecast of service orders indicates that either the company does not expect to lose much market share over the next six years or it has seriously underestimated the number of service orders. Staff believes the latter to be the case. If the Commission wishes to use forecasted service orders for Qwest and

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[4]The forward looking depreciation rate is calculated as 1 plus or minus future net salvage divided by the life. (1-.05)/5.8 = 16.5.

Verizon OSS cost recovery calculations, it should look to either other RBOCs' post 271 service order experience or to the market share experience of AT&T from 1984 to 1990.

42 Qwest proposes to establish a maintenance and operations charge for CLECs that would be applied on a per-service order basis. Ex. T-90. Staff objects to a charge on a per-service order basis because the level of operation and maintenance expenses would not appear to depend on the level of service order activity and the company provided no evidence to the contrary. Staff also notes that operation and maintenance expenses normally are included in prices for retail services. At minimum, before any charge is permitted, Qwest should demonstrate that the charges are not already included in the attributable cost factor or elsewhere in UNE prices.

43 Verizon, is seeking to recover about $1.9 million in OSS start-up costs.[5] Verizon proposes a per order charge of $4.28 to recover its costs. Staff believes that Verizon's charge would be reasonable.[6] However, as set forth below, Staff believes both Qwest and Verizon are recovering their OSS transition costs in their retail rates.

44 Commission Staff believes an audit of the ILECs' OSS start-up cost recovery may now be appropriate. The Commission directed each company to provide a trend analysis of its Account 6724 expenses in order to provide an assessment of the reasonableness of

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[5]Staff notes that Verizon is requesting interim recovery of certain OSS costs in Dockets UT-960369, et al., which apparently were not submitted in this case.

[6]Commission Staff notes, however, that in a compliance filing dated September 18, 2000, Verizon has included an approximately $20.00 per order charge to recover its OSS start-up costs. The Commission Staff believes the $20.00 charge to be excessive and anticompetitive.

OSS amounts requested for recovery. Staff attempted to improve on Qwest's trend analysis by better identifying the expenses but the company did not provide the requested information in a timely manner. Ex. C-352, Ex. C-353. As a result, Staff was unable to provide any confirmation or assessment of the reasonableness of the claimed OSS expense levels. In addition, Staff was unable to determine the extent to which the OSS expenditures benefitted the ILECs as well as the CLECs. *See, e.g.*, Ex. 122.

45 The OSS start-up costs are costs the ILECs incur to update and modify their respective OSSs to allow competitors access. While the Commission has determined that the ILECs are entitled to recover these costs, Staff is concerned that if these costs are not properly determined, or recovered, they will be a barrier to entry. By proposing to recover their OSS start-up costs in high per service order charges, the ILECs, in effect, are imposing a "competitive surcharge" on competitors. Therefore, the Commission should be vigilant in its oversight and an audit of the costs and level of recovery would appear to be necessary at this time.

B. Appropriate Cost Recovery Mechanism

46 Although the Commission decided that the ILECs are entitled to recover their OSS start-up costs from CLECs, the Commission was very clear that if the ILECs have already recovered those costs in their retail rates, they must refund the revenue to retail ratepayers. 17th Supp. Order, ¶ 110. Because the Commission Staff believes that the ILECs currently are recovering their OSS start-up costs, we recommend a retail rate adjustment as set forth below.

47 In their direct testimony, both Qwest and Verizon took the position that they are not recovering their OSS start-up costs in their retail rates because neither company has had a rate case before the Commission since 1997 and 1985, respectively. *See* Ex. T-350 at 7; *see also* Ex. T-90, at 13-14; Ex. T-320, at 8 (Tanimura, Direct). Both companies argue that because their respective retail rates were established before the OSS start-up costs were incurred, the companies are not recovering those costs in retail rates. The Commission should reject the companies' arguments.

48 First, the ILECs' simple analysis is insufficient to "defend" their positions. While a recent rate case may be one way to determine whether the companies are recovering their OSS start-up costs, it certainly is not the only way. If an ILEC currently is meeting or exceeding its authorized rate of return, then its revenues are growing faster than its expenses. Both Verizon's and Qwest's revenue growth have resulted in earnings levels in excess of their authorized rates of return. Ex. 350, at 8-9. Therefore, that additional revenue growth is sufficient to permit recovery of OSS start-up costs. *Id.* at 8.

49 The Commission should not allow the ILECs to double recover the OSS start-up costs. Because the Commission already has held that the CLECs, not retail customers, should pay the start-up costs, Verizon and Qwest must reduce their retail rates or refund to retail customers the amount of OSS start-up costs they recover from the ILECs.

50 Under the ILECs' recent merger settlements, the Commission agreed not to initiate or support complaints against the companies' retail rates. *See 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 Corporation Merger, *et al.*, Docket Nos. UT-981367 *et al.*, Fourth Supp. Order Approving and Adopting Settlement Agreement, Granting Application, Subject to Conditions, at 22-23 (Dec. 16, 1999) (Verizon Merger Order); *In Re Application of US West, Inc. and Qwest Communications International, Inc. for an Order Disclaiming Jurisdiction, or in the Alternative, Approving the US West, Inc. - Qwest Communications International, Inc. Merger*, Docket No. UT-991358, Ninth Supp. Order Approving and Adopting Settlements and Granting Application, ¶ 34 (June 19, 2000) (Qwest Merger Order). However, the merger agreements do not preclude the Commission from accomplishing revenue-neutral rate rebalancing. Verizon Merger Order, at 23; Qwest Merger Order, ¶ 34. A decrease in retail rates for a period of time, or a rebate to retail customers, in order to correct the double recovery of OSS start-up costs would be revenue-neutral. Therefore, such a requirement would not violate the merger agreements.

51 The Commission should permit Qwest and Verizon to recover only the OSS start-up costs that are attributable to Washington state. It would be improper for the ILECs to recover costs attributable to activity in other states for activity in Washington. One of the Commission's goals in this proceeding is to bring competitive choice to Washington citizens. This goal cannot be realized if ILECs are able to set the prices CLECs must pay in excess of their Washington-specific costs.

52 In the 17th Supplemental Order, the Commission held that the OSS rates are interim rates until both Qwest and Verizon provide adequate documentation of their

transition costs. 17th Supp. Order, ¶ 107. The Commission further held that the companies must track the revenues they collect through their OSS rates in order to implement a true-up of OSS rates, and that they file a description of their tracking methods. *In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale*, Docket Nos. UT-960369 et al., 25th Supp. Order: Order Accepting, Rejecting, and Authorizing Refiling of Compliance Filings, ¶ 87 (May 19, 2000). Allowing the ILECs to recover only Washington-specific costs will make it easier for the Commission to track and audit the ILECs' recovery of their OSS start-up costs. *See* Ex. T-350, at 6.

53 As set forth above, a per service order charge for OSS start-up cost recovery could be a barrier to entry if that charge is too high. Therefore, if the Commission decides to permit the ILECs to recover these costs up-front, Staff recommends that this charge not be in excess of $5.00 per transaction. If the Commission agrees with this approach, it can audit the amount collected by the ILECs and order them to discontinue the charge when they have fully recovered their Commission-authorized start-up costs. Ex. T-350, at 6-7.

VI. COLLOCATION

A. Qwest Cost and Pricing Proposal

2. Space Construction

54 The Commission Staff's primary concern with Qwest's proposed collocation charges is that they are not based on Washington-specific information. In its proposal, Qwest studied collocation jobs from 41 central offices throughout its 14 state region. The

purpose of this proceeding is to determine the prices competitors will pay to enter local markets in the state of Washington. Therefore, Qwest's engineering costs should be recalculated using collocation jobs from Washington state.

b. DC Power

55 The Commission should not adopt Qwest's collocation cost study because the company does not properly estimate the costs it will incur for DC power supply. Qwest relied on the power costs for five central offices in its 14 state territory. Two of the central offices in that five-office study are in Washington. Ex. T-360, at 8 (Griffith, Direct); *see also* Ex. C-32, at 17. One of the central offices in the five-office study is located in Crystal, Minnesota, and that office required cable lengths of over 300 feet. Ex. C-32, at 30; *see also* Ex. T-360, at 8; Ex. T-151, at 18-19 (Knowles, Response). By including this job in its cost study, Qwest inflates the cost of collocation in Washington central offices.

56 While the overstatement of the cable lengths itself increases the cost of collocation, this is not the only problem. Power losses in cable will increase with the length of cable. Ex. T-360, at 8. Longer cable runs, therefore, require a larger size or gauge of copper. *Id.* This also increases the cost of the cable necessary for collocated equipment. *Id.*

57 A final concern with Qwest's power proposal is that the company assumes higher costs for power for caged collocation than for cageless collocation. *Id*. at 9; *see also* Ex. 12, at 4-5. Qwest uses two different designs for power for caged collocation, one for

60 amps or less, and another for more than 60 amps. In the lower capacity design, Qwest assumes longer cable runs (and higher costs) to the battery distribution frame board (BDFB) than for cageless collocation. Ex. C-15, at 126, ll.28-29. For the higher capacity design, Qwest does not use a BDFB, but instead runs cables back to the central office main power board. This design uses significantly longer cables and larger gauge cables. Ex. T-360, at 9; Ex. C-15, at 126, l.30.

58 The Commission should reject Qwest's collocation cost study because it is not Washington-specific. The Commission should order Qwest to submit a collocation cost study with data that is specific to Washington state. In the revised collocation cost study, Qwest should use a cable design that runs cables between the BDFB and the competitors' collocated equipment for both caged and cageless collocation.

B. Verizon Cost and Pricing Proposals

59 Commission Staff believes that Verizon's collocation prices must be based on Washington-specific costs. Competitors in Washington should not be asked to pay prices that do not accurately reflect the cost of providing service in Washington.

4. DC Power

60 Commission Staff recommends that the Commission reject Verizon's power cost proposal because it is based on data that is not verifiable. For example, Verizon estimates a single labor rate of 15 minutes per foot for placement of the power cable. In contrast, RS Means uses different labor rates depending on the size of cable being placed. The amount of time required for installing larger cable is longer than the amount of time

required for installing smaller cable. Therefore, the amount of time required for the largest cable (750 kcmils), is about three times as long as the labor rate required for the smallest sized cable (4/0).

61 In contrast to Verizon, Qwest uses variable labor rates in its cost study where the labor cost for 750 kcmil cable is also about three times the labor cost of 4/0 cable. *See* Ex. C-15, at 126, cells 50F-53F. Verizon acknowledges that the time required to place cable varies with size and length of the power cable being placed. Ex. T-293, at 10 (Richter, Rebuttal).

62 Staff also is concerned that Verizon overstates its costs for cable pulls. Verizon assumes two cable pulls equaling 246 feet for every 40 amps of power. Ex. T-360, at 10 and n.10. In Verizon's response to Staff's record request, Verizon lists power jobs that were used to develop its cost study, but placed in states other than Washington. Ex. 806 (Response to Record Req. No. 20). This exhibit shows some instances where only four cables (cable pulls) were required for jobs needing 400 amps of power. *Id.* Therefore, Verizon's cost model results in a CLEC being charged for 20 cables (cable pulls) when the CLEC orders 400 amps, overstating the cost by as much as a factor of five. If the Commission does not require Verizon to rerun its cost study, and provide to the Commission verifiable data, then the Staff recommends that Verizon be required to use an average of three to five minutes per foot for installation of power cable. *Id.*

VI. CONCLUSION

63 Commission Staff has addressed several concerns with the ILECs' cost recovery proposals in this docket. The Commission should adopt Staff's recommendations as set forth above and in its testimony and exhibits in this docket.

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