BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale ..... In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale for U S WEST COMMUNICATIONS, INC. ..... In the matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale for GTE NORTHWEST INCORPORATED _____	**PHASE II** DOCKET NOS. UT-960369, UT-960370, UT-960371

U S WEST'S CLOSING BRIEF

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I. INTRODUCTION

U S WEST Communications, Inc. (U S WEST) hereby submits its closing brief in this generic costing and pricing proceeding.

The Commission in this case has the opportunity and the obligation to complete the work which was begun as a result of the passage of the Telecommunications Act of 1996. The work that remains to be done is the establishment of proper prices to ensure that U S WEST and other incumbent LECs recover the costs they will incur as a result of the mandates of the Act. These costs include the costs for providing access to unbundled network elements (UNEs), including access to U S WEST's operational support systems, the costs U S WEST incurs for providing collocation, and other costs associated with provisioning wholesale services in a multi-provider environment, including costs for nonrecurring activities.

The Commission's proper resolution of the disputes in this case is essential to encourage investment in telecommunications infrastructure and to promote true competitive choices for consumers. The key to the development of economically efficient and rational competitive entry is the development and implementation of cost-based rates for the core elements of interconnection and the basic UNEs identified in the arbitrations and in Phase I of this docket.

This is really a benchmark setting proceeding, to establish prices for basic rate elements that will lend certainty to the process for both the new entrants and the incumbents. As has been discussed during various stages of this proceeding, the goal in Phase II is not to establish terms and conditions for interconnection and access to UNEs – that function has already been performed in the arbitrations and the results have been memorialized in the interconnection agreements.[1] Nor

[1] U S WEST notes that the Commission has already determined that it will not consider terms and conditions in this phase of this proceeding. 14th Supplemental Order at ¶ 75.

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should this pricing process be delayed or hindered by the fact that certain wholesale offerings have changed, or that new ways of provisioning service have been implemented. For example, the SPOT frame has been discussed in this proceeding, but no costs or prices proposed, because the SPOT frame was not a provisioning proposal at the beginning of this proceeding. U S WEST has attempted to keep changes to its basic price list at a minimum, to avoid drawing the proceeding out any longer than is needed. What is necessary at this point is to get the basic prices established for the core elements – the loop, switching, transport, number portability, etc. Once these are determined, the parties should be able to focus on the business of competition.

This docket was opened in November 1996. Hearings were held in 1997, resulting in a cost order in April 1998 which resolved many issues, and left many others unresolved. U S WEST appreciates, and has been an advocate of, the position that the determinations in this docket should not be done hurriedly if that meant sacrificing quality. U S WEST believes that the conduct of the proceedings has shown an appreciation of that advocacy, and commends the Commission and the parties in their willingness to "take the time to do it right." That notwithstanding, the time has come now to make determinations which will give the parties the certainty they need in the market, and U S WEST encourages the Commission to proceed with all due speed to a final order in this case.

II. LEGAL PRINCIPLES

The costing and pricing decisions in this case must comply with both federal and state law, including the Telecommunications Act of 1996 (the Act), the FCC's First Report and Order (CC Docket No. 96-98, First Report and Order, FCC 96-325 [rel. Aug. 8, 1996]) (hereinafter First Report and Order) to the extent the order has been or will be upheld on appeal, the Supreme

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Court's January 25, 1999[2] decision, and applicable constitutional provisions.

A. Federal Law

The governing federal law applicable to this proceeding is set forth in various places, including the Act, the applicable FCC rules and orders, certain decisions from the Federal District Court for the Western District of Washington, the Eighth Circuit's decisions,[3] to the extent not reversed by the Supreme Court, and the Supreme Court decision referenced above. Most of these provisions of law are set forth and discussed in more detail in the sections of the brief below where they are particularly applicable. For example, the FCC's 1997 order on physical collocation is discussed in Section VII. Only a brief discussion of the controlling principles is set forth in this introductory section.

The Telecommunications Act of 1996 is the law controlling the various arbitration proceedings for interconnection, collocation, unbundled elements and resale. This proceeding is essentially conducted under the State's authority to set prices for interconnection, collocation, unbundled elements and resale in the arbitrations. The pricing decisions which will result from this case must therefore comply with the applicable cost and pricing standards set forth in the Act.

Unbundled Elements and Interconnection – Just and reasonable rates for interconnection and network elements are to be based on the cost of providing the network element or interconnection. The cost is to be determined without reference to a rate-of-return or other rate-based proceeding. The charges may include a reasonable profit. 47 U.S.C. § 252(d)(1)(A).

Transport and Termination – Charges for transport and termination of traffic are to be on a

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[2] AT&T Corp. v. Iowa Util. Bd., No. 97-826, Slip op. (U.S. Jan. 25, 1999) 1999 U.S. LEXIS 903. Pursuant to the Commission's January 27, 1999 notice, U S WEST is also submitting a separate brief on the impact of that decision on this docket.

[3] Iowa Util. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997) and Southwestern Bell Tel. Co. v. FCC, 153 F.3d 597 (8th Cir. 1998).

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reciprocal compensation basis. 47 U.S.C. § 251(b)(5). The terms and conditions for reciprocal compensation are to be just and reasonable. Just and reasonable terms and conditions allow each carrier to recover the costs associated with the transport and termination of calls that originate on another carrier's network. § 252(d)(2)(A). The terms and conditions must determine the costs on the basis of a reasonable approximation of the additional costs of terminating such calls.

Wholesale Discount – The pricing standard for establishing a wholesale discount pursuant to the Act is contained in Section 252(d)(3), as follows: "[f]or the purposes of section 251(c)(4), a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier."

Although the Supreme Court upheld the FCC's jurisdiction to establish pricing methodologies for state commissions to apply in arbitrations under the Act, this Commission still has the role of establishing costs and prices under the Act. Thus, this proceeding remains the proper forum for determining U S WEST's costs and prices for UNEs, interconnection, and collocation.

The decision in this case must be consistent with the mandate of the Act, to establish costs as a basis for prices without reference to a rate-of-return or other rate-based proceeding, 47 U.S.C. § 252(d)(1)(A)(i), and to allow incumbent local exchange carriers (LECs) to recover the costs they incur in the provisioning of interconnection and unbundled elements.

U S WEST is entitled to be paid at rates that exceed its actual costs of production. As the Eighth Circuit observed, "[under] the Act, an incumbent LEC will *recoup the costs* involved in providing interconnection and unbundled access from the competing carriers making these

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requests."[4] (Emphasis added). The clear Congressional and judicial recognition of the right to be fairly compensated may not be interpreted as a right of new entrants to use the facilities and services of U S WEST at rates equal to unrealistic, incremental costs that cannot be achieved in the real world. Thus, U S WEST strongly believes that prices must be reasonable, and must bear a rational relationship to U S WEST's other prices, including a fair and equitable contribution to the common costs of the company.

U S WEST believes that, in addition to the Act, the following provisions are particularly relevant to the considerations in this case:

As set forth in detail in U S WEST's accompanying brief on the impact of the Supreme Court's decision on this proceeding, the Supreme Court vacated the FCC Rule – 47 C.F.R. § 51.319 – that established the network elements ILECs must unbundle. U S WEST contends that the Commission should establish prices for the elements in Rule 319, including operational support systems and shared transport, and conduct further proceedings to address any change in the elements U S WEST must unbundle after the FCC conducts proceedings in accordance with the Supreme Court's decision.

Physical Collocation has also been addressed by the FCC, although not strictly under the terms and conditions of the Act, but rather in its tariff review process regarding previously mandated and filed interstate collocation tariffs for expanded interconnection for special access and switched transport. The relevance and applicability of this decision is discussed in Section VII. below.

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[4] Iowa Utilities Board v. FCC, 120 F.3d 753 (8th Cir. 1997), aff'd in part, rev'd in part, AT&T Corp. v. Iowa Utils Bd., 1998 U.S. LEXIS (U.S. Jan. 25, 1999). This basic principle, which is consistent with constitutional prohibitions against taking property without just compensation, does not appear to have been affected by the Supreme Court decision.

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The FCC's decision regarding the interstate nature of GTE's DSL service is particularly compelling as it pertains to the issue of reciprocal compensation for calls to Internet service providers. The FCC has stated that ISP traffic is interstate in nature. Memorandum Opinion and Order, In the Matter of GTE Telephone Operating Cos.; GTOC Tariff No. 1; GTOC Transmittal No. 1148, CC Docket No. 98-79, FCC 98-292, 1998 FCC LEXIS 5594 (rel. Oct. 30, 1998). Since ISP traffic is "interstate," reciprocal compensation arrangements for exchange of "local" traffic are inapplicable.

Finally, a number of Commission-approved arbitrated interconnection agreements have been reviewed by the Federal District Court for the Western District of Washington. Relevant decisions in those actions are presently on appeal to the 9th Circuit Court of Appeals. Some issues are affected by the Supreme Court decision. Other issues decided by the court that are relevant to this proceeding are reciprocal compensation for ISP traffic (required in the MFS case), and shared transport (held that ILECs must offer shared transport in the MCI case).

B. State Law

In the Eighth Supplemental Order, paragraph 4, the Commission stated that "This proceeding is conducted essentially under our statutory authority to set prices for interconnection, collocation, unbundled network elements, and resale." The general authority on rates under state law is RCW 80.36.080 and RCW 80.36.140. The former requires that rates of telecommunications companies be "fair, just, reasonable and sufficient." The latter authorizes the Commission to set rates that are "just and reasonable."

Cases have construed this law as including the requirement that rates be nonconfiscatory, i.e., that in the aggregate they permit a utility a reasonable opportunity to earn a fair return on the value of the property invested to provide service. State ex rel. Dept. of Pub. Serv. v. Pacific Tel. &

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Tel. Co., 19 Wn.2d 200, 142 P.2d 498 (1943). Washington state courts have not addressed the issue of the setting of rates using TELRIC as a cost basis, or what amount above the cost base is necessary to produce fair, just, reasonable and sufficient rates for individual elements. However, U S WEST has presented compelling evidence that the prices it proposes are fair, just and reasonable. The question remains, because the ordered costs are so far below U S WEST's TELRIC, whether the rates are indeed sufficient.

C. Prior Commission Rulings

The Commission has entered a number of orders in this docket which are relevant to the determinations and outcomes in Phase II. To the extent that U S WEST believes that a prior order is determinative, or otherwise addresses an issue, that order is cited in the text of the brief. However, it may be useful to summarize here some of the main issues decided in the prior orders.

Aside from specific cost determinations, the Commission discusses and decides a number of basic principles in the 8th Supplemental Order. For example, the Commission has clearly said that the TELRIC costs established in the 8th Supplemental Order are the price floors for network elements. (¶ 491). This holding addresses one of the questions raised in the Issues List[5], and leaves no doubt that all of the direct costs identified in a TELRIC calculation must be included in the price of the element. Further, because TELRIC cost should include attributable and appropriate amounts of common costs, that total must be the threshold for price determinations. U S WEST re-ran its cost analyses using the Commission's required cost-of-money and depreciation lives, as required by the 8th Supplemental Order, to determine an appropriate cost basis for price determinations. The Commission should provide for recovery of direct costs in all

[5] ***Issue V.4 (Policy)****: To what extent should the Commission provide for recovery of Direct Costs through UNE prices?*

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cases, as there is no basis in law or economics to deny recovery of direct costs in the prices for UNE elements.

Specific cost determinations regarding interconnection and unbundled elements have already been made (for U S WEST) as follows: the baseline cost for the loop is established in the 14th Supplemental Order, paragraph 14; the costs for transport elements are established in the 14th Supplemental Order, paragraphs 30, 32, and 47; the costs for distance sensitive transport elements are to be calculated using U S WEST's transport model, per the 8th Supplemental Order at paragraph 440, and the 9th Supplemental Order at paragraphs 30 and 44; the cost for local switching (both the port and the per minute element) was established in the 8th Supplemental Order at paragraph 320 and the cost for tandem switching was established in the 9th Supplemental Order at paragraph 36; entrance facilities are to be priced based on U S WEST's cost estimate, per the 14th Supplemental Order at paragraph 30; costs for the common channel signaling elements (except the per port charge) were established in the 14th Supplemental Order at paragraphs 59 and 60; the costs for interim local number portability were established in the 8th Supplemental Order at paragraph 436; and the costs for operator services were established in the 9th Supplemental Order at paragraph 41.

It is from these cost determinations that the Commission should proceed to establish prices (as set forth in exhibit 699) that allow U S WEST to recover its costs for interconnection and access to unbundled network elements. Pricing decisions as set forth in Section V. below, which include appropriate levels of attributed and common costs, as well as a reasonable markup, will accomplish that goal and will result in fair and lawful prices.

III. POLICY ISSUES/PURPOSE OF THE PROCEEDING

The purpose of this proceeding is as set forth in the introduction – to establish wholesale

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prices for interconnection, UNEs, and resold retail services. The policy goal, as set forth in the Act and echoed by various courts and regulatory bodies since then, is to encourage competition. The Commission should not, however, read this as a mandate to reach decisions which ensure the success of particular competitors. The success of competition does not mean that every competitor that enters the business should be successful, or be granted some special dispensation from the risks of the marketplace. In fact, the very hallmark of competition is that some firms succeed and others fail.

Thus, the Commission should take care to ensure that its decisions do not artificially distort the market, and do not encourage uneconomic entry by setting wholesale prices too low. To do so would harm all carriers, and ultimately all consumers. The new entrants would be harmed because they would have built their business plans on artificially low prices that do not represent the true costs of doing business. The incumbents would be harmed by not being permitted to recover their costs. Consumers would also be harmed. While some customers would benefit by paying artificially low prices from CLECs that are not paying the true cost of providing service, consumers who choose to stay with the incumbent would be forced to subsidize the CLEC's customer by paying, in rates, costs the incumbent incurred for the benefit of the CLEC.

Thus, U S WEST has made rational pricing proposals in this docket to promote competition in the telecommunications industry, without favor to any particular company. U S WEST's pricing proposals are based on TELRIC cost and equal percentage markups to cover the remaining costs common to the entire company. This equal percentage markup follows the FCC's First Report and Order, ¶ 696.

The Commission will read, in the briefs of the other parties, that U S WEST has not proposed a markup over TELRIC in any other state, and that such a markup should not be ordered

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in Washington. Nextlink and AT&T offered as exhibits U S WEST's pricing proposals in other states, such as Utah and Wyoming, which did not reflect a markup over TELRIC. U S WEST first notes that it would happily accept in Washington the TELRIC calculations from Wyoming and Utah, which do not reflect the significant cost minimizing impact of unsupported models such as Hatfield, and that include full recovery of shared and common cost. That point notwithstanding, U S WEST further notes that the markup it proposes is tied to the level of recovery above Commission-prescribed direct costs that other services provide. U S WEST has advocated that the proper direct cost calculations are in fact much higher than the Commission-ordered costs in this docket. Thus, U S WEST's proposed markup is neither arbitrary nor unreasonable, but is rationally tied to the level of contribution provided by other customers.

Finally, the Commission should not be dissuaded from ordering proper prices, including a markup, by other parties' arguments that this type of pricing would be counter to section 252(d)(1)(A)(i) of the Act. This is the provision which requires that prices be "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element." The Commission should recognize that "based on cost" is not the same as "set at direct cost." Prices in this proceeding will be based on the TELRIC cost of providing the interconnection or UNE, which TELRIC will have been established without reference to a rate-based proceeding. The final price should be determined based on that direct cost, with a markup to ensure the recovery of the costs common to the entire firm. This pricing will result in just and reasonable rates as mandated by section 252(d)(1).

IV. COST ISSUES (RELATED TO PHASE I)

In Phase I of this proceeding, the Commission made a number of cost decisions, and left some cost issues to be resolved in this phase of the proceeding. To the extent not expressly

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addressed in other sections of the brief, those remaining cost issues are discussed here.

A. 4-Wire Loop Costs

The cost of the 4-wire loop is a carry-over issue from Phase I of this proceeding. U S WEST and GTE presented evidence on this issue in Phase I, and the Commission, in paragraphs 189 through 195 of the 8th Supplemental Order, determined that the cost for a 4-wire loop was 125% of the cost of a 2-wire loop. U S WEST requested reconsideration of this determination. On reconsideration, the Commission agreed that the 125% represented only the incremental difference in materials between the 4-wire and the 2-wire loops, and not the full TELRIC of the 4-wire loop (9th Supplemental Order at ¶ 13). In paragraph 22 of that same order, the Commission noted that it was not making a determination on the proper price differential between a 2-wire and a 4-wire loop.

In response to the Commission's 9th Supplemental Order, paragraph 20, U S WEST filed an explanation and cost study results "demonstrating the result of running the four-wire loop cost study using more reasonable data for '257C' investment." U S WEST calculated a 4-wire loop cost, based on the 2-wire loop cost analysis, assuming double the copper investment, but holding the 257C digital loop carrier (DLC) investment constant. The analysis produced a result showing the investment for a 4-wire loop to be 182% of a 2-wire loop. U S WEST noted that if the DLC investments were 30% higher for 4-wire than for 2-wire, as suggested in GTE's cost study, the weighted average investment would be 187% of a 2-wire loop.

U S WEST further noted that it disagreed with the Commission's conclusion, at paragraph 20, that it is an unreasonable assumption that the 4-wire, "257C" investment is twice as expensive as the capital required for a 2-wire loop. U S WEST pointed out that the DLC estimate is complicated by the impact that a 4-wire circuit has on the capacity of the system and the cost of

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the channel units, resulting in a system with a higher total cost that produces fewer circuits. If all of these considerations are included in the 4-wire loop cost calculation, the result is over 200% of the 2-wire loop cost.

After U S WEST's filing, in response to the 9th Supplemental Order, the Commission entered its 10th Supplemental Order, rejecting TRACER's request that the Commission rely on its original cost determinations in the 8th Supplemental Order, and requiring U S WEST to provide additional information regarding investments and costs related to the 2-wire and 4-wire loops. U S WEST did so on August 5, 1998. That filing explained that the original (using RLCAP version 3.5) *cost* relationship between the 2-wire and the 4-wire loop was 182.7%, based on holding the demultiplexing investment constant while doubling the loop and MDF investments. The later calculation (using RLCAP version 4.0) of loop *investment* relationships shows that investment for the 4-wire loop is 181.8% of the investment for the 2-wire loop. The relationship is coincidental only.

Pursuant to paragraph 24 of the 10th Supplemental Order, U S WEST also produced a cost and investment calculation assuming that the DLC investment would be 30% higher for the 4-wire loop. The result is that the investment for the 4-wire loop is 195% that of the 2-wire loop, and the cost for the 4-wire loop is 194% that of the 2-wire loop.

In spite of all of this explanation, and in disregard of the Commission's rulings on this issue, TRACER persisted in its advocacy that the cost of the 4-wire loop should be determined as an incremental cost to the 2-wire loop. As noted above, and in U S WEST's motion to strike portions of Dr. Zepp's testimony, this is counter to the Commission's rulings in both the 9th and 10th Supplemental Orders (paragraphs 13 and 26 respectively). U S WEST urges the Commission to again reject TRACER's attempt to produce an incremental cost calculation for the 4-wire loop,

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as opposed to a TELRIC calculation.

U S WEST explained that consistent with the Commission's requirements in the 9th Supplemental Order at paragraph 14, U S WEST's 4-wire loop costs assume that each pair has been assigned an equal portion of the structure costs. This means that for all copper loops, the cost for placement, materials, and structure would be exactly double, resulting in a cost for the 4-wire loop that is twice that of the 2-wire loop. Since the majority of loops in the cost model are copper loops, the cost result for the 4-wire loop, by definition, must be greater than 150% of the 2-wire loop. (Ex. 540 at 4).

TRACER's insistence on pursing this issue is also puzzling in light of the fact that the Hatfield model does not produce a cost for a 4-wire loop (8th Supplemental Order at ¶ 192). No sponsor of the Hatfield model has taken issue with this finding. In fact, TRACER has belatedly attempted to introduce piece-part results of the newer version of the Hatfield model, HAI 5.0a, through Dr. Zepp's testimony. (Ex. 547). This is clearly improper, as that version of the model was never introduced into evidence in this case, and the Commission declined to adopt it in the proceeding in which it was introduced, Docket No. UT-980311(a). Furthermore, Dr. Zepp did not even perform the modifications to HAI 5.0a and did not perform the runs of the model to produce the results he reported in his testimony. (Tr. 728-9). Thus, there is no way in this proceeding to explore the validity of this adjustment, and there can be no reliance on Dr. Zepp's testimony regarding the proper cost for the 4-wire loop.

The Commission has already rejected an attempt to rely on HAI 5.0a for other purposes in this proceeding. AT&T/MCI attempted to use 5.0a for a deferred taxes calculation. The Commission noted that AT&T/MCI relied upon a version of the model that was not filed in this docket, and testimony that was given in a different docket (10th Supplemental Order at ¶¶ 11 and

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12). In the 14th Supplemental Order, the Commission properly rejected a deferred taxes adjustment based on HAI 5.0a (¶¶ 2-8). The Commission should similarly reject this attempt to rely on HAI 5.0a to establish a cost for the 4-wire loop.

The Commission should also reject TRACER's attempt, on rebuttal, to misconstrue the record and assert, contrary to the evidence, that Hatfield and RLCAP model loops and not pairs. (See, e.g., Ex. 549 at 14). To the extent that this testimony thus suggests that either model includes 4-wire loops in the unit count of loops, this testimony is misleading at best, and at worst is flatly wrong. It is true that the proxy models at issue in this proceeding model the cost of loops, but what is also true, and what is most important to the discussion here, is that in each of the models, the loops are *always assumed to be 2-wire pairs*. (Tr. 646, 725, and 753).

In addition, TRACER's assertion in this docket that each loop should bear the same amount of placement cost, regardless of whether it is a 2-wire or a 4-wire loop, is contrary to both the Commission's prior rulings in this docket, and to Dr. Zepp's own testimony in the universal service proceeding in September 1998. In that docket, Dr. Zepp contended that there is no difference in the cost of the first line to a location and the cost of all other lines to that location. Dr. Zepp agreed in this case with that contention (Tr. 751). Thus, each line (i.e., each *pair*) must bear the same amount of placement cost, consistent with the Commission's 9th Supplemental Order, paragraph 17.

In conclusion, U S WEST has shown that the cost of the 4-wire loop is at least 182% of the cost of the 2-wire loop, and may be higher than that, depending on the assumptions regarding investment. With regard to the pricing of the 4-wire loop, the price should be twice that of the 2-wire loop, to avoid arbitrage of the 4-wire loop price to provide two separate lines. Such arbitrage is possible because a 4-wire all-copper loop is nothing more than two 2-wire loops. A

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purchaser of such a loop could easily use it to provide two lines. Thus, the pricing should mirror the price for two 2-wire loops, to make the purchaser indifferent to such arbitrage opportunities.

B. Avoided Cost Discount for OS/DA

U S WEST and Staff filed testimony regarding the proper discount calculation for operator services and directory assistance (Exs. 509-511). The discount on these services, according to U S WEST's formula of dividing avoided cost by total cost, is 6.9%. According to the formula adopted in Phase I of dividing avoided cost by total revenue, it is 7.97%. No party disputes these calculations. Staff supports the Phase I formula, with which U S WEST disagrees. Ms. Gude sets forth the rationale for dividing by total cost instead of total revenue at pages 10 through 12 of exhibit 509. The primary reason is that revenues are more volatile than costs and therefore produce a less reliable discount calculation. For example, if U S WEST loses revenues to competition, such loss would produce a higher discount, but would not necessarily be coupled with a different level of costs or avoided costs. Thus, the discount would be artificially and improperly inflated. The Commission should determine that the avoided cost/total cost calculation is acceptable for these reasons, and should establish the discount on these services at 6.9%.

C. NRC Studies/Compliance with Commission's Orders

The Commission asked the parties to specifically address the issue of whether U S WEST's nonrecurring cost studies comply with the Commission's prior orders in this docket.[6] U S WEST filed testimony on this issue describing the ordered changes to its UNE nonrecurring cost studies and establishing compliance with all of the Commission's requirements.

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[6] ***Issue XII-1 (Factual):*** *Do the UNE nonrecurring cost studies which U S WEST filed on May 18, and revised on June 19, 1998, and GTE filed on May 19, and revised on June 5, 1998, comply with the Commission's Eighth and Ninth Supplemental Orders? (Issues List served on July 10, 1998)*

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U S WEST's nonrecurring cost studies are fully compliant with the Commission's orders. These orders require U S WEST to revise all of its nonrecurring cost studies to be consistent with the principles stated by the Commission regarding the required adjustments to the unbundled loop (LIS-LINK) nonrecurring cost study (8th Supplemental Order at ¶ 474). The Commission required that the unbundled loop nonrecurring costs be recalculated with the following adjustments:

reduce ISC order processing work time on the initial order from 45 minutes to 6 minutes,

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reduce the probability that a link order will require manual plant line assignment from 45% to 15%,

modify the disconnection segment of the study to reflect 6 minutes of ISC, 2 minutes of central office frame, and 3 minutes for removal of jumper,

remove common costs (common cost recovery is to be decided in Phase II).

U S WEST has filed studies consistent with the Commission's recalculation of the basic unbundled loop nonrecurring cost (including disconnection costs, but without attributed and common costs) at $41.73. Attributed and common costs of $10.21 (8.19 attributed + $2.02 common) bring the total cost (and price) to $51.94. U S WEST discusses its pricing philosophy, and explains why it does not propose an additional markup for nonrecurring costs, in Section V. below.

In accordance with the 8th Supplemental Order, at paragraph 474, U S WEST adjusted its other nonrecurring studies in a manner consistent with the Commission's directives on the unbundled loop study. Exhibit MSR-3 (Ex. C-538) is a summary of the adjustments made to U S WEST's nonrecurring cost studies as directed by the Order. No party challenged this analysis, or the conclusions that U S WEST's nonrecurring cost studies had been properly modified as ordered.

Staff undertook an independent review and analysis of the compliance filing, and deemed the studies to fully comply with the 8th Supplemental Order (Ex. C-656 at 8). No other party presented any valid criticism of U S WEST's nonrecurring cost studies, or established that they failed to comply with the ordered requirements. Only AT&T challenged the studies, and the testimony of Ms. Starr on that issue is simply a series of allegations without proof. For example,

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Ms. Starr suggests that U S WEST's nonrecurring cost studies continue to overstate cost because they continue "to rely on manual processes" (Ex. 637 at 11). Yet Ms. Starr acknowledged that U S WEST had, in fact, reduced its order processing time from 45 to 6 minutes in accordance with the Commission's order. That reduction reflects significant efficiencies that have yet to be achieved.[7] Ms. Starr complained that AT&T did not want to pay for manual processes, but did not know whether AT&T had its side of the electronic interface built, and did not know whether AT&T could pass orders electronically at this point or not. (Tr. 1539-40).

Further, AT&T's criticism about the use of "manual processes" ignores the Commission's 8th Supplemental Order at paragraph 482, which states clearly that the cost findings in the order do not yet reflect the transactional efficiencies that may be achieved through computer links between ILEC and CLEC systems. U S WEST has committed, and the Commission has approved, that studies will be revised to reflect these efficiencies when the systems are in operation. Thus, AT&T's criticism is premature at best, and, absent any evidence that AT&T has its side of the interface in operation, is directly contrary to the Commission's prior orders in this case.

In addition, it is questionable whether Ms. Starr's testimony can be given any weight at all, in light of the fact that she does not appear qualified to testify on the subject of pricing policy and decisions. Ms. Starr testified that she was an expert on the subject, and stated that the Commission decisions in this case should mirror what happens in a competitive market. (Tr. 1522). However, she then went on to acknowledge that she had not analyzed the pricing behavior of AT&T in the competitive interLATA toll market (Tr. 1530) or any other firm operating in a competitive market

[7] U S WEST did petition for reconsideration on the issue of 6 minutes versus 45 minutes. U S WEST is disappointed that reconsideration was not granted on this point, but has revised its studies accordingly. Consistent with what U S WEST stated in that petition, U S WEST continues to believe that 45 minutes is correct – thus, the Commission-ordered reduction represents a more than seven-fold increase in efficiency.

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(Tr. 1532). Thus, it is difficult to accept AT&T's advocacy on these issues as anything more than conclusory, self-serving statements which provide no substantive support for AT&T's position.

The Commission has asked the parties to address the issue of whether the Commission should facilitate competitive entry by requiring ILECs to recover nonrecurring UNE costs on a recurring basis.[8] U S WEST disagrees with recovery of nonrecurring UNE costs on a recurring basis. Costs should be recovered in the same manner in which they are incurred. When U S WEST performs a one-time activity associated with interconnection or UNEs, U S WEST incurs an up-front cost which it is entitled to recover. Recovery delayed may be recovery denied, if cost recovery is allowed only on a recurring charge basis. For example, if U S WEST incurs $1,000 in nonrecurring costs, and is required to recover those costs through recurring charges that extend recovery over a period of two years, U S WEST only recovers those costs if the element or function is purchased for the full two-year period. If the CLEC discontinues service after only a year, U S WEST recovers only 50% of its nonrecurring costs. Thus, this outcome is not pro-competitive, as it sends distorted cost and pricing signals to CLECs about the true cost of market entry.

U S WEST does not believe that any party has seriously proposed that nonrecurring costs be recovered through recurring charges, except insofar as AT&T (and others) have proposed that the loop unloading cost be recovered through recurring charges for the loop. This issue is discussed in that particular section of the brief, below. Suffice it to say here that AT&T attempts, incorrectly, to identify loop unloading charges as "outside plant investment" and thus summarily concludes that such investments are always recovered in recurring charges, such as the monthly

[8] See, *Issues List* of July 10,1998 Issue XII-2.

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recurring charge for the loop. The fallacy of this argument is that loop unloading is not "outside plant investment." It is, in fact, the very activity that AT&T identifies as a nonrecurring event, the costs for which should be recovered in a nonrecurring charge. AT&T agrees that certain costs are properly recovered through nonrecurring charges, specifically, costs associated with one-time activities. (Tr. 1552). Loop unloading, by definition, only ever happens once per loop. The costs are properly recovered through a nonrecurring charge.

Other issues concerning nonrecurring charges associated with turning up additional channels on a transport facility were raised in the Issues List,[9] but were not addressed by any party other than U S WEST. In response to this specific concern, U S WEST notes that it has not filed nonrecurring costs associated with changing configurations or turning up additional channels once a transport facility is in place. However, U S WEST maintains that it is entitled recovery of such costs should the situation arise, just as it is entitled to recovery of other nonrecurring costs.

D. Customer Transfer Charge (CTC) Cost Calculation[10]

U S WEST's CTC is a cost-based nonrecurring charge to recover costs associated with the transfer of U S WEST retail customers to resellers. U S WEST's Phase I CTC cost analysis contained two distinct components: the loaded labor costs associated with processing the order and an amortized recovery of the cost of system changes necessary to process reseller orders through U S WEST's operating support systems. U S WEST filed cost studies in support of the CTC (Ex.

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[9] ***Issue XII-3 (Policy):*** *To what extent should an ILEC recover the costs of "turning up" additional channels once a transport facility is in place?* ***Issue XII-4 (Policy)****: To the extent the Commission resolves Issue XII-3 by requiring or allowing cost recovery, what is the best cost recovery mechanism?*

[10] This section addresses the customer transfer charge issue, and specifically addresses the two issues on this subject identified in the July 10, 1998 *Issues List*, as follows: ***Issue XIV-1 (Factual):*** *Are U S WEST's and GTE's resale customer transfer cost estimates reasonable?* ***Issue XIV-2 (Policy):*** *Should the Commission allow ILECs to recover customer transfer costs through a nonrecurring charge?* U S WEST answers both of these questions in the affirmative.

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C-541). No party challenged the cost calculation for the CTC.

After Staff filed its testimony on this issue, U S WEST concurred with Staff's recommendation for a new rate structure for the CTC, eliminating the distinction between business and residence customers and adding separate CTCs for private line and frame relay. However, U S WEST continues to dispute Staff's proposed adjustments to exclude the system cost and to

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reduce the order processing time. As Mr. Reynolds testified, the time estimates are based on actual representations of the individuals managing the ordering and implementation activities and should not be arbitrarily reduced. (Ex. 540 at 16). Further, Staff's proposed reductions are not based on an analysis or study of what the proper estimates should be. Thus, there is no basis in the record to support such reductions, which, if ordered, would be arbitrary and without rationale.

On October 27, 1998, U S WEST filed with the Commission a revised cost study supporting the customer transfer charge cost calculation corrections described by Mr. Reynolds in his testimony on October 17, 1998. These corrections support the recommendations of Staff regarding the proper costs and rate design for the customer transfer charge. (Ex. 658).

E. Loop Conditioning[11]

Loop conditioning is a nonrecurring activity consisting of loop unloading (removal of load coils) and/or bridged tap removal. Both activities require the dispatch of a truck and a technician, and it is these costs which are reflected in the cost study for this activity. Loop conditioning is necessary to make loops digitally capable, and is therefore a specific mandate of the Act and the FCC's rules, which require that loops be digitally capable. For the most part, it is only copper loops longer than 18,000 feet which will require unloading. Loops are typically loaded in 25-pair binder groups, and have load coils or bridged taps to enable or enhance voice-grade communications on long copper loops. Thus, not all loops in a particular binder group will require unloading, nor permit it if analog voice telephony is to continue to be provided on those loops.

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[11] This section discusses the issues defined in the Issues List, as follows: ***Issue V.11 (Policy):*** *To what extent should the Commission provide for recovery of "conditioning" (i.e., removal of load coils and bridge taps)?* ***Issue V.12 (Methodology):*** *If the Commission resolves Issue V.11 by providing for cost recovery, what is the most appropriate cost recovery mechanism?* As described herein, U S WEST believes that the Commission's 8th Supplemental Order has already addressed these questions, and that U S WEST's pricing proposal is in complete conformance with the Commission's conclusions.

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The Commission has already decided that the costs of loop unloading are real costs which should be recovered from the CLEC requesting the activity. (8th Supplemental Order at ¶ 155). U S WEST agrees with the Commission's order that loop conditioning costs are incurred to satisfy the requirements of a particular end user and that it is appropriate to recover those costs from the cost-causer. As set forth in exhibit 535, U S WEST's loop conditioning costs have been recalculated with the following adjustments:

reduce technician work time at splice locations from 160 to 120 minutes,

reduce plant engineering design time from 3 hours to 60 minutes,

remove common costs (common cost recovery is to be decided in Phase II),

change study assumption of bridged tap removal at 3 locations to 1 location.

In conformance with the provisions of the 8th Supplemental Order, U S WEST recalculated the cost of the loop conditioning element intended to remove load coils at a TELRIC cost of $292.28. This is the cost for removing load coils for a 25-pair binder group, regardless of the number of loops to be unloaded. This cost does not include common costs, and is for removal of load coils only. In accordance with the Order, U S WEST has separately calculated the cost of bridged tap removal at a single location to be a TELRIC cost of $141.63. The removal of bridged tap will be a separate cost and rate element that will apply when only bridged tap is required to be removed. In situations where both load coils and bridged tap are to be removed for the same job, only the load coil nonrecurring charge will apply.

U S WEST proposes nonrecurring charges for load coil removal and bridged tap removal of $304.12 and $147.34, respectively. These rates are based on direct and attributed costs plus common costs of $11.84 and $5.74, respectively. U S WEST revised its NRC study for loop conditioning in accordance with the Commission's prior order. U S WEST's pricing proposal

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conforms with the Commission's directives and recovers the cost from the total number of loops (in a particular binder group) which require unloading.

Finally, U S WEST disputes the contention that the costs of loop unloading are already recovered in U S WEST's maintenance factor. (Ex. 637). U S WEST addressed this issue through the testimony of Mr. Reynolds (Ex. 540). This testimony establishes that the only unloading activity recovered in the maintenance factor is the historic unloading activity that would have taken place in isolated instances in the single-provider, non-digital network. (Ex. 540 at 9). The loop unloading costs in U S WEST's nonrecurring cost study identify activities in addition to the historic levels of activity. They are therefore not covered by the maintenance factor and are correctly recovered in a separate charge.

F. <u>Unbundling Costs</u>

For the most part, U S WEST understands this issue to be one regarding GTE's proposals. However, U S WEST has addressed the costs associated with loop unloading in response to the Commission's directive, at paragraph 461 of the 8th Supplemental Order, to address the issue of cost causation and cost recovery with respect to the costs associated with unbundling and providing access to unbundled network elements.

U S WEST's network was engineered and built to achieve the greatest efficiencies of an integrated system. It is a fact that there will be costs associated with unbundling this integrated network. In accordance with the Act, and state and federal regulations to implement the Act, U S WEST has prepared its network and operations to allow for interconnection with competitors' networks; for competitors to resell U S WEST's retail services and for competitors to access unbundled network elements. It is clear that U S WEST is obligated to make a minimum number of unbundled network elements available to its competitors. It is also clear that different

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competitors will require different UNEs.

U S WEST is required under the current state of the law to ensure that competitors are able to recombine any and all UNEs of their choosing. Accordingly, U S WEST has established an efficient, cost-effective means of allowing competitors access to unbundled network elements in order to combine them into bundled services. This is accomplished through single point of termination (SPOT) frames that allow CLECs access to UNEs and allow CLECs the ability to combine UNEs. U S WEST has determined that the SPOT concept is the most cost-effective and efficient means of allowing access to UNEs throughout its network as it establishes a single point of provisioning for both the CLEC and U S WEST.

U S WEST believes that, in accordance with the Act, it is entitled to recover all reasonable costs associated with preparing its network and operations to allow for competitive access to its unbundled network elements, interconnection with competitors' networks, and the resale of its retail services by competitors. To the extent that CLECs want to purchase fully bundled integrated services, they can resell retail services at a wholesale discount.

V. PRICING ISSUES

In the 8th Supplemental Order, the Commission held that it will set rates in Phase II of this proceeding. The Commission discussed the importance of making correct pricing decisions as follows:

> Setting economically efficient prices will provide the right signal to competitive local exchange carriers (CLECs). Most importantly, it will help them in making their decision either to construct their own network or to lease facilities from the incumbent local exchange carrier (ILEC). If the price of an unbundled network element is set too high, a CLEC may build facilities when society's scarce resources would be better employed if it had rented facilities from the ILEC. On the other hand, if the price of unbundled network elements is set too low, a CLEC may rent facilities from an ILEC

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> rather than build. This would reduce society's well-being, because the least cost supplier is not the one who is building and maintaining the network facilities.

8th Supplemental Order at ¶ 12.

U S WEST agrees with the Commission that prices for unbundled network elements should foster economic behavior. Essentially, U S WEST's UNE pricing methodology attempts to establish UNE rates that provide an equitable contribution to the common costs of the network and also provide an opportunity for CLECs to rebundle UNEs and compete under the price umbrella established by U S WEST's retail services. (Ex. 540 at 12).

This methodology is also consistent with the pricing advocacy of Staff as described by Dr. Blackmon, who testifies that ". . . all customers – those who obtain service via unbundled elements, those who obtain service via resold service, and those who obtain service via retail service – should be required to contribute similarly to the overhead and return of the incumbent. That policy will promote fairness among customers, fair competition among local exchange companies, and efficient incentives to invest for all companies." Dr. Blackmon concludes that " . . . incumbent local exchange companies be given considerable flexibility, at least initially, in setting the individual element prices within the range established by the individual element floors and the all-element ceiling." (Ex. 553 at 4-5).

In Exhibit MSR-1 (Ex. C-536, revised 08/05/98), using UNE costs established in Phase I of this proceeding and current retail rates and average revenues, U S WEST determined the weighted average contribution for business and residence exchange services, including average feature, toll and access revenues. U S WEST selected a conservative markup between the "all element" ceiling (based on the discounted rate levels for resold services) and the UNE price floors which allowed CLECs the ability to recover costs associated with collocation and UNE

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interconnection and also earn a profit on their services. U S WEST applied its markup equally to all UNE recurring elements, to ensure full recovery of attributed and common costs. (Ex. 699). U S WEST did not apply a markup to nonrecurring rate elements because of specific directives by the Commission in its 8th Supplemental Order regarding reductions in nonrecurring cost calculations.

With respect to the issue regarding whether "markups" should be applied on an equal percentage basis or allowed to vary by UNE,[12] U S WEST supports an equal percentage markup. As Mr. Reynolds points out, ". . . because of the relatively nascent stage of the interconnection/UNE elements, no meaningful wholesale market data (i.e., measures of elasticity of demand) exists." (Ex. 535 at 4). Accordingly, without market data to differentiate UNE margins, an equal percentage markup represents the fairest, most reasonable alternative method of pricing.

In response to several of the Issues List Questions[13] regarding compliance with the Federal Telecommunications Act, U S WEST believes that its UNE pricing advocacy is totally consistent with the broad pricing prescription of the Act, at Section 252(d)(1):

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

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[12] ***Issue V.10*** *(Policy): To the extent the Commission decides to provide for recovery of more than the direct cost of UNE's, should the Commission adopt a uniform mark-up or a percentage that varies by UNE?*

[13] ***Issue V.1*** *(Legal): Does the 96 Act require the Commission to provide for recovery of all of an ILEC's "actual costs" through UNE prices?*

Issue V.5 *(Legal): If the answer to Issue V.1 is no, does the 96 Act require the Commission to provide for recovery of all of an ILEC's common costs through UNE prices?*

Issue V.6 *(Policy): If the answer to Issue V.5 is no, to what extent should the Commission provide for recovery of common costs?*

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> (A) shall be---
> (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and
> (ii) nondiscriminatory, and
> (B) may include a reasonable profit.

Clearly, there is nothing in the Act which limits this Commission's authority to develop an integrated pricing plan that ensures that all users of the network, including CLECs, contribute equitably to common costs. Although the Act and the FCC rules explicitly specify that UNE rates be based on cost, they provide no guidance with respect to any specific type (i.e., direct, attributable, or common) of cost recovery. This determination is obviously left to the State Commission in the context of dockets such as this one.

U S WEST is entitled to recover all of its costs (including direct, attributable and common costs), associated with the provision of interconnection and UNE elements and submits that the appropriate mechanism for such recovery is the rate associated with those activities that cause the cost to be incurred. It is a basic tenet of TSLRIC and TELRIC cost methodology that the costs be recovered from the cost causers. In fact, to do otherwise either results in insufficient cost recovery, or the requirement that the cost burden be borne by ratepayers other than the cost causers. Both of these alternatives are inconsistent with this Commission's past actions with respect to costing and pricing determinations.

A. Recovery of Attributed and Common Costs

U S WEST properly applied attributed and common cost factors to the UNE cost findings in the 8th Supplemental Order. Section 252(d)(1) of the Act requires that rates for interconnection and network elements be based on the cost of providing the interconnection or network element. In response to Bench Request 101 (Ex. C-701), U S WEST provided a detailed analysis of how its

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factors are developed. This response demonstrated the proper application of those factors to the appropriate investment and expense data associated with network elements. Also, the testimony of Ed Freye, in Phase I of this proceeding, provided information about how U S WEST develops and applies its various cost factors.

Specifically, with respect to the application of U S WEST's attributed cost factor of 19.62%, the FCC stated that "[A] properly conducted TELRIC methodology will attribute costs to specific elements to the greatest possible extent, which will reduce common costs." (First Report and Order, ¶ 695). The attributed factor reflects those attributed costs. Another validation of U S WEST's attributed costs is the fact that many of the costs represented by U S WEST's attributed factor are actually included as direct costs in the Hatfield model. These include engineering (account 6535), network administration (account 6532), and plant operation administration (account 6534) costs.

U S WEST's common cost factor of 4.05% is based on costs associated with legal expense, office equipment, computers, and information management. Although not specifically identifiable with any one particular service, these are valid costs of doing business which require equitable contributions from all services, including UNEs, to ensure adequate and nondiscriminatory cost recovery.[14]

U S WEST consistently applied its attributed and common factors to all unbundled element recurring and nonrecurring direct costs, with the exception of several elements for which the Commission specified costs in one of various cost orders in this proceeding. This is a correct application of the factors because the costs for all the elements, recurring and nonrecurring, are

[14] ***Issue V.6*** *(Policy): If the answer to Issue V.5 is no, to what extent should the Commission provide for recovery of common costs?*

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included in the denominator in the factor development. The specific amounts of attributed and common costs added to each element are easily identifiable on Exhibit 699.

One additional issue with respect to the recovery of attributed and common costs is U S WEST's response to whether the Commission Staff's use of a 20% common overhead factor, in conjunction with its Hatfield Model cost estimates, is appropriate.[15] First, it should be noted that U S WEST only uses Staff's Hatfield common overhead factor on the Hatfield portion of those elements for which the Commission used Hatfield Model results in their ordered costs. Specifically, the attributed and common loadings for those elements are detailed below and include the Unbundled Loop, Tandem Switching, Tandem Switched Transport, and Signaling Per Query elements. U S WEST utilized Staff's Hatfield common overhead estimate instead of AT&T's for several reasons.

U S WEST disagrees with AT&T/MCI that the Hatfield Model's 10.4% common overhead factor, originally based on a common overhead factor for AT&T, is at all representative of U S WEST common overheads. The 10.4% factor is artificially depressed by inclusion of access-charge related revenues in the denominator of the formula. Access charges that AT&T pays, and the revenues that cover those charges, are essentially a pass-through item. If those revenues are removed, as U S WEST believes they should be, the 10.4% figure would increase to 15-16% (Tr. 183). Thus, even the actual AT&T overhead figure is closer to Staff's proposed 20%. U S WEST also wanted to use a factor that had been introduced on the record and used by a Hatfield Model proponent. (Tr. 659-663).

For certain elements for which the Commission ordered specific costs, U S WEST made

[15] ***Issue V.8*** *(Factual/Policy):To what extent is Staff's 20% mark-up for attributed costs appropriate.*

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specific determinations and calculations, on an element-by-element basis, regarding the appropriate attributed and common cost factors. These specific calculations were necessitated by the fact that for some elements the Commission ordered costs based on the results of multiple models and for other elements the Commission simply applied no attributed or common cost factors. A review of the specific calculations made by U S WEST for the affected elements follows. All of these calculations are also footnoted in Exhibit 699.

Unbundled Loop - The Commission based its cost for the unbundled loop on three separate loop cost estimates from the Hatfield Model, the RLCAP Model, and the BCPM Model. Based on the 8th Supplemental Order at paragraph 256, data from Appendix A of the 8th Order, and a review of the expenses included in the Commission run of BCPM (also see U S WEST's response to Bench Request No. 104), U S WEST determined that the Commission's ordered loop cost of $17.00 (later revised to $16.25) for U S WEST, did not include common overheads in the Hatfield Model estimate, application of U S WEST's common cost factor for the RLCAP estimate, nor inclusion of certain attributable and common costs in the BCPM estimate.

In order to determine the proper factor to be applied to the Commission's estimate, U S WEST calculated a simple average of the common cost factors from the three respective models. U S WEST averaged the 20% Hatfield common overhead factor endorsed by Staff, the 4.05% common cost factor sponsored by U S WEST, and a common overhead factor of 21.73% for BCPM to arrive at an average common factor of 14.86% ((20.00 + 4.05 + 21.73) / 3 = 14.86). This calculation was slightly modified to 15.18% when the Commission changed U S WEST's unbundled loop cost from $17.00 to $16.25. Ultimately, U S WEST's proposed $22.08 unbundled loop price is based on the $16.25 Commission ordered unbundled loop cost, a $2.47 attributed and common cost additive, and a $3.51 markup which is described further in the next section.

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Unbundled Port and Switching - The Commission ordered costs of $1.29/port and $0.00115/mou for the 2-Wire Analog End Office Line Port and Local Switching UNE rate elements, respectively. (8th Supplemental Order at ¶ 320). The Commission calculated these costs by applying an annual charge factor of 22.95% to investment estimates that were based on a gross switching/port investment per working line estimate of $150.00. (8th Supplemental Order at ¶ 312). The 22.95% annual charge factor does not account for attributed and common costs. Accordingly, and consistent with the development of costs for the other UNEs, U S WEST applied its attributed and common cost factors to the Commission-ordered costs in order to determine its base for pricing.

Tandem Switching and Tandem Switched Local Transport - The Commission ordered a cost of $0.001304 for the U S WEST Tandem Switching element (9th Supplemental Order at ¶ 36) and a cost of $0.000256 for the U S WEST Tandem Switched Local Transport element. (14th Supplemental Order at ¶ 47). As explained by the Commission, both costs were based on averages of each respective element's costs from U S WEST and Hatfield cost model runs. Neither common costs nor common overheads were added to the U S WEST and Hatfield estimates to arrive at the Commission's cost. Accordingly, U S WEST averaged the 20% Hatfield common overhead factor endorsed by Staff and the 4.05% common cost factor sponsored by U S WEST to arrived at an average common factor of 12.025% ((20.00 + 4.05) / 2 = 12.025%). Ultimately, U S WEST's $.00172 Tandem Switching price is based on the $0.001304 Commission Tandem Switching cost, a $0.00016 average common cost additive, and a $0.00026 markup which is described further in the next section. Likewise, U S WEST's $.00034 Tandem Switched Transport price is based on the $0.000256 Commission Tandem Switching cost, a $0.00003 average common cost additive, and a $0.00005 markup which is described further in the next

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section.

Signaling - Per Query - The Commission ordered a Signaling Per Query cost of $0.00131. (14th Supplemental Order at ¶ 59). The Commission's cost was based on a Hatfield Cost Model Signaling Per Query estimate. The Commission's Hatfield Cost Model run did not apply the Hatfield common overhead factor. Accordingly, U S WEST applied Staff's 20% Hatfield common overhead factor to arrive at a cost of $0.00157 ($0.00131 * 1.2 = $0.00157). Ultimately, U S WEST's $.00185 Signaling Per Query price is based on the $0.00131 per query cost, a $0.00026 common overhead additive, and a $0.00028 markup which is described further in the next section.

Interim Number Portability - The Commission ordered an Interim Number Portability cost of $1.50. (8th Supplemental Order at ¶ 436). The Commission did not specify whether its cost estimate included attributed or common costs. Accordingly, U S WEST applied its standard attributed and common cost factors, consistent with its treatment of other U S WEST cost results. Mr. Griffith, on behalf of Commission Staff testified that if the Commission had already included attributed and common costs then U S WEST's price would be the Commission's cost multiplied times U S WEST's markup, or $1.77. In his Rebuttal Testimony, Mr. Reynolds agreed that "[I]f the Commission decides that such costs are included in their estimate, then U S WEST would agree with Mr. Griffith's calculation. However, U S WEST believes that $1.50 does not include attributed and common costs. The Commission specifically held that common costs are a Phase II issue, lending support to the contention that no such costs were included in the $1.50. Thus, U S WEST believes that $2.20 is the proper price, as set forth in Exhibit 699.

B. Markup Over Cost

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UNE prices must be cost-based under the Act. The current FCC rules[16] expressly recognize that U S WEST is entitled to recover its common costs when providing interconnection and access to UNEs. To the extent common costs cannot be attributed to specific elements, the FCC order permits recovery through a uniform percentage markup.

U S WEST's markups provide an equal percentage markup over direct costs. To ensure equitable recovery of common costs by all services, U S WEST based its markup on the current average markup over UNE TELRIC costs for its retail exchange and vertical services, adjusted to account for avoidable costs, rebundling, and CLEC return. Specifically, as shown on Exhibit MSR-1 (Ex. C-536), U S WEST's weighted average markup for its exchange services and accompanying toll, access and features, is approximately 1.65. Removing avoidable costs from the equation using the wholesale discount rate of 14.74% effectively reduces this margin to 1.49. Instead of using the weighted average 49% retail markup for common cost recovery, U S WEST used an 18% markup that when applied to the 4.05% common cost factor results in a 22.78% markup to recover the common costs of the firm. This is a conservative approach considering that U S WEST's markup calculation for its retail services (1.49) is heavily weighted by the proportionately smaller residential services margin (1.26), while the CLECs have been predominately focused on the substantial margins contained in the U S WEST business services rates (2.01).

U S WEST applied its proposed markup only to recurring rate elements. Although it believes that nonrecurring rates should recover all relevant costs, including attributed and common costs, U S WEST did not apply its additional proposed markup to nonrecurring rate elements

[16] The Supreme Court upheld only the FCC's jurisdiction to establish pricing rules. The challenge to the merits of the FCC's rules is pending before the Eighth Circuit. The FCC's pricing rules may change as a result of that appeal.

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because of the specific directives of the Commission, in its 8th Supplemental Order, regarding reductions in nonrecurring cost calculations. (Ex. 535 at 5).

U S WEST's pricing methodology, including the comparison of UNE elements with retail rates as depicted in MSR-1, establishes that the proposed UNE prices are fair, just and reasonable.

C. Interim USF/Stranded Cost

U S WEST does not specifically address this issue.

D. Rate Design Issues

1. NRC for Installation/Disconnect

In the 8th Supplemental Order, at paragraph 471, the Commission recognizes that AT&T/MCI criticize the bundling of disconnection and connection charges. In paragraphs 472 and 473, the Commission comments on the disconnection portion of U S WEST's unbundled loop nonrecurring cost and explains that it has adjusted U S WEST's labor time assumptions for the interconnection service center and the central office frame to arrive at a cost for the disconnection portion of the nonrecurring charge of $11.58. The Commission does not reach a conclusion on the issue of bundling disconnection and connection charges into a single nonrecurring charge.

AT&T claims that the Commission ordered that ". . . it is inappropriate to price installation and disconnection in a combined fashion." (Ex. 635 at 20-21). However, when asked if AT&T charges its end user customers disconnection fees, AT&T's witness testified that in general, and for the interexchange market, end users are not charged for disconnections (Tr. 1528) and suggested that a competitive market would not allow such a rate structure.

U S WEST does not agree that the Commission's statement regarding the cost of disconnection constituted a requirement that U S WEST split the nonrecurring loop charge. U S WEST does not recover any of its other nonrecurring charges on that basis. (Ex. 539 at 8).

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Neither AT&T nor U S WEST recover disconnection costs at the time of disconnection, because the likelihood that they would receive payment from a disconnecting customer is low.

The fact is that the Commission took issue with certain aspects of the disconnection portion of U S WEST's nonrecurring costs and *adjusted* those costs – which is a separate and distinct issue from *how to recover* those costs. The Commission should find that installation and disconnection nonrecurring costs should be recovered at the time of installation, the way that AT&T, U S WEST and the rest of the industry currently recover such charges. To do otherwise would jeopardize full cost recovery for the costs incurred.

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2. Customer Transfer Charge (Staff Proposal to Eliminate the Business vs. Residence Distinction)

Staff has proposed modifications to U S WEST's rate structure for the Customer Transfer Charge (CTC). (Ex. C-656 at 3-5). Ms. Roth listed five changes to the study. Of these, the reduction in order processing time, the change in the cost of money, and the exclusion of system costs have previously been addressed in Section IV. D. The other two modifications are collapsing the business and residence manual and mechanized charges (first and additional line) into a generic exchange service "POTS" category, and the creation of two new CTC categories for private line and frame relay services. Ms. Roth justifies her residential and business CTC rate structure modifications based on the efficiency of eliminating multiple rates where cost does not justify such rate differences. Alternatively, for private line and frame relay services, Ms. Roth contends that due to the complex nature of the services, additional order processing time is warranted and should be reflected in different rates. Notwithstanding U S WEST's disagreement with Ms. Roth's cost modification, U S WEST supports her recommended modifications to the CTC rate design. As Mr. Reynolds testified:

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

Ex. 540 at 15.

3. Unbundling Cost Recovery

This issue has been discussed in Section IV.F.

4. Loop Conditioning Cost Recovery

This issue has previously been addressed in Section IV. E.

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5. Transport and Termination Pricing

In the 8th Supplemental Order, paragraphs 437-442, the Commission discussed the Transport and Termination rate elements in the context of interconnection. The Commission found that due to route-to-air mile ratio calculation problems, the Hatfield Model should not be used to calculate inter-office costs. The Commission points out, however, that transport compensation is currently handled through a bill-and-keep procedure and, subsequently, no quantification of transport costs is required unless this procedure changes. The Commission then invited parties to propose alternative compensation methods, which, if adopted, would require GTE and U S WEST to modify their transport and termination studies to reflect the cost of money and depreciation adjustments required in the 8th Supplemental Order. The Commission suggests that if they adopt bill-and-keep compensation, there will be no need to re-do the studies.

U S WEST has responded to the Commission's directives regarding transport and termination. Mr. Reynolds testifies that reciprocal compensation should replace bill-and-keep compensation. Reciprocal compensation is the only economic, cost-based, form of compensation for the use of network facilities. (Ex. 535 at 7-9). The Commission has consistently identified bill and keep as an interim compensation mechanism, and now is the time to replace it.

ISP Traffic. This recommendation is conditioned on the caveat that reciprocal compensation should not apply to the Internet traffic which is routed to Information Service Providers (ISPs). The rationale for this exception is that ISP traffic is interstate in nature and, thus, should be subject to interstate regulation. In fact, as Mr. Reynolds points out, the FCC has exempted ISP traffic from access charge compensation. The fact that the FCC has the authority to exempt such traffic is ample proof that the FCC, and not the states, has jurisdiction over ISP traffic. Furthermore, just because the FCC has indefinitely exempted ISP traffic from access

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charge compensation does not mean that it should somehow qualify as local traffic subject to reciprocal compensation.

It is interesting to note that a number of CLECs filed testimony supporting reciprocal compensation (ELI, Nextlink, MFS), but vehemently opposing the exemption of ISP traffic from such arrangements. This is because CLECs with reciprocal compensation clauses in their contracts (and the corresponding arbitrator's decision that includes ISP traffic in such compensation) enjoy a one-way reciprocal compensation windfall in targeting Internet service providers as customers.

From another perspective, as explained by Mr. Reynolds (Tr. 674-676), ISP traffic represents new traffic on the network that was not anticipated when exchange rates were set. More specifically, exchange rates were initially set based on average usage statistics that predated the use of the voice network for access to ISPs. Since that time, average call holding times have increased by hundreds of percentage points due to the unprecedented use of the Internet by millions of users. This has forced U S WEST to play catch-up in ensuring that it has adequate facilities in place to meet minimum network standards. Because this traffic is interstate in nature, a logical solution to the funding issues associated with the network requirements necessary to meet the increased traffic loads would be to allow companies to recover their costs through access charges. Access charges would allow all carriers of the traffic, ILECs and CLECs alike, to recover their respective costs. In an effort to foster growth in the ISP market, however, the FCC exempted ISP traffic from access charges. If the Commission now allows this traffic to be subject to reciprocal compensation, it results in a situation in which U S WEST not only does not receive compensation for the increased traffic loads on its network, it must also compensate CLECs to terminate the traffic. Ultimately, U S WEST asks the Commission to treat all providers the same.

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Either allow both CLECs and ILECs to receive compensation through an access type structure, or deny compensation to both by exempting ISP traffic from reciprocal compensation.

Flat rated v. mou Another issue associated with transport pricing, and initially raised in the direct testimony of TCG witness Page Montgomery, is the concept of flat rated capacity charges. Ironically, Mr. Montgomery's testimony on capacity charges follows his long dissertation on unified pricing, which simplistically argues that the same network element rates should apply to both access and local traffic for the same functionality. It is important to note that the switched access transport and termination (local switching) rate structure that currently exists in virtually all interstate and intrastate jurisdictions is identical to the rate structure that U S WEST filed for its local interconnection and UNE transport and termination rate elements. In other words, if a unified pricing approach is really desirable, as Mr. Montgomery testifies, it makes much more sense to use a rate structure that is currently in place for both services, has been used for over five years, is embedded in the billing systems of virtually all IXCs, CLECs, and ILECs, and is deployed virtually everywhere. (Ex. 540 at 15). Additionally, the currently proposed plan [by U S WEST] offers companies usage sensitive, or flat rated, bandwidth sensitive options for call termination, depending on their termination requirements. U S WEST's proposed rate structure allows a CLEC to terminate traffic via tandem switching and common trunks for a per minute-of-use charge, or via direct trunked transport facilities for a flat rated per circuit charge which varies based on bandwidth (i.e., DS-1, DS-3). Id. at 14-15.

Finally, the Commission has already ruled in favor of U S WEST's Direct Trunked Transport and Tandem Switched Transport cost studies. Mr. Montgomery filed no cost studies to support his rate structure, and when asked about his supporting analyses in Tables 1 and 2 to his direct testimony, Mr. Montgomery states that:

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> A. It wasn't based on any particular data; it was based on my estimate of what the value would be. It's not a calculation. I've tried to refer to these tables in my testimony as an illustration, meaning I wouldn't – I'm not recommending that these are the absolute correct numbers to apply.

Tr. 1668.

This is hardly the documentation upon which to base a Commission decision. U S WEST believes that the Commission has already made the right decision in its findings supporting U S WEST's transport costs studies which, in turn, support a universally accepted transport rate structure.

6. Interim Local Number Portability (ILNP) Cost Recovery and Pricing

In the 8th Supplemental Order, at paragraph 435, the Commission invites parties to address cost recovery issues associated with ILNP in Phase II of this proceeding. At paragraph 436 of the same order, the Commission finds that the per path cost for providing ILNP is $1.50. U S WEST has filed a $2.20 rate for ILNP, including attributed and common costs and markup, consistent with its pricing approach as discussed above. As explained in Mr. Reynolds' Responsive Testimony at page 10, "[i]nterim number portability is little more than "call forwarding" from the ILEC's switch to the CLEC's switch. Initially most numbers will be ported from ILECs to CLECs, with the ILEC incurring costs for call forwarding and transport." If CLECs are required to port numbers to ILECs there is no reason to believe they will not be entitled to similar cost recovery. This certainly meets all standards of "competitive neutrality."

Both Ms. Starr, for AT&T, and Mr. Montgomery, for TCG, filed ILNP cost recovery testimony which suggests that the costs for ILNP be allocated among providers. (Ex. 637 at 28; Ex. 642 at 16). Mr. Montgomery suggests that the allocation be based on the FCC's methodology for allocating the cost of regional databases and functions related to permanent number portability,

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while Ms. Starr offers no insight on an allocation methodology. However, as U S WEST has pointed out, the implementation of permanent Local Number Portability (LNP) and the accompanying cost recovery are very different processes from those for ILNP. (Ex. 539 at 9-10). The LNP process is an industry-wide initiative that will require new databases and network upgrades that will be used by, and benefit, the entire industry and, thus, cost allocation among the various industry participants is appropriate. ILNP, by contrast, is simply the process of routing a call from the switch where a customer was previously served to the switch where a customer is currently served. The company that incurs the cost of the call transfer should be entitled to recover its costs. The Commission has already ordered that the per path cost for ILNP is $1.50 per path. In accordance with all economic theory and prior Commission decisions, the Commission should further order that companies that incur such a cost should be allowed to recover it.

Finally, U S WEST disagrees with Staff's recommendation that its nonrecurring charge for ILNP should be reduced by 50%. This recommendation is based on Staff's interpretation of the 8th Supplemental Order, which U S WEST believes to be incorrect. The 8th Supplemental Order required a discount of 50% as the *avoided cost discount for retail nonrecurring activities,* not for wholesale nonrecurring activities such as ILNP. (8th Supplemental Order at ¶ 533). U S WEST's nonrecurring cost study for ILNP was modified as required by the Commission (see, Ex. C-538), and those costs should not be arbitrarily reduced by 50%.

VI. OSS/TRANSITION COSTS

A. The CLECs Should Compensate U S WEST for the Costs it Incurs to Provide CLECs with Access to its Operational Support Systems.

U S WEST's right to recover the costs of providing CLECs access to its Operational

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Support Systems (OSS) is established by section 252(d)(1) of the Act.[17] While Congress required ILECs like U S WEST to open their networks to competition, it also sought to ensure that ILECs would be fully compensated for the costs they will incur to comply with this mandate. Accordingly, § 252(d)(1) requires that rates for interconnection and network elements be "just and reasonable" and based on "the cost . . . of providing the interconnection or network element." Under the Act, an incumbent LEC must be permitted to recoup the costs involved in providing interconnection and unbundled access from the competing carriers making these requests.

Under the now-vacated FCC Rule 51.319, OSSs are one of the network elements to which ILECs must provide CLECs with access. In defining the OSS network element, the FCC specifically included "[o]perations support systems functions consist[ing] of pre-ordering, ordering, provisioning, maintenance and repair, and billing functions supported by an incumbent LEC's databases and information." 47 C.F.R. § 51.319(f)(1)[18].

To the extent U S WEST must provide OSS access, the Act and the FCC's First Report and Order establish U S WEST is entitled to recover its costs relating to providing CLECs with access to its OSS. Indeed, testifying for staff, Mr. Dittemore acknowledged that ILECs should be compensated for providing nondiscriminatory access to OSSs. (Tr. 1577-78).

Two federal district courts have recently confirmed that CLECs are obligated to pay the

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[17] ***Issue IV-1 (Legal):*** *Does the 96 Act require the Commission to provide for recovery of all "transition" costs which an ILEC incurs in complying with the Act?* Furthermore, U S WEST has already addressed ***Issue IV-2 (Legal)****: If the answer to Issue IV-1 is yes, does the Act allow the Commission to apply the wholesale discount to an ILEC's transition costs?* U S WEST discussed this issue in its October 5, 1998 testimony summary. Pursuant to Section 251(c)(4), only retail telecommunications services must be discounted. The charges proposed to recover U S WEST's transition costs are not charges for retail telecommunications services and are therefore not subject to the discount.

[18] As set forth above and in U S WEST's accompanying brief, the FCC may change the obligation to provide OSS access on remand from the Supreme Court's decision. Nevertheless, the Commission should establish rates for OSS access now.

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costs of OSS development. First, in AT&T Communications of the South Central States v. BellSouth Telecommunications, Inc., No. 97-79 (E.D. Ky. Sept. 9, 1998), the Kentucky court held that because OSS costs associated with developing interfaces are caused by CLECs and benefit only them, the CLECs must pay these costs:

> The PSC correctly notes that '[o]ne would not argue he was denied access to a concert on the basis that he was required first to buy a ticket.' . . . Because the electronic interfaces will only benefit the CLECs, the ILECs, like BellSouth, should not have to subsidize them. . . . AT&T is the cost causer, and it should be the one bearing all the costs; there is absolutely nothing discriminatory about this concept.

Slip op. at 16.

Similarly, in U S WEST Communications, Inc. v. AT&T Corp., Nos. A1-97-085, A1-97-082 (D.N.D. January 8, 1999), the federal district court for North Dakota held that U S WEST has no obligation to pay the costs of OSS development:

> [T]he Agreement provides that those who create the cost, pay the cost. No one disputes that access to the OSS is essential. It is in fact a critical and essential part of the infrastructure being sold to a competitor. The Act and the Agreement mandate the provision of interconnection, again, on a non-discriminatory basis. That does not mean that the incumbent LEC must pay a portion of the costs involved in providing the interconnection for the use of a competitor.

Slip op. at 21 (emphasis added).

The facts in this case are identical to those in the Kentucky and North Dakota cases. U S WEST developed its OSS interfaces – including Electronic Data Interexchange ("EDI") and Interconnection Mediated Access ("IMA") – only for the benefit of the CLECs. Mr. Buhler directly addressed this issue, explaining that without the obligation to serve CLECs, "[w]e would not have built the electronic interfaces that we did for pre-ordering, ordering, and the rest of the categories." (Tr. 551). Testifying for MCI, Mr. Hydock candidly acknowledged the same point,

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stating that U S WEST developed EDI and IMA specifically to meet its obligations under the Act to provide CLECs with access to UNEs and resale services. (Tr. 241-42, 245). Mr. Hydock acknowledged further that U S WEST did not develop EDI and IMA to meet the needs of its own customers. (Tr. 248). Similarly, Mr. Montgomery, on behalf of TCG Seattle, now AT&T Local Services, acknowledged that U S WEST's creation of EDI would not have occurred but for the needs of the CLECs and U S WEST's obligations under the Act. (Tr. 1633-34).

As this evidence shows, neither U S WEST nor its customers caused the OSS interface expenditures. Based on the same reasoning that the courts followed in AT&T v. BellSouth and U S WEST v. AT&T, these costs should be borne exclusively by the CLECs. Similarly, to provide access to its OSSs, U S WEST was required to modify its internal systems to allow them to recognize and process orders from CLECs. (Ex. 515 at 5-8). These modifications benefit only the CLECs, not U S WEST or its customers. Id. at 8.

A recent decision by the New Mexico Commission further supports this conclusion. In In re the Consideration of the Adoption of a Rule Concerning Costing Methodologies (Phase II), Docket Nos. 96-310-TC, 97-334-TC, Supplemental Findings of Fact, Conclusions of Law and Order (Dec. 31, 1998), the Commission found that U S WEST was entitled to recover the cost of OSSs from CLECs. Id. at ¶ 67. The Commission rejected the CLECs' suggestion that U S WEST should be responsible for the costs:

> The Act is designed to facilitate efficient entry into the local market. The Act does not state that the ILECs or its retail customers should subsidize the price of UNEs. Rather, the Act provides that when a CLEC orders a UNE, it shall pay a fair and just price, which will compensate ILECs for its costs. The fact that not one but all CLECs benefit from the OSS does not negate their collective responsibility for recovering this transition cost.

Id. at ¶ 72.

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The costs that U S WEST seeks to recover fall into three categories,[19] each of which relates to activities that U S WEST is performing to provide CLECs with access to U S WEST's OSSs in a manner that will allow them to compete in the local exchange market.

First, U S WEST built its EDI and IMA electronic interfaces that allow CLECs to communicate with U S WEST's internal OSSs. These interfaces allow CLECs to obtain information important to preparing an order for service – such as customer service records, telephone number assignments, and installation appointment selections – and to transmit orders known as local service requests ("LSRs") to U S WEST's OSSs. (Ex. 515 at 9).

Second, as described above, U S WEST has modified extensively its existing OSSs to add information and functions that are needed to process orders from CLECs. Id. at 5-8.

Third, U S WEST has ongoing maintenance and operations expenses associated with the CLECs' use of U S WEST's internal OSSs and the electronic interfaces. Id. at 16-18.

B. U S WEST's Development of the Electronic Interfaces

U S WEST developed its EDI and IMA real-time, electronic interfaces for CLECs to use for preordering and ordering, and for maintenance and repair transactions U S WEST built an electronic bonding trouble administration (EB-TA) interface. (Ex. 515 at 11-14). A review of the evidence relating to these interfaces establishes that they are forward-looking, efficient interfaces that give CLECs the ability to compete effectively in Washington's local exchange market.

1. IMA

IMA uses human-to-computer technology to provide CLECs with access to U S WEST's OSSs. It gives CLECs either private line or dial-up access to U S WEST's internal OSSs for the

[19] ***Issue IV-5 (Factual/Methodological)****: If the Commission decides . . . that it should provide for recovery, what are U S WEST's and GTE's transition costs?*

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categories of pre-ordering, ordering, provisioning, maintenance and repair. When U S WEST first released IMA on January 1, 1997, the interface supported these categories of OSS transactions for POTS resale. U S WEST later enhanced IMA to provide these categories of transactions for unbundled loops, unbundled switch ports, INP and LNP, and design services resale. Id. at 12. The interface also gives CLECs the functionality needed for maintenance and repair for POTS resale, design services resale, and unbundled network elements. Id.

IMA is the same type of interface that U S WEST's retail units use. U S WEST's retail employees use a desktop computer to communicate with U S WEST's OSSs. They view computer screens to transmit and receive information to and from U S WEST's OSSs. Similarly, CLEC representatives using IMA view computer screens to gain access to the same information from U S WEST's OSSs that is available to U S WEST's retail representatives. For example, IMA gives CLECs access to customer service records ("CSRs") that are stored in U S WEST's internal systems known as BOSS and CARS; these are the same systems that U S WEST's retail representatives access to retrieve CSRs. (Ex. 532 at 22).

IMA is an essential, long-term solution that is important to the ability of many CLECs to compete in U S WEST's region. It meets the OSS needs of all CLECs, including those that do not have the significant resources that are needed to build their own OSSs and electronic interfaces. A human-to-computer interface like IMA is essential for the many CLECs that cannot afford the large-scale investments that are required to build their own OSSs and electronic interfaces. (Ex. 515 at 12-13). As Mr. Buhler explained in commenting on the reason that a large number of CLECs are using IMA:

> CLECs are using IMA because it affords them with a much cheaper, low-cost alternative to competing in the local marketplace. It's obviously forward-looking technology, because it uses web technology, and that's

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> very hot, and it's the least-cost solution because of the initial investment that it takes to gain access to our systems via IMA. (Tr. 546).

A significant benefit of IMA is that, to use it, a CLEC needs only a personal computer, a modem, and Netscape version 3.01. (Tr. 450). Even Mr. Hydock acknowledged that the low-cost solution of a human-to-computer interface could be beneficial to CLECs that cannot afford the substantial investment required to build an EDI interface. (Tr. 237).

The effectiveness of IMA is demonstrated by the significant number of CLECs that are using it. As Mr. Buhler testified, in the past year, approximately 30 CLECs competing in Washington have used IMA to submit orders to U S WEST. (Tr. 449-50). Moreover, the CLECs' use of IMA is increasing as U S WEST issues new releases with additional functionality each quarter of the operating year. (Id. at 516-17).

While the CLECs in this proceeding challenge IMA on several grounds, their criticisms are uninformed and are belied by their own admissions. For example, in his pre-filed testimony, Mr. Hydock sweepingly asserted that IMA does not comply with industry standards, without identifying any specific standard that IMA does not meet. (Ex. 508 at 4-5). During his live testimony, however, Mr. Hydock conceded that IMA complies with several national and international standards. (Tr. 239-40). Similarly, in his pre-filed testimony, Mr. Hydock conveyed the impression that IMA always requires so-called "double entry" of orders. (Ex. 508 at 4-5). During the hearing, though, he acknowledged that IMA electronically converts – or flows through – certain local service requests ("LSRs") into service orders. (Tr. 241).

The criticisms of Mr. Montgomery, on behalf of TCG Seattle, are similarly without basis. In fact, Mr. Montgomery agreed that he was not an expert on OSS and was not appearing in that capacity. (Tr. 1627). He also testified that he had never personally used IMA or EDI, nor had he

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seen either system in action . (Tr. 1629). Further, what Mr. Montgomery does know about these interfaces supports cost recovery for their development. For example, Mr. Montgomery does not know whether some CLECs have plans to use an IMA interface. (Tr. 1630). He also agreed that IMA gives a CLEC access to the same "back-end" systems that EDI does. (Tr. 1634). Thus, the issue is not the systems which are being accessed. No party challenges that U S WEST is giving access to the necessary and appropriate systems. The issue is the interface, and U S WEST has established that it offers both an IMA and an EDI interface, and that it should be entitled to cost recovery for the development of those interfaces. (Ex. 515 at 16-21).

2. EDI

U S WEST's EDI interface is a computer-to-computer interface that allows a CLEC's OSSs to communicate directly with U S WEST's internal OSSs. EDI, which is based on national standards, is available for use by CLECs that have their own OSSs and electronic interfaces. The CLEC's electronic interface exchanges information directly with U S WEST's interface. Id. at 12-13.

On December 31, 1997, U S WEST released its first version of EDI, which supported ordering for POTS resale. Another release of EDI in 1998 provided additional functionality, including pre-ordering, for both POTS resale and unbundled loops. Id. at 13-14.

Significantly, MCI does not oppose U S WEST's recovery of the costs of developing EDI. In response to a question concerning whether MCI is opposing cost recovery for U S WEST's EDI interface, Mr. Hydock responded with an unequivocal "no." (Tr. 242-43).[20] This

[20] Mr. Hydock qualified this acknowledgment by stating that U S WEST should recover the costs of EDI in a manner that is competitively neutral, meaning that the costs would be borne by CLEC end-users and U S WEST end-users. (Tr. 242-43). As discussed below, requiring U S WEST end-users to pay for an interface that they do not use violates the fundamental principle of cost causation that only those who cause a cost should pay for it.

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acknowledgment stems from MCI's recognition that EDI is based on national industry standards and is a forward-looking technology. (Tr. 243, 245).

3. EB-TA

The EB-TA interface is a computer-to-computer interface like EDI, built according to the standards for maintenance and repair. EB-TA was first implemented in April 1998 and has since been enhanced further. U S WEST will use the EB-TA standard developed for the exchange of trouble tickets by the IXCs for facilities leased from the RBOCs. (Ex. 515 at 13-14).

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C. U S WEST's Changes to Its Internal OSSs

In addition to building the interfaces described above, U S WEST has significantly modified its internal OSSs to add data and functionality needed to support the CLECs' OSS needs. For example, U S WEST's service order processors ("SOPs"), an important OSS component, were designed to handle U S WEST service orders, not orders submitted by CLECs. U S WEST has had to modify its SOPs to provide the ability to identify orders with individual CLECs. This requires unique codes for the CLECs. In addition, to enable CLECs to use its OSSs, U S WEST has created new universal service order codes ("USOCs") and field identifiers ("FIDs"). These codes support resale services and unbundled network elements and are essential for processing orders and billing. (Ex. 515 at 5).

U S WEST has made many other changes to its OSSs to support the CLECs. For example, in the area of resale, U S WEST has expanded the capacity of many of its systems to account for the increased amount of activity and the greater level of data to be stored as a result of CLEC activity. It also has changed some of its systems to permit them to perform tasks that the ILECs require, such as recording and billing of CLEC-ordered wholesale products and services and the ability to perform resale edits. Id. at 5-7.

To support the ordering of UNEs, U S WEST has expanded the capacity in several of its systems. This expansion was needed to handle the additional data that identify the unbundled elements and their features and to allow for ordering, provisioning, repair, and billing for those elements and features. Another example of a system change to support unbundled elements is U S WEST's addition of the ability to design and keep inventory on unbundled loops in the loop inventory system (FACS) and TIRKS trunk inventory. Id. at 6.

U S WEST also modified its OSSs to support orders from the CLECs for Local

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Interconnect Services ("LIS") trunks, which are the interoffice facilities that support interconnection traffic. Specifically, U S WEST is increasing capacity for its TIRKS system, which stores trunk inventory, and WFA, which supports circuit installation management and repair. Id. at 6-7.

The system changes described above are just a few of the many changes U S WEST has made to its OSSs to support the entry of CLECs into the local market. A complete list of these changes is set forth in Exhibits DWB-3 through 13 (Exs. C-518 through 528) of Mr. Buhler's direct testimony. Id. at 5-7.

Just as with the development of the interfaces, U S WEST's changes to its internal systems are for the benefit of the CLECs only; they do not benefit U S WEST or its customers. Id. at 8. Indeed, Mr. Hydock acknowledged it is not likely that U S WEST will receive "a direct benefit" from the changes to its internal systems designed to allow CLEC access. (Tr. 249).

Despite MCI's admission that U S WEST's changes to its legacy systems are for the benefit of the CLECs, it nevertheless opposes U S WEST's recovery of the costs under the guise of "competitive neutrality." (Tr. 249-50). MCI argues that CLECs incur their own OSS costs to conduct business in the local exchange market, and that those costs offset U S WEST's costs. Stated another way, as MCI would have it, since both CLECs and ILECs incur OSS costs, each party should bear their own costs. Id. There are three fundamental flaws in this contention.

First, the costs that U S WEST incurs to develop interfaces and modify its internal systems are required by law. As discussed earlier, OSS is an unbundled element to which ILECs must give CLECs access. U S WEST could not meet this legal obligation without incurring the costs it has to develop interfaces and modify its internal systems. By contrast, as both Mr. Hydock and Mr. Montgomery acknowledged, the CLECs voluntarily incur costs to change their OSSs; their

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changes are not required by law. (Tr. 251-52 and 1641-42).

Second, section 252(d)(1) of the Act gives ILECs a statutory right to recover the costs they incur to provide access to unbundled elements. There is, of course, no similar cost recovery provision in the Act for CLECs.

Third, requiring U S WEST or its customers to bear the costs of OSS developments and modifications that benefit only the CLECs and their customers violates the basic principle of cost causation: costs shall be paid only by those who cause them. Mr. Hydock himself acknowledges this principle. (Tr. 247). Even TCG cannot escape this conclusion, acknowledging that certain modifications to U S WEST's billing systems are caused by the CLECs (Tr. 1645). But rather than acknowledge that the plain rules of the game then require that the CLECs pay these costs, TCG attempts to change those rules and to argue that the beneficiary of the costs should pay, not the causer. Mr. Montgomery states that U S WEST, as the net beneficiary of modifications to its billing system to enable it to bill CLECs, should pay the costs of those modifications. This would, of course, plainly violate the Act. U S WEST is required to modify its systems to comply with the law; for those modifications, U S WEST is entitled to cost recovery. To suggest that U S WEST should somehow bear its own costs for the development of a method to bill the cost causer to recover those costs, because U S WEST is thereby enabled to receive revenues, is the worst kind of syllogism.

D. U S WEST's OSS Cost Studies Properly Identify the OSS Costs Associated with Providing Access for CLECs.

To recover the OSS development and enhancement costs described above, U S WEST is seeking a start-up service order charge of $13.81. (Ex. C-610). U S WEST calculated the start-up charge by dividing the start-up costs for 1997, 1998, and 1999 by an estimate of the number of

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CLEC orders for the years 1999 through 2004. (Ex. 515 at 20). The start-up costs for 1997 are actual costs that U S WEST has incurred, and the costs used for 1998 and 1999 are based on estimates of the costs U S WEST will incur in those years. Id. The costs included in the study are based on 1997 through 1999 because U S WEST's systems plan calls for the changes to existing OSSs and the construction of the interfaces to be completed during that three-year period.

In 1997, U S WEST spent $27,442,000 in OSS start-up costs across its 14-state region, of which $4,173,000 related to supporting activities in Washington. (Ex. 515 at 17). The total amounts U S WEST projects it will spend in 1998 and 1999 across its region are $59,700,000 and $15,369,000, respectively. Id. Of these amounts, $9,079,000 in 1998 and $2,337,000 in 1999 are expected to support OSS activities in Washington. Id. These costs include salaries, benefits and overhead for employees who define CLEC business needs, define systems to support those needs, and design and test the systems. The costs also include charges for purchasing software licenses and charges associated with other development-related tasks. Id. at 15.

U S WEST's Information Technologies Group tracks all the OSS start-up costs by project, which allows U S WEST to use accurate, actual cost figures for 1997. The estimates for 1998 and 1999 are based on estimates of the hours that U S WEST will need to complete its OSS development and enhancement project. Those estimates are multiplied by the applicable labor rate. Id. at 18-20.

U S WEST also is proposing a per service order charge of $2.49 to recover costs associated with ongoing maintenance and operations activities associated with the electronic interfaces. (Ex. C-611). These costs arise from the periodic software changes that U S WEST must perform on the interfaces and running the OSSs and the interfaces on a daily basis. Id.

U S WEST developed the per order charges of $2.49 based on estimated maintenance and

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operations costs for 1999, including the costs relating to salaries, travel and training for employees involved in implementing OSS table updates, resolving OSS error conditions, initializing the application software, and other tasks. U S WEST converted these inputs to TELRICs and allocated common costs. These costs were then divided by the estimated number of CLEC orders that will utilize the OSSs in 1999. Id. at 19.

E. Criticisms of U S WEST's Cost Tracking Methodology Are Unfounded.

TCG Seattle criticized U S WEST's cost tracking methodology. Mr. Montgomery's main criticism of U S WEST's cost data appears to be that U S WEST discovered certain corrections that needed to be made, and filed those corrections in updated and revised testimony. TCG takes that as an indictment of U S WEST's methodology. However, as explained by Mr. Buhler, nothing could be further from the truth. In fact, U S WEST's cost tracking methodology is very accurate, and subject to numerous checks and reviews. One such review disclosed the potential for double recovery of Cross-7 costs, which costs were then removed from the revised study. What is important to note is that these costs were appropriately tracked by U S WEST – they are wholesale costs appropriately recoverable from the CLECs. The reason they were removed from the OSS development and enhancement cost study is because U S WEST had developed a separate cost study to include these costs, not because there was any error in the cost tracking. Projects related to local competition and their associated tracking codes are separate and distinct from retail projects and tracking codes (Ex. 634 at 3), and no party to this proceeding has established otherwise.

Mr. Montgomery further contends, a little late in this proceeding, that U S WEST's factors somehow recover OSS costs. This is absurd. This contention is based on nothing more than an assumption, and is unfounded. In fact, Mr. Montgomery admitted on the record that U S WEST's

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factors were developed based on 1995 costs, and could not include OSS development and enhancement that did not exist and was not mandated during 1995. (Tr. 1651). Likewise, Mr. Dittemore stated that the 1995 expense factors used in U S WEST's recurring cost studies do not

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include the OSS costs U S WEST is seeking to recover for 1997 through 1999. (Tr. 1585-86). Thus, U S WEST cannot possibly be recovering these costs from its retail customers or through its factors, as there has been no opportunity to include those costs in either place.

Mr. Montgomery further asserts that U S WEST's computer costs are declining (Exs. 649 and C-665). However, this assertion is unsubstantiated. It is based on a comparison of 1997 actuals with 1998 annualized data. The comparison is not shown to be an equivalent one, and this same data shows that actual 1997 expenses were higher than 1996, lending equal support to the suggestion that these costs might be increasing. However, what is really important is that these costs do not represent the universe of U S WEST's OSS development and enhancement costs, which are reflected in U S WEST's OSS cost studies – it is those costs which are relevant to this inquiry, not those in Exhibit C-665.

U S WEST responded to, and supplemented, an AT&T data request with extensive detail regarding its 1997 OSS expenses for OSS development and enhancement. (Ex. C-553, Tr. 411-12). No party challenged the fact that U S WEST incurred these costs and properly recorded them to these codes. It is indisputable that U S WEST has incurred costs for OSS which it would not have incurred absent the mandate of local competition. The Telecom Act provides for recovery of those costs, and U S WEST should be granted that recovery in this proceeding.

Staff's criticism of U S WEST's OSS costs, and recommended disallowance thereof, is particularly troubling. Staff's recommendation, made in August 1998, was never updated, in spite of the fact that U S WEST provided significant additional information on OSS cost issues. In fact, U S WEST provided, but Staff did not review, a bench request response on this issue prior to the December hearings (Tr. 1582) . Staff further testified that data request responses were still outstanding at the time of hearing. (Tr. 1593). This was incorrect, since U S WEST worked

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informally with Staff to clarify Data Request No. 15, and responded to it on November 12, 1998 (Ex. C-666). This request was apparently designed to elicit information regarding how retail OSS costs are recovered from retail customers, in line with Staff's advocacy that there should be comparability between retail and wholesale. (Tr. 1581). U S WEST provided both a formal response to the data request (Ex. C-666), and discussed the matter informally with Staff in at least one meeting and one conference call. U S WEST believes that Staff should not now be permitted to suggest that U S WEST failed to provide additional information or to support its cost recovery, when Staff did not examine the information that was provided.

F. U S WEST's Pricing for OSS Cost Recovery is Reasonable

The method that U S WEST has chosen for OSS development, enhancement, and ongoing maintenance costs is that of a per service order surcharge. The charge is $13.81 for OSS development and enhancement costs, and $2.49 for ongoing maintenance. U S WEST believes that these surcharges are very reasonable. The calculation of the surcharges was based on an assumed number of orders for each year that costs will be recovered. U S WEST's actual experience (response to Bench Request No. 111) has shown U S WEST's assumed number of orders to be generously high, resulting in a lower per order charge than might be warranted based on actual experience.

U S WEST is willing to accept a longer amortization period for cost recovery, which would reduce the per service order charge. U S WEST is also willing to accept a true-up to actual costs incurred if such modifications to its cost recovery proposal make them more acceptable. Modifications to the rate design or pricing can be determined in this or subsequent proceedings, but the Commission should, in this case, approve recovery of the OSS costs identified in Mr. Buhler's testimony.

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VII. COLLOCATION ISSUES

Collocation issues have been a part of this proceeding since the docket was opened in 1996. Although other parties have repeatedly attempted to introduce new cost evidence in Phase II, the Commission has properly limited the issues in this phase to the consideration of ILEC cost studies and their compliance with the FCC's physical collocation order. The parties did not address that issue in hearings in Phase I, because the FCC's order was issued only a month prior to those hearings, and well after the testimony was filed.

Thus, the Commission clearly stated in the 8th Supplemental order, and reiterated in the 15th Supplemental Order, that it does not wish to start a separate proceeding, or to reopen the record to receive testimony and arguments that should have been submitted in Phase I. Included in the arguments that should not be raised at this point are the arguments by the CLECs that U S WEST's cost studies do not comply with the Act, and arguments that ILEC cost estimates are unrealistically high relative to market prices. (15th Supplemental Order at 9.)

Nonetheless, CLECs have persisted in raising these issues, and U S WEST addresses them below as necessary to be responsive to testimony introduced in Phase II. U S WEST reiterates though that many of these issues are not properly raised under the scope of the Commission's prior orders, and encourages the Commission to limit its decisions on these issues accordingly.

A. Policy Issues (e.g. need for cages)[21]

U S WEST submitted evidence on three methods for physical collocation. The first method provides a secure cage. (Ex. 621 at 3). Alternatively, CLECs may obtain cageless

[21] Several "policy" issues were the subject of testimony during the hearing, but given that this phase of the docket is limited to the conformance of the ILEC filings to the Collocation Order and certain issues pertaining to market caps and self-provisioning, it is unclear to what extent the Commission will entertain and make decisions on pure policy issues.

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physical collocation. Id. The cageless CLEC assumes the risk of having its equipment open in the

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central office, but it saves the cost of the cage and is able to occupy a smaller floor space. Finally, CLECs may use the SPOT frame to combine UNEs without collocating any equipment. Id. The Commission, in Docket Nos. UT-960323, et al.,[22] has determined that U S WEST is not required to offer cageless collocation. U S WEST does not believe that additional policy discussion or decisions are necessary or warranted in this proceeding.

B. U S WEST

1. Cost Estimates[23]

U S WEST submitted its collocation cost studies in Exhibits C- 541 and C-605, supported by the testimony of Gary Fleming. (Exs. 602, 608). U S WEST's cost studies are based on TELRIC principles, and U S WEST responded to paragraph 417 of the 8th Supplemental Order as discussed below. (Ex. 602, adopting Ex. 535 at 16).

Specifically, U S WEST filed cost studies supporting its physical collocation costs (Ex. C-541) and its EICT costs. (Ex. C-605). Staff supported the reasonableness of the assumptions and results of the revised EICT study. No party presented TELRIC-based costs for collocation in U S WEST's central offices other than U S WEST, although parties have known this to be an issue for well over two years.

Nextlink/ELI/TCG witness Turner and Covad witness Murray challenged U S WEST's studies on the basis that the costs were not based on a "forward looking central office." (Ex. 501 at 11; Ex. 503 at 20). This criticism is both outside the scope of this phase of the docket and incorrect. Under the 15th Supplemental Order, at 5, the issue in this phase is whether the new

[22] Final Order dated September 11, 1998 in Docket Nos. UT-960323, 960326 and 960337 regarding physical collocation.

[23] ***Issue IX-1(Factual):*** *Do the collocation cost studies which U S WEST and GTE submitted comply with the FCC's collocation order*? This issue is also discussed below in a separate topic heading.

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ILEC filings comply with the FCC's Collocation Order, which does not require that U S WEST estimate costs on the basis that the central office is rebuilt in its entirety. In paragraph 35 of the Collocation Order,[24] the FCC agreed that collocation charges may vary from one central office to another to reflect variations in cost. This would be impossible if the FCC required that costs be calculated as if all central offices were rebuilt on the same CLEC-designed model.[25]

2. Proposed Prices[26]

U S WEST's prices are fair, just, reasonable and nondiscriminatory. U S WEST's proposed collocation prices are contained in Exhibit 699. For recurring cost elements which include the entrance enclosure, DC power cable, external AC power, equipment shelf, space rent, and EICT, U S WEST calculated prices based on the directive in the 8th Supplemental Order, and as described in Sections III. and V., above. U S WEST computed recurring prices for DC power cable at three different amperage loads, on a per foot basis. (Ex. 699). U S WEST computed recurring prices for space rents based on three geographic zones reflecting differences in real property values from area to area. (Id., Ex. 541, workpapers). For nonrecurring cost elements which include the entrance enclosure, fiber splicing, power cable installation, labor for engineering, equipment, maintenance, inspectors and training, the EICT installation, and the quote preparation, U S WEST computed nonrecurring TELRIC, including direct and attributed costs,

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[24] In the Matter of Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport, 12 F.C.C.R. 18730, (1997).

[25] Even if the Commission considers the issue, it should reject the argument. Collocation is occurring in U S WEST's existing offices. (Ex. 621 at 3-4). No party presented an alternate model. U S WEST is required by law to incur costs and dedicate property to providing collocation. This constitutes a taking of property. State of Washington ex rel. Ore. R. &. N. Co. v. Fairchild, 224 U.S. 510, 56 L.Ed. 863, 32 S. Ct. 535 (1911). The law requires just compensation for that which is actually taken, not some hypothetical amount which would be taken if conditions were different than they are.

[26] ***Issue IX-2:*** *To what extent should the Commission authorize U S WEST and GTE to recover the following costs through collocation prices: direct costs; directly and indirectly attributed and assigned costs; common costs; other costs*? U S WEST's response is that the Commission should allow recovery of such costs that have been shown in U S WEST's cost studies and exhibits in this case.

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and a reasonable share of common costs. (Ex. 699).

Nextlink witness Knowles claimed that U S WEST's proposed prices contained higher markups over "TELRIC" than U S WEST had proposed in a recent Utah docket (Ex. 689 at 17-18). Nextlink introduced Exhibits 619 and 620 to attempt to show this. It is true that these exhibits do not include columns with amounts for "attributed cost" or "additional markup" as does Exhibit 699. However, the record shows, and Mr. Knowles admitted, that the base or starting point in this pricing docket, pursuant to the requirements of the 8th Supplemental Order is TELRIC direct costs, which is a different starting point than the Utah Commission required. (Ex. 699; Tr. 1995-1996). Thus, the comparison is not valid, and there is no inconsistency in U S WEST's position.

Fiber Splicing. Nextlink/ELI/TCG witness Turner challenged U S WEST's prices for fiber splicing. (Ex. 501 at 23). Mr. Turner argued that the final cost per fiber splice setup should be $150.00 based on three hours of setup time at $50.00 per hour for labor including "cost factors." Id. Mr. Turner did not quantify these cost factors, nor did he have any direct experience with or knowledge of the activities involved in setting up the work area to perform a fiber splice (Tr. 47-48). There is no evidence on whether or not the cost factors are based on U S WEST's current union contract rates, or whether they include attributed and common cost or any markup. U S WEST's prices are based on recovering these costs.

Ultimately, Mr. Turner agreed that U S WEST splices in the (point of interconnection) POI hole *and* the cable vault (Tr. 46), and further agreed that there would be more than three hours of

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setup time involved to set up in both places. (Tr. 50).[27]

DC Power. Mr. Turner attacked the U S WEST prices for DC power cable because he believed that U S WEST did not incorporate a Battery Distribution Fuse Board (BDFB) in its calculation to minimize the lengths of cable. (Ex. 501 at 24). U S WEST established that BDFBs are included in its calculations where the maximum load is sixty amps or less. This is because a fuse for a load greater than sixty amps will not fit in the BDFB. (Ex. 621 at 11). Thus, this criticism is unfounded.

Mr. Turner also argued that U S WEST had incorporated a fixed distance of 32 feet in its FCC tariff for DC power. (Ex. 501 at 27). This argument is clearly incorrect. First, there is no evidence of what elements are recovered in the fixed length charge in the federal tariff. The Nextlink/ELI/TCG comparison divides a per foot charge in Washington that includes TELRIC direct and attributed costs, and common costs into an interstate fixed length charge without evidence that those same elements are included in the fixed length charge. Mr. Turner argues that if U S WEST believes that 32 feet is too short, then U S WEST must admit that it has overstated the cost per foot in this Washington docket. There is no factual basis for this claim. According to paragraph 3 of the FCC's Collocation Order, the FCC investigation began with an order suspending tariffs in 1993. Mr. Fleming testified that the information that supports U S WEST's current

[27] Another Nextlink witness, Mr. Sobieski, impeached Mr. Turner's estimate with a "market" price for splicing of $30 per fiber, which is eight times Mr. Turner's rate. (Ex. 678)

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proposed rates in this docket was gathered in 1995. (Tr. 1358). The arithmetic that Mr. Turner performed does not support his conclusion.

3. SPOT Frame

U S WEST did not introduce prices, costs or direct testimony on the issue of the SPOT frame. U S WEST did not submit costs or prices for the SPOT frame because it was outside the scope of the issues in this phase of the docket. (Ex. 540 at 11). Other parties, however, insisted on discussing this issue, and U S WEST submitted responsive testimony explaining the SPOT frame, and how its use ensured efficient operation of the network. (Exs. 621, 623, 626 and 628).

U S WEST originally developed the SPOT frame in light of the decision of the Eighth Circuit in Iowa Utilities Bd. v. FCC, *supra*, to allow CLECs to recombine unbundled network elements for themselves. (Ex. 540 at 10). This court decision occurred after the set of collocation cost elements that would be litigated in this docket had been determined by the submission of cost studies in Phase I.

Notwithstanding this, U S WEST believes that the SPOT frame concept is wholly consistent with the proper operation of a network, and is also wholly consistent with U S WEST's rights and obligations to manage the space and equipment in its central offices. Intermediate connecting frames are quite typically used in U S WEST's own network, and a SPOT frame is nothing more than such an intermediate frame. (Ex. 621 at 9-10).

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C. Alternatives to ILEC Proposals

1. Nextlink Market Price Proposal

a. The Commission should not cap collocation rates at "prevailing market rates."[28]

Both Nextlink and Covad argued that U S WEST's rates for collocation should be subject to a "cap" that a CLEC would pay a third party to do the collocation construction. (Ex. 689 at 18; Ex. 503 at 22). Nextlink proposed that the specific amount of this "cap" be the prices in Exhibits 674 and 678. (Tr. 1977). Nextlink's proposal would be tantamount to the Commission abdicating its pricing responsibility in favor of private contractors who would bid on collocation site preparation work.[29] The Commission's duty to determine just and reasonable rates would not be fulfilled in this manner. The Commission should reject Nextlink's proposal.

The Commission should also reject this proposal because it creates an ad hoc and discriminatory process for pricing collocation compared to other aspects of required provision of services or facilities by ILECs to CLECs. The "forward looking economic cost" that Covad argues would be established by the "market price cap" (Ex. 503 at 23) is not the same as the "forward looking economic cost" which is included in TELRIC. The primary difference is that U S WEST's attributed and common costs are entirely omitted from this result-oriented definition, and under Covad's advocacy, U S WEST is denied proper cost recovery.

Nextlink claims that its proposed prices are those that would be offered by contractors to Nextlink, where Nextlink is the customer of collocation site preparation "service." This is far

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[28] ***Issue IX-3b (Policy):*** *If the Commission does not fully require ILECs to allow self-provisioning, should the Commission cap collocation charges at prevailing market rates*? U S WEST answers this question in the negative.

[29] In Wagner v. City of Milwaukee, 177 Wis. 410, 188 N.W. 487 (1922), the court invalidated an ordinance which provided that in city contracts, labor should be paid not less than the prevailing wage paid to members of any organization of skilled workers, as an unconstitutional delegation of the legislative power.

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different from the cost U S WEST incurs as the provider of the service.[30]

The CLEC argument is wrong for three reasons. First, the purpose of this proceeding is to set just and reasonable rates for U S WEST to provide collocation. Collocation site preparation cannot be exempted from responsibility for U S WEST's attributed and common costs, or other services will subsidize collocation. This would violate the § 251(c)(6) standard that rates be nondiscriminatory.

Second, Nextlink's approach is not a TELRIC cost analysis, but rather is a misdefined short run marginal cost approach. The Nextlink study does not even include all of the direct costs of providing collocation that are listed in the FCC's Collocation Order, as discussed below. The Nextlink approach is a short run marginal approach because it omits overheads that Nextlink must incur in the long run to obtain collocation.[31]

Third, the reason that Nextlink gives for singling out collocation site preparation for the "market price cap" treatment is an illusory distinction. Nextlink claims that unlike loops, which are only available from the ILEC, collocation space construction can physically be provided by others than the ILEC and market prices should apply (Ex. 690 at 3-4). This is nonsense. Contractors also perform much of the placement activity of the outside plant which generates the forward looking cost of the loop. (8th Supplemental Order at ¶ 45). The distinction that Nextlink advocates makes no sense. The fact that an activity can be performed by contractors is not a reason to use a short run marginal cost approach for that activity if all other activities are being

[30] U S WEST as "customer" uses outside contractors to do much of the construction work, (Tr. 1417). Logically, aside from omitting certain direct cost items and using short run prices from entities of unknown qualifications and using incorrect demand assumptions as Nextlink does, the only way that the outcome could be different from U S WEST's analysis is if one ignores TELRIC requirements to assign U S WEST's attributed and common cost to the collocation activity.

[31] The FCC's Collocation Order at ¶ 32 recognized that a reasonable assignment of overhead was proper in setting prices for collocated equipment installation.

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costed using TELRIC principles.

b. Nextlink's prices are not "market prices."[32]

The Commission should not accept the Nextlink prices because there is no substantial evidence that they are "market prices." For two-thirds of the proposed prices, Nextlink provided no evidence of who the providers were, and under what conditions the prices would be honored.[33] There is no basis on which to determine that the remaining prices are truly market prices.

The Nextlink study also made erroneous assumptions on usage which result in inflated usage and understated cost. Nextlink includes U S WEST on the demand side of transactions which will not involve U S WEST, and it assumes nonexistent CLEC demand for other elements. For example, Mr. Sobieski assumed that the cost of the entrance facility would be spread on a per-fiber pair basis over 230 fibers. (Ex. 674, note 1). Yet the CLECs would use a tiny fraction of this number of fibers, and would pay for the entrance facility only on a per fiber basis.

Nextlink supported the assumption that the cost should be spread over so many fibers on the basis that *U S WEST's* fibers would use the same entrance facilities as the CLECs, including a conduit that is assumed to run from the Point of Interconnection (POI) without interruption to a fiber distribution frame no more than fifty feet from the collocation space. (Tr. 1956-1957). Nextlink contended that it would use U S WEST's "manhole zero" to enter the central office. (Tr. 1404).

There are several serious errors and inconsistencies in Nextlink's assumptions. These

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[32] ***Issue IX-4(Policy):*** *If Issue IX-3b is answered in the affirmative, how should the Commission determine the prevailing market rates*?

[33] Nextlink provided documentary support for only six of the eighteen collocation elements. (Exs. C-675, 678, and C-679). Those elements are cage construction, racking, DC power cabling, grounding, entrance enclosure (Ex. C-675) and installation labor. (Ex. C-679) There is a document in Ex. C-675, the last page, that purports to provide a cost for interconnecting communications cable, but this cost is not the same as the "market prices" for that Nextlink proposes for cable. (Exs. 674 or 678).

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errors also apply to Covad's assumption that all entrance facility costs should be allocated to U S WEST's fibers as well as the CLECs' fibers. (Ex. 503 at 11).

First, "manhole zero" is a congested facility that is not suitable for multiple CLEC core drilling and splicing fibers. (Ex. 621 at 5-6). It is prudent engineering to place a separate, smaller POI hole near "manhole zero" for the purpose of interconnecting with CLECs. Id. CLECs do not use U S WEST's "manhole zero" to enter the central office, and U S WEST's fiber does not use the special POI hole which is placed for CLEC entry. None of the cost of the POI hole should be assigned to U S WEST.

During cross examination, Mr. Sobieski contradicted Nextlink's earlier position that it would enter the central office through "manhole zero," and stated that Nextlink would use the POI hole (Tr. 1957). With this admission, Nextlink's cost analysis and advocacy are effectively contradicted. The 288 fibers over which the cost of that facility was assumed to be spread could not be placed in the POI hole. (Tr. 1963).

Nor did Mr. Sobieski provide any cost for a fiber splice to change water resistant sheath to fire retardant sheath within fifty feet of entering the cable vault. (Tr. 1899). Instead, Mr. Sobieski assumed a continuous 600 foot conduit from the POI hole through the cable vault to the fiber distribution frame, making a splice to change to fire retardant sheath unnecessary. Id. This practice would not comply with the National Electric Code. U S WEST splices in the vault for its own facilities in order to comply with the National Electrical Code. (Ex. 625 at 4; Ex. 731). Mr. Turner agreed that such a change of cable sheath in the cable vault was necessary. (Tr. 46, 50). U S WEST's fiber would simply not be run as described by Mr. Sobieski.

The Nextlink prices for other elements are based on clearly erroneous and unsupported assumptions about the assignment of cost. Mr. Sobieski divided by ten the total costs for a

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configuration of ten collocators located contiguously. (Tr. 1873). Mr. Sobieski justified this approach by claiming that collocation costs were "linear" as a mathematical function of the floor space area used for collocation. (Ex. 677 at 15). However, he provided no empirical or mathematical proof of this linear relationship, although he admitted that whether such a linear relationship exists can be tested. (Tr. 1874).

Nextlink used this linear cost assumption for cage construction (apparently), HVAC cost, DC power cable cost, grounding and racking. There is reason to question the Nextlink assumption of linearity of cost. The FCC's Collocation Order, paragraph 60, found that DC power cost is not linear with collocation square footage. DC power cable cost is linear with *distance* as long as the cable gauge stays unchanged. (Tr. 1284-1285). A cage builder incurs fixed costs (Tr. 1873) which will result in higher costs per square foot for a smaller than a larger size cage. (Tr. 1877).

Another reason to question the linear cost assumption arises with cable racking. Cable racking must provide point-to-point support for the cable between the point of interconnection and the equipment in the collocation cage, regardless of whether a single cage or ten contiguous cages require that support. Mr. Sobieski was unable to explain how a single isolated cage could be connected to its power or communications connection points if only one-tenth of the required cable racking distance outside the cage area was available. (Tr. 1880). Yet that is the effect of his assumption which calculates the price for a single cage by dividing the total racking cost for ten cages by ten.

On average, only 1.6 CLECs have sought collocation per central office in Washington where such collocation has been requested. (Ex. 602 at 18). Based on the Nextlink "market prices," which assume ten collocators, U S WEST would never recover the actual forward looking cost to provide racking to collocators because the prices would have been artificially depressed

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through spreading fixed costs over nonexistent demand units.

For the twelve collocation elements in the "market study" as to which Nextlink produced no "market data," the Commission should reject the study's prices. U S WEST requested the documentary "market data" supporting the prices in discovery. (Ex. 681; Tr. 1885-1886). The response was that all such data were in Ex. C-675. (Ex. 681). This was untrue. (Tr. 1886). Nextlink's witness admitted at hearing that the prices were based in part on documents that had been the subject of prior litigation in Utah, and in fact were not contained in Exhibit C-675. (Id., Tr. 1887). Thus, there is simply no reliable support in this record for Nextlink's prices. All of the evidence on which the Nextlink study relies is hearsay, which does not meet an exception to the hearsay rule.[34]

Furthermore, even though Nextlink provides collocation to other telecommunications providers, and thus has direct knowledge of costs associated with that, Nextlink did not submit any evidence of its prices for collocation to its collocation "customers" relative to the "market study" prices. (Tr. 1980). Nextlink's own costs and prices as a provider of collocation space to others are relevant to whether Nextlink should be believed when it says that U S WEST prices that are higher than those in the Nextlink "market study" are a barrier to entry. There is no substantial evidence on this record as to what the "market prices" for collocation site preparation are, if the Commission determines that it would make a finding on this issue.[35]

c. Nextlink's prices omit necessary direct, indirect and overhead costs of collocation.

The Commission should reject the Nextlink study because it omits certain costs for

[34] See Nextlink/TCG Motion for Reconsideration of Eleventh Supplemental Order at 8, describing "documents authored by others" as not being capable of authentication by an affiant with knowledge of the facts and inadmissible hearsay.

[35] This is Issue IX-5, from the July 10, 1998 Issues List.

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

It is inconsistent with the assumptions of this proceeding to decide the desirability of forcing U S WEST to allow self-provisioning or to cap TELRIC based prices (Issues IX-3a and 3b) at the levels Nextlink proposes, without including all pertinent costs that a CLEC would incur to self provision or buy from contractors. The Commission reiterated in the 15th Supplemental Order at 10 that its policy is to maximize society's well-being by setting economically efficient prices. This requires an accounting of the portion of society's resources that the CLEC would consume in overheads related to collocation if it self-provisions or buys from contractors, compared to U S WEST's overheads.

Nextlink has not accounted for necessary indirect or overhead costs of collocation. Mr. Sobieski admitted this at Tr. 1859:

Q. So specifically, you have not included any amount in

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your price list for overheads; is that correct?
A. *I put direct engineering cost, no overheads.*
[emphasis added]

The Commission should reject the argument that the Nextlink study shows a need to cap U S WEST's TELRIC based prices or allow self-provisioning because Nextlink has failed to produce evidence of necessary overhead costs to allow a proper comparison.

2. Self/Third Party Provisioning[36]

a. Self-provisioning of collocation site preparation will not produce more efficient pricing than U S WEST's prices.

Under the 15th Supplemental Order, if Issue IX-3a is answered in the negative, the Commission will decide Issues IX-3b, 4 and 5, and it may consider the relationship between ILEC prices and market prices in deciding whether self-provisioning is desirable. U S WEST has described the errors in the Nextlink evidence on "market prices."

No record exists that welfare will be maximized by forcing U S WEST to allow CLECs to self-provision. In fact, a comparison of U S WEST's cost study and Nextlink's "market prices" reveals that U S WEST's TELRIC costs are less than half of the "contractor price" for entrance enclosures.[37] The primary reason that Nextlink shows a lower cost per fiber for the enclosure than U S WEST, is that Nextlink spreads the cost over a much larger number of fibers, which explicitly

[36] ***Issue IX-3a (Policy):*** *To what extent should the Commission require ILECs to allow self-provisioning*? U S WEST answers this issue by stating that CLECs should be permitted to self-provision only to the extent of provisioning the collocation cage.

[37] Ex. C-675, pages 14 and 15, compared with Ex. 541 workpapers at 3, Col. D.

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includes U S WEST's fibers. (Tr. 1956). This is unreasonable because U S WEST will not use the POI hole for itself. (Exs. 622, 602 at 18). Nextlink and Covad have not explained who besides the collocating CLECs will pay the contractor for this facility if the Commission orders U S WEST to permit self-provisioning. U S WEST will not pay because U S WEST will not be requesting or using the facility. If no one besides the CLECs pays the contractor, then the price per fiber under the Nextlink approach will be much higher than the U S WEST price.

Nextlink claims that its "market study" is not a TELRIC study and that TELRIC is irrelevant to whether U S WEST should be forced to permit self-provisioning as a check on U S WEST's supposed ability to impose costs on CLECs. (Ex. 690 at 8). Yet Nextlink also claims that it is appropriate to spread the cost of the entrance facility that it will supposedly self-provision or hire to be built over U S WEST as well as CLEC fiber because "the facility can be, *and largely is*, used predominantly by U S WEST." (Ex. 677 at 17) [emphasis added]. These concepts are inconsistent. Self-provisioning does not apply to the existing "manhole zero," because there is no need to self-provision or hire construction of a facility that is already in place. However, if Nextlink is referring to the new POI hole, the analysis is also flawed because Nextlink agreed that one could not assume that this POI hole would have U S WEST fibers in it. (Tr. 1963).

The Nextlink price for the entrance facility is without basis. Clearly, self-provisioning could only relate to work that can be done in the real world, not on work that would be done hypothetically if the network were rebuilt. Yet according to Nextlink's response to U S WEST Data Request 18, Nextlink wants to use "manhole zero" to enter the central office, not the POI hole that is the subject of Nextlink's pricing proposal. (Tr. 1404). "Manhole zero" is the only facility that meets the description of being "predominantly used by U S WEST," yet there is no

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evidence on this record of its cost. Nextlink's study divides the cost of a much smaller facility, the four foot square "handhole," by the 230 fibers which Nextlink assumes that both it and U S WEST will use (288 at 80% fill), to arrive at its per-fiber entrance facility cost.[38] There is no need in the real world to replace "manhole zero," and so there is no basis for a "market price cap" or self-provisioning on this issue.

The Nextlink price for DC power cable is based on a specific load, 60 amps, and a specific distance, 250 feet. (Ex. C-675). Mr. Sobieski stated that he did not intend that the price in his study apply to a higher load than 60 amps. (Tr. 1923). U S WEST's prices are stated on a per foot basis for the length of cable that a collocator actually needs to serve the stated load. (Ex. 699). Nextlink's contention that U S WEST is asking the Commission to adopt prices based on charging for average lengths of 242 feet multiplied by U S WEST's per foot rates, is simply without support in the record. (Ex. 689 at 11). The cost for an actual installation for a 60 amp load at U S WEST's rate[39] may be higher or lower than the $7,200 in the Nextlink study, depending on the distance.

Nextlink claims that the difference between its "market prices" and U S WEST prices justifies forcing U S WEST to permit self-provisioning. However, Nextlink's prices are seriously flawed by omission of direct and overhead costs, and by erroneous assumptions regarding usage. Based on this evidence, there is no record to support a finding that use of self-provisioning would result in economically more efficient prices.

b. <u>U S WEST is willing to allow limited self-provisioning</u>.

Nextlink and Covad contend that U S WEST should be required to permit CLECs to do

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[38] Clearly, the four foot by four foot "handhole" enclosure that is specified in Ex. C-675 is far smaller than "manhole zero." Mr. Hubbard testified that "manhole zero" contains between twenty and thirty large network copper cables with attendant splices. (Tr. 1412). It would be impossible to fit twenty to thirty large network copper cables into a four foot square enclosure.

[39] This rate includes racking, engineering, core drills, cable duct and firestop as shared costs.

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their own collocation construction in areas throughout the U S WEST central office. (Ex. 503, Tr. 1985-1986). This includes installing cable racks, drilling holes through floors and walls, laying cable in racks and all other construction for collocation. (Tr. 1985-1986). U S WEST is willing to allow collocators to contract with U S WEST approved contractors for construction of collocation cages. (Ex. 535 at 17).[40] No party submitted evidence specifically addressing issue IX-7.[41] U S WEST submits that since the evidence is that U S WEST already uses outside contractors to perform site preparation work, this issue is moot.

The Commission cannot require U S WEST to permit collocators to perform their own construction directly or through the use of contractors in U S WEST's central offices, beyond that to which U S WEST has agreed. Neither the Telecommunications Act of 1996 nor any state statute contains affirmative authority for such an action. The FCC's rules, 47 C.F.R. § 51.323(h)(2), state that an ILEC need not permit self-provisioning by CLECs of connecting transmission facilities outside of the collocation cage. The only affirmative legal authority for CLECs to do any construction in the ILEC central office over the ILEC's objection is paragraph 598 of the First Report and Order, and that is limited to the collocation cage. U S WEST will permit this level of self-provisioning.

The U S WEST central office is private property. For CLECs to do their own construction outside the collocation cage, the CLECs would have to physically invade the spaces within the central office. The enforced physical invasion of the entire extent of the central office by CLECs for the purpose of hanging cable racks, cutting holes and related activities, if it were authorized by

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[40] U S WEST notes that the cost of construction of the physical cage is a small part of the cost of the group of activities that U S WEST undertakes to ready physical collocation space, including the possible need to make modifications to environmental systems to account for additional loads.

[41] ***Issue IX-7 (Policy):*** *To what extent should the Commission require, or allow requesting carriers to require, ILECs to solicit bids from outside contractors for site preparation work*?

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statute, is clearly a regulatory taking which requires just compensation. Sintra v. City of Seattle, 131 Wn.2d 640, 935 P.2d 555 (1997). Courts examine statutory authority carefully and require an explicit and affirmative grant of authority for an agency to perform a regulatory taking which would result in the need to pay just compensation.[42]

The CLECs' request that the Commission force U S WEST to permit them to construct outside the collocation cages compounds the taking that results from collocation. The physical invasion is qualitatively and quantitatively greater for self-provisioning than it is for collocation alone.

The Nextlink and Covad witnesses did not describe any limit on the extent of the requirement to allow CLECs to do their own construction within the central office. Mr. Knowles testified in effect that Nextlink wanted to be treated equally with the owner of the property in regard to the ability to perform construction activity on the property. (Tr. 1986). The taking that would be accomplished by such a requirement as the CLECs seek here would apparently include the entire central office, thus requiring just compensation to U S WEST for the fair market value of the each central office in which such CLEC construction is required. The value of this taking is substantial, and just compensation would amount to substantial funds from the public treasury.

The reasoning of the court in Bell Atlantic, *supra*, is persuasive. The Commission should construe the Commission's statutory authority when it can reasonably be done to avoid creating a class of cases that seek compensation for takings. The Commission should thus refuse to require U S WEST to permit broad scale invasions of its central offices by collocators who seek to self-

[42] Bell Atlantic Telephone Co. v. FCC, 24 F.3d 1441 (D.C. Cir. 1994). The court invalidated an FCC order that required ILECs to permit physical collocation because the court found that such collocation would generate a broad class of takings compensation cases but the FCC lacked affirmative statutory authority to order such a taking.

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provision all of their space preparation and support structure. This is a reasonable construction that will obviate such takings claims on this point.

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Further, forced self-provisioning carries with it an enormous potential for disruption in the U S WEST central office with regard to the use of scarce common overhead space and HVAC and DC power capacity. The overhead space in the central office is used for the routing of communications and power cables in racks and HVAC ducts. If each CLEC is, as Nextlink advocates, free to treat the central office as its own property for establishing cable runs and connections (Tr. 1986) and presumably modifications to HVAC equipment as well, no entity would have overall responsibility to manage these resources. Without an entity that has overall responsibility, each CLEC will have an incentive to occupy space so as to cause itself the least cost, without regard to whether later uses of the same space by other entities that would be a beneficial use of society's resources, would be foreclosed. This could result in a CLEC claiming the right to move or remove existing facilities, such as cable racks, from its desired path simply because the CLEC would have "the same rights as the property owner" to deal with the physical facilities in the central office.

The Commission should not require self-provisioning. There is no evidence that forcing U S WEST to permit self-provisioning other than for the cage would result in economically more efficient prices. Such an action would cause operational problems and would be a taking of U S WEST's property which would require substantial just compensation.

D. Compliance of Parties with Paragraph 417 of the 8th Supplemental Order[43]

1. What is Required to Comply with the 8th Supplemental Order?

At Paragraph 417 of the 8th Supplemental Order, the Commission held:

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[43] ***Issue IX-1(Factual):*** *Do the collocation cost studies which U S WEST and GTE submitted comply with the FCC's collocation orders*? U S WEST answers this question in the affirmative, qualified by the observation that pursuant to paragraph 417 of the 18th Supplemental Order where such compliance was impossible or inappropriate, U S WEST addressed these issues in its testimony.

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> Therefore, we will require GTE and U S WEST to submit testimony in Phase II of this proceeding regarding the degree to which their studies comply and are consistent with the Physical Collocation Order (including, but not limited to, U S WEST's EICT recurring cost study). To the extent that the studies are not consistent, we will require GTE and U S WEST to modify the studies to be in compliance with the FCC's Order. In their testimony on the collocation studies, the ILECs are free to address the reasonableness of the modifications that may be required pursuant to the FCC's Order.

In order to comply, U S WEST must have submitted testimony on the degree to which its collocation cost studies comply with the FCC's Collocation Order including the EICT recurring cost study. In the 15th Supplemental Order, page 4, the Commission noted that U S WEST had filed its collocation cost study and commented on the reasonableness of modifications in testimony. In the same order at page 9, the Commission said it is "appropriate to limit discussion in Phase II to the issue of whether changes [to the studies to reflect Collocation Order methodology or inputs] are necessary."

2. U S WEST Complied with Paragraph 417 of the 8th Supplemental Order.

U S WEST complied with paragraph 417 of the 8th Supplemental Order. U S WEST filed testimony addressing this issue (Ex. 602). In that testimony, Mr. Fleming described the issue of compliance with the FCC's Physical Collocation Order. The studies that the FCC reviewed in issuing the Collocation Order were TSLRIC studies, while U S WEST's studies in this current Washington docket are TELRIC studies. TELRIC and TSLRIC are different methodologies. Id. Paragraph 417 of the 8th Supplemental Order does not require a blind adherence to the FCC's Collocation Order's requirements, when such requirements do not make sense in this proceeding.[44]

[44] Covad witness Murray inconsistently criticizes U S WEST for failing to modify its collocation cost studies to conform to the FCC's Collocation Order pursuant to paragraph 417 of the Eighth Supplemental Order, and then states that had U S WEST done such modifications, U S WEST's cost studies would still fail to comply with the Telecommunications Act and unidentified "methodological requirements" of this Commission. (Ex. 503 at 7). Ms.

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U S WEST made certain changes to its cost studies where appropriate to reflect the findings of the FCC. Mr. Fleming describes the changes U S WEST made to its cost studies for collocation based on the FCC's Collocation Order. (Ex. 602, referencing adoption of Mark Reynolds' Exhibit 535 at 17). These changes all tie to specific criticisms in the FCC's Collocation Order. First, U S WEST changed the method of recovering the present value of recurring costs through nonrecurring charges as required by Collocation Order, paragraph 27. Mr. Fleming testified that U S WEST's revised rate structure reflects the true recurring or nonrecurring nature of the underlying costs.

Covad argued that three components of the entrance enclosure are useful for more than a single customer and should be treated as recurring, and that sales expense, product management and business fees-regulated were recurring and should not be included in nonrecurring costs. (Ex. 503 at 12-13). These arguments are incorrect.

There is no evidence that a cost item must be recovered as a recurring cost if it is useful for more than one customer. The Collocation Order at paragraph 27 defined recurring costs as "costs like income taxes, maintenance expenses, and administrative expenses are costs that are incurred not initially, but over time." U S WEST incurs the cost of a single entrance facility initially, not over time. It is therefore proper to treat these costs as nonrecurring. Also, simply because sales and product management expenses and business fees *in general* recur, does not mean that it is incorrect to assign some such costs that are specific to a nonrecurring event (such as establishing a collocation installation), to the nonrecurring cost of that installation.

Second, U S WEST adjusted its EICT nonrecurring charge, quote preparation fee and

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Murray criticized the FCC Order, and also criticized U S WEST for failing to conform to an order which she stated was inconsistent with the Telecommunications Act of 1996.

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inspector labor rate elements to remove cost of money, depreciation and income tax, as required in paragraph 87 of the FCC's Collocation Order. (Ex. 602, adopting Ex. 535 at 17). Mr. Turner contended that it was impossible to determine if U S WEST's testimony on this point was true because according to him U S WEST had not submitted a cost study for the EICT nonrecurring charge and quote preparation fee (QPF). U S WEST's nonrecurring cost studies for the EICT and the QPF were indexed and refiled in accordance with the Commission's directives. (Ex. C-538). Mr. Turner is incorrect, because no investment is used in the development of the nonrecurring cost or charge for EICTs. The FCC's Collocation Order discussion on U S WEST's EICT costs addressed only the removal of amounts pertaining to investment that had not been adequately documented.

Third, U S WEST modified factors that it uses in enclosure bid calculations for Americans with Disabilities Act costs and contingencies (Ex. 602, adopting Ex. 535 at 17) as required at paragraph 100 of the FCC's Collocation Order. Fourth, U S WEST eliminated the regeneration rate element for DS-1 and DS-3 EICTs, as required by paragraph 215 of the FCC's Collocation Order. Id. Fifth, the FCC directed that the POT bay element be unbundled from the cross connect and the CLEC be given the opportunity to provide this element itself. U S WEST's costs for the EICT comply with this requirement. (Ex. C-605). The FCC required U S WEST to document the investments, assumptions and valuation methodology that it used in costing out the EICTs on the basis of four different provisioning types. U S WEST's cost study workpapers show that the different designs are based on assumptions about the frequency with which specific types of equipment will be used in installations, such as collocator blocks, termination blocks and types of cable, and these designs are then weighted together to provide an average cost. (Ex. C-605 workpapers). Finally, Mr. Fleming testified that U S WEST had complied with the depreciation

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and cost of money requirements of the Commission's 8th Supplemental Order. Id.

U S WEST did not submit a cost study for cage construction. The FCC's Collocation Order prescribes no particular methodology for such construction. The Order does indicate generally that individualized prices for collocation are contrary to the FCC's requirements. However, U S WEST has not violated the FCC's requirements. Mr. Hubbard testified that the conditions in each office make the costs differ from office to office. (Ex. 621 at 13). The FCC's Collocation Order, paragraph 35, indicates that it is permissible for charges to vary to reflect cost differences from office to office. Mr. Fleming testified that U S WEST was performing studies to obtain the information that would permit the filing of generally applicable prices. (Ex. 602 at 7-8). U S WEST is currently charging for cage construction and associated environmental conditioning on an individual case basis (ICB). (Tr. 1355). The Collocation Order directs that ICB rates should be converted to generally applicable rates once the carrier has gained sufficient experience with the cost of the service. (FCC Collocation Order at 118, n.168). U S WEST's prospective action is consistent with this provision of the FCC's order.

U S WEST's current prices reflect charges per foot for various amperage loads for DC power cable installation. Both Mr. Turner and Ms. Murray criticized these prices as allegedly violating the FCC's Collocation Order because they were "in the nature of" individual case basis (ICB) pricing, and were not based on a "systematic methodology." (Ex. 501 at 15; Ex. 503 at 8, 14). The FCC's Collocation Order does not prohibit charging for DC Power cable installation on a basis that reflects the cost per foot of actual cables and racking installed for collocators. (FCC Collocation Order, at ¶ 284). Mr. Turner admitted that this was true. (Tr. 41). The Collocation Order requires tariffed "per unit time and materials charges." Id. Here, the unit is per foot of cable at three maximum ampere loads. (Ex. 699 at 8, Tr. 1287, BR 124). Nothing in paragraph 67 or

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elsewhere in the Collocation Order requires a "systematic methodology." Mr. Turner agreed that systematic methodology was not discussed in the FCC's Collocation Order. (Tr. 32).

Mr. Turner argued that U S WEST's previous EICT cost studies assumed the maximum length cable that could be provided without regeneration, and he claimed that this was contrary to the FCC's Collocation Order. In Exhibit C-605, U S WEST submitted a revised cost study and in Exhibit 699 revised prices for EICTs that are based on an assumption of an average 184 foot cable length. Mr. Turner testified that such a length is "very close" to what would be reasonable in his view. (Tr. 67).

Ms. Murray argued that U S WEST's entrance facility costs violate the FCC's requirement in paragraph 23 of the Collocation Order that costs for pricing collocation must reflect the manner in which they are incurred in providing collocation. (Ex. 503 at 11). The issue that Ms. Murray raised is that because "*manhole zero*" is used by U S WEST as well as collocators, it violates cost causation principles for U S WEST to include the cost of a *point of interconnection hole* and assign that cost to collocators. This argument is flawed, as discussed above in connection with the Nextlink "market study."

U S WEST rebutted this argument by establishing that the *point of interconnection hole* is built for collocators' exclusive use. (Ex. 602 at 11). The U S WEST approach is to splice an entrance cable to the collocator's cable in the *point of interconnection hole,* then pull the fiber *through manhole zero* into the cable vault, where it is spliced for change of sheath to a fire resistant type. (Tr. 1412-1414, Ex. 622). There is no

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reason for U S WEST to use the POI hole for its cables, and it would be unreasonable to base costs and prices on the assumption that U S WEST would use *manhole zero* for interconnection with the CLECs. Thus, U S WEST's studies do not violate cost causation principles.

Covad witness Murray argued that U S WEST's floor space rental calculations violated paragraph 97 of the FCC's Collocation Order in part because U S WEST included the same 17% common area/access factor in its study in this docket that the FCC had disallowed in the Collocation Order. (Ex. 503 at 17-18). Ms. Murray is correct that U S WEST included the same factor that the FCC disallowed, but it is entirely appropriate to include this factor. The floor space rental rate is the element that is supposed to compensate U S WEST for the taking of its property.

The FCC's disallowance would mean no compensation is to be paid U S WEST for common access areas used by CLECs to reach their enclosed or unenclosed collocation spaces. However, it is incorrect that compensation is due only when space is taken for the exclusive use of a single CLEC. U S WEST has clearly been required by law to suffer the physical invasion of its property as to areas of the central office that CLEC employees use to gain access to the collocation enclosures or unenclosed physically collocated equipment, and is entitled to cost recovery.

Covad also argued that the amount of U S WEST's floor space rental rate exceeds that of GTE and therefore effectively fails the FCC's "outlier" test in the Collocation Order. (Ex. 503

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at 15). This argument is flawed because there is no evidence that GTE's floor space rental rates are proper rates for U S WEST's floor space. The Covad witness also criticized U S WEST's evidence on the market value of its central office space, but she presented no evidence of her own. Ms. Murray claimed that U S WEST's floor space rental costs did not comply with the FCC's Collocation Order because U S WEST based these costs on a quote from a single real estate broker. U S WEST has no superior access to information on real estate values, compared to that of other parties. Ms. Murray admitted that she did not know whether the U S WEST rental values in this docket are consistent with those the FCC approved in the Collocation Order. (Tr. 149-150). The FCC approved a rate of $3.56 per square foot and U S WEST's proposed rates range from $3.03 to $4.04 per square foot, depending on the zone. (Tr. 53, 59). Covad has not produced any evidence of its own on proper rental rates.

Ms. Murray argued that U S WEST's collocation studies do not comply with the FCC's Collocation Order because the studies, which differ from those which the FCC reviewed, have not been subjected to a "comparable level of scrutiny." (Ex. 503 at 9). This claim is nonsensical. The record shows that these parties have vigorously analyzed and contested issues relating to U S WEST's studies.

Mr. Turner argued that U S WEST's collocation rates must meet the Telecommunications Act §252(d)(1)(A) cost standard. The Commission ruled in the Fifteenth Supplemental Order at page 9

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that such arguments should have been made in Phase I and are not properly part of this phase of the docket.

Based on the foregoing evidence, the Commission should find that U S WEST has complied with paragraph 417 of the 8th Supplemental Order. U S WEST is the only party who has established valid costs/prices for the physical collocation it provides in its central offices.

VIII. SHARED TRANSPORT

A. Background

The 14th Supplemental Order in this proceeding, at paragraphs 41 and 42, requires that U S WEST develop a cost estimate for shared transport that is consistent with the FCC's and the 8th Circuit Court's findings that the ILECs must provide shared transport.[45] Furthermore, U S WEST is directed to show that the methodology and input data used in the development of the shared transport cost estimate is consistent with the methodologies and inputs used in its prior cost submission in this proceeding and comports with all modifications to those cost submissions ordered by the Commission in this proceeding.

On August 18, 1997 the FCC released its Third Report and Order on Reconsideration in CC Docket 96-98, which clarified that ILECs were required to provide access, on a shared basis, to the same transmission facilities used to carry an ILEC's own traffic between ILEC end offices and tandems.[46] Because this definition has the effect of requiring U S WEST to recombine parts of its interoffice network into a finished service,

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[45] As noted in U S WEST's accompanying brief on the Supreme Court decision, an ILEC's obligation to provide shared transport is not settled.

[46] This includes all transmission facilities connecting ILEC switches - including facilities between an end office and a tandem switch, between two end offices, or between two tandem switches.

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U S WEST appealed the FCC's proposed rule on

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shared transport to the 8th Circuit Court of Appeals, on the basis that it was in conflict with that Court's prior decision on combinations. On August 10, 1998, the 8th Circuit Court denied the petitions for review and affirmed the FCC's Third Report and Order.[47] It was this action that caused the Commission to order that a shared transport rate element and accompanying cost support be filed in this proceeding. (Ex. 595 at 4-5).

Shared Transport, as defined by the FCC, is access to an ILEC's shared interoffice facilities. Interoffice facilities, which carry traffic between an ILEC's various central offices, consist of fiber optic cables between the offices and the electronic equipment required to integrate and desegregate the traffic signals. Interoffice facilities can be common or shared facilities used to carry a mix of customer and carrier traffic, or can be dedicated to a particular customer's or carrier's use. Shared interoffice facilities are designed to handle most of the traffic on the U S WEST network and are accessed through central office switches, including the standard routing tables which determine the proper trunk group to which traffic is switched for call termination. (Ex. 606 at 2). The FCC recognized that shared transport is a product used exclusively in conjunction with unbundled switching when it stated:

> A requesting carrier that uses its own self-provisioned local switches, rather than unbundled local switches obtained from an incumbent LEC, to provide local exchange and exchange access services would use dedicated transport facilities to carry traffic between its network and the incumbent LEC's network. *Thus, the only carrier that would need shared transport facilities would [be] one that was using an unbundled local switch.* [48]

Accordingly, shared transport is only available for CLECs who also purchase a switch port and unbundled local switching. (Ex. 595 at 9). This too was recognized by the FCC in the Third

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[47] Southwestern Bell Tel. Co. v. F.C.C., 153 F.3d 597 (8th Cir. 1998).
[48] FCC's Third Report and Order, n.127 (emphasis added).

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Report and Order:

> Requesting carriers that purchase shared transport as a network element to provide local exchange service must also take local switching, for the practical reasons set forth herein . . .[49]

The Supreme Court has now vacated Rule 51.319, which included the obligation to provide shared transport. Thus, ILECs currently have no duty to provide shared transport under the FCC's rules. Nevertheless, to comply with the Commission's orders, U S WEST has created a shared transport offering and has priced shared transport in accordance with the Act. If the FCC determines on remand that ILECs are not required to provide shared transport, the Commission must revisit this issue.

U S WEST's shared transport offering is structured such that a CLEC customer's traffic will be routed and switched to the appropriate shared transport trunk group utilizing the end office line port, local switching, and shared transport rate elements. Functionally, when a CLEC customer served by unbundled switching originates a call, the U S WEST switch will use the same U S WEST routing table to determine the availability of an outgoing trunk port for the CLEC customer as would be used for a U S WEST customer. Thus, the CLEC has access to the same routing table capabilities, the same trunk port, and the same direct and tandem-routed interoffice facilities available to U S WEST to route its retail local traffic.

Finally, it should be noted that shared transport will also be available to CLECs to route exchange access traffic (i.e., traffic that will be routed to an interexchange carrier) over shared trunk groups between end offices and the access tandem. CLECs will have the ability to render an access bill to interexchange carriers for such traffic. CLEC traffic routed over dedicated facilities,

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[49] Id. at ¶ 47.

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however, will be recovered by the dedicated access charges (i.e., direct trunk transport and entrance facility) that U S WEST bills directly to the interexchange carriers. (Ex. 595 at 10-11).

U S WEST's transport network is a key element in serving the needs of U S WEST customers, interexchange carrier customers and CLEC customers. As such, the careful management of this critical resource is the centerpiece of the following principles that guided U S WEST's development of its shared transport product:

The first principle is to recognize the inherent risks that are faced by facilities-based providers of telecommunications networks – risks that are faced by parties that own their own networks as well as those whose network consists of unbundled network elements provided by another party. These risks include the requirements to make an up-front investment sufficient to build a network or to purchase all required network elements; to design and manage the network; and to build an inventory of facilities to serve customers.

The second principle is to encourage the efficient use of U S WEST's interoffice transport network.

The third principle is to create incentives to ensure that one CLEC's actions or inactions will not adversely affect the use of the shared transport network by U S WEST customers or other CLECs.

The fourth principle is the costs incurred by providing shared transport should be recovered from shared transport users.

The fifth principle is to create incentives to ensure that U S WEST is not required to build excess interoffice transport capacity as a result of the availability of shared transport.

(Ex. 595 at 12).

The consideration of these guiding principles led U S WEST to develop a rate structure

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that requires a CLEC to forecast its use of the shared transport network, and to bear the risks of investing in too much or too little capacity. To do otherwise would allow CLECs to enjoy the benefits of being a facilities-based provider, without bearing the concomitant risks. To do otherwise would also have the effect of shifting the CLECs' risk to U S WEST. (Ex. 595 at 14).

One additional consideration that influenced U S WEST's shared transport rate structure was the fact that shared transport consists of a bundled combination of unbundled switching, information in routing tables, trunk ports, and direct and tandem-switched interoffice transport. In fact, the absence of an unbundled loop is the only substantive difference between the combination of unbundled switching and shared transport and resold residence or business exchange service. In light of this high degree of bundling, U S WEST has developed a recombination charge which recognizes the relative similarity between shared transport and exchange services. (Ex. 595 at 15).

The previous considerations are reflected in U S WEST's proposed rate structure for shared transport:

Elements	**Capacity** (mou/month/trunk)	**Cost** (w/o attributed and common costs)	**Rate**
Forecasted - Local Trunk DS0	8,813 mou	$15.96/month	$23.44/month
Forecasted - Local Trunk DS1	213,047 mou	$113.25/month	$166.33/month
Forecasted - Access Trunk DS0	6,229 mou	$10.86/month	$15.95/month
Unforecasted - Local Trunk DS0	per 8,813 mou increment over forecast	$15.96/month	$46.88/month
Unforecasted - Access Trunk DS0	per 6,229 mou increment over forecast	$10.86/month	$31.90/month
Recombination Charge / per port	NA	NA	Business: $9.24 Residence: $.16

(Ex. 595 at 23-27). The costs and prices associated with this rate structure will be discussed in

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more detail in the following sections.

B. U S WEST's Shared Transport Cost Study

Paragraph 41 of the 14th Supplemental Order requires U S WEST ". . . to develop a cost estimate for direct transport that is consistent with the 8th Circuit Court's finding that the ILECs must provide shared transport." The Commission further orders, at paragraph 42, that "U S WEST and GTE must show that the methodology and input data used in developing the cost estimate are consistent with the methodologies and inputs used in their prior cost submissions in this proceeding, and comport with all modifications to those cost submissions ordered by the Commission in this proceeding (e.g., authorized rate of return, and Commission prescribed depreciation rates, etc.)."

In response to the Commission's directives, U S WEST filed a Shared Transport study which was developed using Version seven (7) of the Transport Model, the same version of the model that was used in calculating the direct transport costs filed in Phase I. The network design contained in that model was not altered in this current filing. The model U S WEST filed in this phase of the proceeding is virtually identical to the model previously filed with this Commission. (Ex. 606 at 7). The Shared Transport cost study also utilized Commission-prescribed cost of money (9.63%) and prescribed depreciation rates. Id.

The one modification made to the dedicated transport cost study to determine shared transport costs was a revision of the fill assumption for the DS1 card in the multiplexing equipment used to access the transmission network. The fill was changed to reflect the fact that traffic entering the multiplexer was coming directly from the trunk port on the switch rather than from a dedicated circuit. (Ex. 606 at 8).

Shared Transport allows for the use of U S WEST's interoffice

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transport network in the same manner in which U S WEST routes its own local traffic. Thus, transport costs to support the DS1 capacity element, which constitute the basic unit of interoffice transport on U S WEST's network, were developed for both the direct trunks between various end offices and the trunks which connect end offices via the local tandem switch. U S WEST weighted these two alternatives in accordance with its own traffic flows such that the direct end-office-to-end office trunks were weighted at 86% and tandem routed trunks were weighted at 14%. Essentially, as the percentages indicate, U S WEST has determined that it is most economical to direct trunk for a majority of the traffic and to tandem trunk for over-flow traffic and for any traffic destined for end offices for which there are no direct trunks groups. (Ex. 606 at 10).

The DS0 level shared transport cost for local traffic was developed based on the assumption that the traffic between end offices would be routed through the tandem 100% of the time. (Ex. 606 at 10). The Commission asked the parties to specifically address the reasonableness of this assumption. U S WEST acknowledges that it actually will route all shared transport traffic in the same manner that it routes its own local traffic. (Tr. 1386-9). U S WEST believes that its assumption is reasonable and appropriate because it reflects the fact that in developing a facilities-based network, a company could never economically build facilities directly between end offices if traffic volumes were significantly below the capacity of a DS1. (Ex. 606 at 10-11).

Ultimately, U S WEST developed its shared transport capacity cost estimates, as detailed above, using the average per minute cost for each shared transport element. The per minute costs, in

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turn, were based on the actual utilization characteristics of the existing network for DS1 and DS0 circuits. These utilization averages are provided in the Shared Transport rate structure matrix above. Additionally, U S WEST filed its Shared Transport Cost Study (Ex. C-607) as an attachment to Mr. Fleming's testimony. U S WEST chose to use a capacity circuit-based charge rather than a usage-based charge partly because the cost of measuring and billing transport on a peak capacity basis would have significantly increased the overall cost of the product. (Ex. 606 at 11). Other reasons for not using a usage-based charge are addressed in the pricing section which follows.

No other party provided a substantive shared transport rate proposal, much less a supporting cost study. In fact, the only rebuttal testimony to U S WEST's shared transport cost study was the largely unsubstantiated and mostly inappropriate testimony of Douglas Denny and Kenneth Wilson, on behalf of AT&T. Mr. Denny's contention that the Commission reject the U S WEST transport model as the basis for setting shared transport rates, based on the previously filed testimony of Dr. Zepp, also on behalf of AT&T, and his contention that the Commission should use Hatfield Model version 5.0a to calculate shared transport, is totally inconsistent with the Commission's directives in this proceeding.

As Mr. Fleming points out on page 14 of his testimony, "[i]n its Fourteenth Supplemental Order this Commission found that the transport model sponsored by U S WEST should be used in determining U S WEST's shared transport costs. U S WEST has followed this Commission directive." Furthermore, the Hatfield Model 5.0a is not a part of the record in this proceeding. Thus, it is totally inappropriate to rely on it as evidence at this point in the docket. (Ex. 609 at 13-14).

Mr. Wilson's three criticisms of U S WEST's study are not well founded. He raises concerns about double charging CLECs for the cost of tandem switching; the assumption that 14% of

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U S WEST's local traffic is tandem routed; and, U S WEST's average usage assumptions for its Shared Transport DS0 and DS1 capacity elements.

With respect to the concern associated with double charging tandem switching, Mr. Fleming clearly points out that the tandem switching costs that are recovered in shared transport rates (for the 14% of the traffic that is expected to be tandem routed) are completely separate from, and incapable of being charged simultaneously with, the "stand-alone" tandem switching rate element that would be applied to a CLEC's terminating interconnection traffic via LIS trunks. (Ex. 608 at 2-6).

Mr. Fleming also rebuts Mr. Wilson's notion that U S WEST's assumption that 14% of its local traffic is routed through a local tandem is too high. Mr. Fleming points out that while Mr. Wilson's belief is based on a casual conversation during negotiations, U S WEST's percentage was calculated by measuring actual usage patterns on the network. (Ex. 608 at 7-8). Further, 10% of all (inter and intra office) traffic is wholly consistent with 14% of inter office traffic. (Ex. 608 at 8).

Finally, Mr. Fleming counters Mr. Wilson's absurd contention that U S WEST's average usage assumptions are too low for its DS0 and DS1 shared transport capacities because they are only 20% of the total capacity of the circuits. Mr. Fleming points out that U S WEST's estimates correctly take into account the desired level of blocking during the peak period of usage on the respective trunk groups. Assumptions of higher average usage levels will clearly result in blocking assumptions that exceed network standards. In addition, U S WEST's assumptions are consistent with that of another AT&T witness (Page Montgomery) and the FCC. (Ex. 608 at 9-13).

Finally, with regard to cost issues, U S WEST addresses the Commission's question

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regarding the appropriateness of including billing costs in the study if those costs are also a part of the switching element cost estimates. The billing costs that U S WEST has included in its shared transport cost study appropriately recover costs associated with the billing activities for the shared transport rate structure. Specifically, these costs include tracking the forecast to determine if the usage is within the ordered capacity limits, billing either the standard or premium DS0 and DS1 capacity charges, and billing the recombination charge. (Tr. 1317-18). The switching element cost estimate appropriately includes the cost of billing unbundled switching usage. (Tr. 1394-95).

The two costs are clearly not the same cost because they represent the billing activities which are unique to each UNE element. It should be noted that, although a component of shared transport billing requires traffic usage, U S WEST is not seeking a usage sensitive charge for shared transport, but rather is seeking various capacity charges (DS0 and DS1 standard and premium) and a recombination charge. The unbundled switching usage rate element is a usage-sensitive element that requires usage sensitive billing capability.

U S WEST's Shared Transport costs are consistent with this Commission's directive in the 14th Supplemental Order. No other party filed a shared transport cost study in this proceeding. U S WEST has adequately responded to all of the concerns and contentions of the opposing parties. The Commission should accept U S WEST's Shared Transport cost study in support of its Shared Transport proposal.

C. U S WEST's Shared Transport Pricing Proposal

1. Capacity-Based Charges

As outlined in the Shared Transport rate structure matrix above, U S WEST proposes three distinct capacity rate elements for shared transport. For access to local call transport, U S WEST proposes flat rated charges for DS0 and DS1 capacity. For access to exchange access call

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transport (switched access traffic), U S WEST proposes flat rated charges for DS0 capacity. Although the U S WEST interoffice network consists primarily of DS1 trunking capacity, U S WEST believes it is reasonable to allow CLECs to order shared transport on a smaller increment, to minimize their start-up costs. (Ex. 595 at 23). The rates, costs, and relevant quantities (i.e., mou) associated with each capacity element are contained in the rate structure matrix above. These three rate elements, coupled with the premium charges for unforecasted usage and the recombination charge, discussed later in this section, constitute the Shared Transport rate elements.

As discussed previously, a necessary precondition to using shared transport is accessing shared transport via unbundled switching, including an end office switch port and unbundled switch usage. The switch port functionality includes a routing table which provides the trunking information required to switch a call to the proper trunk group for call termination. It is the trunk group capacity between the various end offices for which a CLEC requires call transport that comprises the Shared Transport capacity elements. It is important to note, however, that AT&T witness Kenneth Wilson's claim that "[o]ne assumption that U S WEST is tacitly making is that the CLEC will only use U S WEST loops" (Ex. 692 at 8) is totally unfounded and patently untrue. (Ex. 601 at 6).

In addition to the price structure matrix above, U S WEST has also included Shared Transport prices in its revised cost/price schedule. (Ex. 699 at 11). The presentation of Shared Transport costs and prices in Exhibit 699 reveals that U S WEST has consistently applied the same attributed, common, and markup factors it applied to all other recurring UNEs.

Finally, it should be noted that the DS0 Shared Transport rates differ for local versus access trunks. This is because the costs are based on different amounts of assumed traffic, due to

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different blocking criteria. (Ex. 595 at 24).

2. Forecasting

To initiate Shared Transport service, the CLEC would provide an eighteen month forecast of its originating traffic for all relevant end offices. The traffic forecast would be used to determine the quantity of trunks, by originating end office, that the CLEC will require to transport traffic to each of the potential terminating end offices in the local calling area. The forecast would also include the number of trunks the CLEC will require between the originating end offices and the U S WEST access tandem for the purposes of originating and terminating switched access traffic. A CLEC will be required to commit, in advance, to the initial six months of capacity in its eighteen month forecast. This will be an ongoing requirement such that at any given point in time the CLEC will always have a commitment for the succeeding six months of forecasted capacity. It is the forecasted capacity, by trunk group, for the succeeding six month period, which will determine the DS0, or DS1, Shared Transport Forecasted Capacity Charges. (Ex. at 22-25). Although a CLEC may increase or reduce its forecasted shared transport demand for the last twelve months of their eighteen month forecast, over-forecasting during the succeeding six month period will not result in a rebate and under-forecasting will result in the application of Premium Charges for unforecasted capacity. (Ex. 595 at 25).

The whole purpose for this type of rate structure, versus a simple usage structure, is to provide incentive for the CLECs to provide accurate forecasts. This is important to U S WEST because over-forecasting will result in U S WEST incurring the costs of surplus inventory while under-forecasting results in insufficient inventory, which eventually leads to increases in call blocking. (Id. at 18). Counter to Mr. Wilson's contention that U S WEST will somehow magically know CLEC traffic loads and traffic distributions (Ex. 692 at 14, lines 6-17), there is no

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guarantee that U S WEST will know how many CLEC loops will be terminating on a particular switch with enough lead time to provide meaningful information for network planning. Furthermore, the recent CLEC penchant for courting Internet service providers in order to reap the benefits of "reciprocal" compensation is a good example of how CLEC's customers' usage characteristics might differ dramatically from the norm, given the proper incentives. (Ex. 601 at 9).

To facilitate accurate CLEC forecasts, U S WEST will offer CLECs a six-month grace period during which Premium Charges would not apply for under-forecasting. Furthermore, the grace period would not begin until U S WEST has developed the necessary usage reports upon which the CLECs will rely to determine their trunking requirements, based on their usage patterns. Also, the grace period would apply on an office-by-office basis. (Tr. 1210-11). This refutes Mr. Wilson's claim that CLECs will lack the information required to perform forecasts for Shared Transport. (Ex. 601 at 8).

3. Premium Charges

U S WEST will assess the CLEC a premium charge for the traffic that exceeds the capacity that has been purchased by the CLEC. The premium charge was calculated by simply multiplying the standard "Forecasted Capacity" charge by two. The intent of the rate element is to provide incentive for the CLEC to commit to an accurate forecast in advance of its requirements. Without the price differential, a CLEC would avoid all risk of forecasting too much capacity by submitting a very low forecast, knowing that it will pay no penalty for the actual capacity it uses above that commitment. U S WEST has learned from its interconnection trunking experience that without "pricing tension," CLECs have little incentive to maintain efficient utilization on interconnection trunk groups. (Ex. 595 at 27-28).

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4. Recombination Charge

The three basic components of U S WEST's retail exchange services are a loop, switching, and interoffice transport. With the advent of the Shared Transport rate element the components of interoffice transport (common and dedicated transport, tandem switching, and call routing) have been bundled with unbundled switching into a macro network element that constitutes a majority of the functionality of retail exchange service. The relatively simple connection of an unbundled loop to this macro element completes a service for the CLECs that in most respects is the functional equivalent of U S WEST's residential and business exchange services. U S WEST believes that there needs to be linkage between the rates for these UNEs and the revenues generated from the exchange services (i.e., basic exchange service, subscriber line charge [SLC], toll, access, and features) in order to stem a significant uneconomic arbitrage opportunity. U S WEST believes that such arbitrage is uneconomic because it allows the CLECs to purchase virtually complete services, including subsidy-laden vertical services such as toll, access and features, at rates substantially lower than the wholesale retail rate available to resellers. (Ex. 595 at 29).

Consequently, U S WEST proposes the Recombination Charge which recognizes the relative similarity between functionality for bundled resold services and the combination of unbundled loops, unbundled switching, and shared transport. The starting point for the development of the Recombination Charge was to compare the sum of the unbundled network element prices (i.e., loops, switching, and shared transport) with the price of a resold retail residence or business exchange service and its accompanying average vertical service revenue streams. This comparison, which is actually an "imputation" of the UNE prices into the bundled resale service rates/average revenues, is provided in Exhibit 599. More specifically, Exhibit 599

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determines the difference between the wholesale revenue streams from business and residential exchange services (including average exchange service revenues, SLC, average per line features, average per line toll, and average per line interstate and intrastate switched access) and the rates for UNE elements that would be used to provide the retail services (including unbundled loop, switch port, switching, shared transport, EICTs, and certain access facilities - entrance facilities/multiplexing).

Because Shared Transport does not represent a total bundling of the UNEs required to provide the retail services, U S WEST proposes that the Recombination charge be set at one-half the difference between the average resale and unbundled element revenue streams, as calculated in Exhibit 599. This results in a Recombination Charge of $.16 for residence services and $9.24 for business services. The charges differ depending on whether the CLEC is providing business or residential service for the same reason that the rates for U S WEST's business exchange service are set well above the comparable rates for residential exchange service - namely to establish a subsidy flowing from business to residential exchange service. This same subsidy flow is maintained when CLECs resell U S WEST's business and residence exchange services. Without a Recombination Charge, therefore, the unbundled switching/shared transport combination offers CLECs an inappropriate opportunity to arbitrage the differences between UNE pricing and resold business and residence exchange services. (Ex. 595 at 31-34).

In summary, U S WEST recommends that the Commission adopt its proposal for the Shared Transport rate element which meets the requirements outlined in the Commission's Order and the Federal mandate. The proposal consists of cost-based, flat rated capacity charges that allow CLECs the ability to lease as little as a DS0 level of capacity with the ability to expand to DS1 capacity as their traffic volumes grow. The rate elements carry a requirement for accurate

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forecasting in that CLECs will be required to provide an eighteen month forecast, with a firm commitment for the succeeding six months at any given point of time. During this succeeding six-month period, CLEC traffic which exceeds the forecast would be subject to a premium charge (two times the normal rate) and no rebate would be allowed for unused capacity. It should be noted that at no time does U S WEST plan to block any traffic that is tendered to it under Shared Transport. Finally, U S WEST proposes that the service include a Recombination Charge (charged on a per switch port basis) that would recognize the relative similarity between resold exchange services and the combination of an unbundled loop, unbundled switching, and shared transport.

IX. OTHER ISSUES

Covad has raised the issue of "free loops", essentially arguing that because U S WEST does not impute any of the cost of the loop to its xDSL retail services, Covad must be given the same "free" access to loops under the nondiscrimination requirements of the Act. Under Covad's proposal, it would be permitted to offer xDSL over the same loop, and to the same customer, as U S WEST provides voice grade service. This is ridiculous, for several reasons.

First, U S WEST accesses the local loop for xDSL services in exactly the same manner as provided to other carriers – specifically, only a single carrier may provision local services over a single loop. The FCC recognized this in its First Report and Order, paragraph 385, where it found, among other things, that "[g]iving competing providers exclusive control over network facilities dedicated to particular end users provides such carriers the maximum flexibility to offer new services to such end users." That is true whether the carrier is U S WEST or Covad – each obtains exclusive access to the loop and the services and capabilities that the loop can be used to offer. Thus, there is no discrimination or preference.

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Second, Covad's argument, if it had any merit at all, is an argument pertaining to the proper pricing of retail services based on an imputation analysis. It is not an argument which addresses either the proper cost or the proper price for the loop. The Commission has already established the cost for the loop, which is the price floor. Covad's self-serving arguments regarding free access to loops do not provide any guidance to the decisions necessary in this proceeding. The Commission has already ruled on this issue in response to Covad's motion to compel U S WEST to respond to data requests. The Commission expressly held that U S WEST's retail rates are not at issue in this proceeding, that it does not intend to revisit its decision to use

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Phase I cost findings as price floors, and that Covad can raise its issues in a rate case or a complaint. (16th Supplemental Order, dated October 9, 1998.)

Third, even though this was not directly at issue in this case, U S WEST has established that its retail end user services, on average, do pass an imputation test with the imputed UNE prices it advocates in this case. (Ex. 599).

Fourth, and finally, the Commission should consider the decision of the California Public Utilities Commission on this same issue, in a case where the issue was apparently much more thoroughly developed than in this case.[50] In that case, PDO Communications, Inc. also asked for free loops, under a similar analysis as advanced by Covad here. The Commission rejected PDO's request, citing unresolved technical questions, and issues of how customer disputes or defaults would be handled between the carriers. The PUC also noted that the FCC is considering this issue in Common Carrier Docket 98-147.

For these reasons, Covad's arguments that it be given free loops should be rejected out of hand.

X. CONCLUSIONS AND RECOMMENDATIONS

In conclusion, the Commission should order U S WEST's proposed prices as the rates that should be used in all existing interconnection agreements. These prices are based on TELRIC cost

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[50] In the Matter of the Petition of PDO Communications, Inc. for Arbitration Pursuant to Section 252 of the Federal Telecommunications Act of 1996 to Establish an Interconnection Agreement with Pacific Bell, Decision No. 99-01-009, Application No. 98-06-052, January 7, 1999. (1999 Cal. PUC LEXIS 8).

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estimates, and include appropriate levels of attributed and common costs, and a markup to ensure equitable contribution by all customers to the common costs of the company.

Dated this 18th day of February, 1999.

U S WEST Communications, Inc.

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