

1     **8.     Miscellaneous Issues**

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3     *Transport Study*

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5     **Q.     Please turn to the eighth and final section of your testimony, covering miscellaneous**  
6     **issues. First, have you reviewed SWBT's transport study?**

7     A.     Yes, briefly. We received the transport studies relatively late in our review process, and  
8     concluded that it would not be feasible to examine them in as much detail as the loop studies.  
9     However, we noted that the methodology used in conducting these studies is quite similar to the  
10    one used in the loop studies. Furthermore, many of the inputs used in the Company's transport  
11    cost study are analogous to, or identical with, the corresponding inputs used in the loop cost  
12    studies. Thus, the transport studies apparently exhibit many of the same problems we identified  
13    with the loop studies. For instance, it appears that the same sort of inconsistent gauge weights  
14    are being used in the transport studies as I described earlier in my testimony concerning the  
15    loop studies. Similarly, it appears that the transport entrance facility studies include the same  
16    feeder stub and fiber feeder investments errors that we uncovered in our examination of the  
17    loop studies process.

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19    **Q.     What do you recommend regarding SWBT's transport study?**

20    A.     I recommend that the Commission require all of the modifications and corrections described  
21    earlier in my testimony be applied to the transport studies, to the extent applicable. For  
22    instance, the gauge weighting of embedded sheath feet should be corrected to use more  
23    appropriate weights that match each specific gauge. Similarly, the feeder stub should be  
24    removed from the transport entrance facility calculations to prevent overstatement of fiber  
25    feeder investments and double-counting of the feeder stub.

1     *DIP/DOP*

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3     **Q.     Would you next address Issue MA-0002, the assumptions to be used concerning**  
4     **Dedicated Inside Plant and Dedicated Outside Plant?**

5     A.     Yes. Briefly, this issue concerns the degree to which it is reasonable to assume that dedicated  
6     inside plant exists within the central office (DIP) and dedicated outside plant exists between the  
7     central office and a customer's premises (DOP) which can readily be made available for use  
8     when UNEs are ordered by a CLEC. To the extent such dedicated plant exists and can be  
9     used, the nonrecurring costs associated with UNEs can potentially be reduced correspondingly.

10           AT&T claims that maintaining an inventory of DIP and DOP "is the most economically  
11     efficient practice, is used by most RBOCs and is used for SWBT's own customers." [IM-  
12     MA0002.] SWBT, on the other hand suggests that DIP and DOP are separate issues, and that  
13     while a certain level of DOP is assumable, the same is not true of DIP in the context of UNEs,  
14     since "[u]nbundling always requires the removal of cross-connects and installation of facilities to  
15     the CLEC." [Id.].

16           I largely agree with SWBT that the extent to which DIP and DOP efficiencies apply  
17     may not be the same for unbundled elements as for SWBT's bundled services. For example,  
18     the benefits of both DIP and DOP apply in a situation where one tenant leaves an apartment  
19     building and "left in dial tone" remains in place until a new tenant moves into the apartment. If  
20     the new tenant reuses the existing loop and port combination, the amount of work required to  
21     connect the new tenant will be relatively minimal. However, if the previous tenant was a SWBT  
22     customer and the new tenant is a CLEC customer, some of these efficiencies will be lost when  
23     the existing loop is disconnected from SWBT's port and is rerouted to the CLEC's collocation  
24     cage for connection to the CLEC's switch. Of course, to the extent SWBT rents loops and  
25     ports on a bundled basis, these extra steps can be avoided.

1           As the industry moves away from a quasi-monopoly structure and a multi-carrier  
2 environment increasingly becomes the norm, new technologies and procedures will undoubtedly  
3 be developed that will minimize the inefficiencies involved when customers switch from one  
4 carrier to another. For the time being however, it is reasonable to recognize that the efficiencies  
5 applicable to the provision of SWBT's wholesale and retail services may not be attainable or  
6 applicable in a context where unbundled elements are being rented to other carriers—particularly  
7 in the situation where the CLEC combines SWBT's loops with its own transport or switching  
8 facilities.

9  
10 **Q.    What about the DOP assumption?**

11 A.    I agree with SWBT's observation that "[o]utside plant is never left in place 100% of the time."  
12 [Id.] However, drop wire, distribution cable and even feeder cable are frequently left in place,  
13 creating a dedicated path from a particular customer's premise to the wire center. At least  
14 during the near future, this situation will probably remain unchanged—except for large customers  
15 in high density locations located near CLEC fiber rings. In the latter case, when a large  
16 customer's switches from SWBT to another facilities based carrier, it is likely that the  
17 distribution and feeder cable that was previously dedicated to that location may instead be  
18 placed into a generic "inventory" of spare capacity, for potential use by other customers in the  
19 same general area.

20           In any event, SWBT does not always have to make a visit to the customer's premise in  
21 order to connect or disconnect loops. Often, no travel is required, or at most a visit to the FDI  
22 may be necessary, to connect a dedicated pair of distribution cable to available capacity within  
23 the feeder cable. This FDI-related activity is appropriately included in the recurring cost study,  
24 as part of the "plant specific" costs. These are typically calculated as a percentage of the

1 investment in each type of plant, based upon historic relationships between the ARMIS expense  
2 accounts in which these costs are recorded and the corresponding investment accounts.

3 However, it is appropriate for the CLEC to pay a higher rate where a special visit to  
4 the customers' premise is required. These extraordinary costs should be excluded from the  
5 recurring cost study, and instead be included as a surcharge or element of the nonrecurring  
6 rates. Under this approach, the CLEC will pay the cost of special visits in exact proportion to  
7 their actual occurrence.

8  
9 **Q. What is your recommendation with regard to Issue MA-0002?**

10 A. I recommend that DIP procedures not be assumed, since carriers are presumably renting loops  
11 that are unbundled from ports, and thus the savings that can potentially be achieved when a port  
12 remains "glued" to a loop are not generally applicable in the UNE context. I recognize that  
13 there could be some cost savings and other potential benefits if CLECs were allowed to rent  
14 ports that are bundled with bops. However, the 1996 Telecom Act seems to contemplate  
15 rental of elements of an incumbent LEC's network, which are unbundled from at least some  
16 other elements of the incumbent LECs network, and are connected instead to some of the  
17 CLEC's own facilities. Thus, the Telecom Act does not contemplate a purely "business as  
18 usual" situation in the context of UNE rentals.

19 The question of whether, or when, it might be appropriate for the Commission to  
20 require "gluing" of elements together is beyond the scope of my testimony in this proceeding.  
21 From the assumptions used in developing UNE costs, it is appropriate to assume generally that  
22 loops are rented separately from ports. My recommendations concerning DIP and DOP are  
23 consistent with this approach, as are my recommendations concerning common costs.

24 Recall that I recommend a relatively low level of common cost recovery from UNE  
25 rates, on the assumption that a carrier is just renting elements of a network, not a complete

1 service. Thus, I have recommended removing network administration and other costs  
2 associated with the engineering and provisioning of complete services when developing the  
3 common cost factor for UNE rate development.  
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5 *Use of Embedded Costs in Setting Rates*  
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7 **Q. What is your view of Issue MA-0010? Should SWBT's embedded costs be used or**  
8 **referenced to establish "just and reasonable" UNE rates?**

9 A. The importance of embedded cost data has been limited by the Pricing Standards provisions of  
10 the 1996 Telecommunications Act, which require UNE prices not only to be "just and  
11 reasonable" but "based on the cost (determined without reference to a rate-of-return or other  
12 rate-based proceeding) of providing the ... network element." [§252(d)(1)(A)(i).] Embedded  
13 costs have historically been analyzed primarily in the context of rate-of-return proceedings, and  
14 one of the benefits of an embedded cost study is that the results of the study can be directly and  
15 precisely tied to the rate base and revenue requirement developed in the rate of return  
16 proceeding. Not surprisingly, then, some have argued that embedded costs should not be  
17 considered in the setting of UNE rates. [AT&T Issues Matrix Comment, MA-0010.]

18 But while the cost basis of UNEs must be determined without reference to rate-of-  
19 return proceedings (and thus arguably can be made without any reference to embedded costs),  
20 it is not self-evident that embedded costs must be dismissed or ignored altogether. To the  
21 contrary, I agree with SWBT that the term "just and reasonable rates" implies that rates must  
22 be just and reasonable for ratepayers and competitors, as well as for SWBT, whose charges,  
23 as the Act also provides, "may include a reasonable profit" [§252(d)(1)(B).] One way of  
24 ensuring this result would be to compare the long run cost estimates to embedded costs. Of  
25 course, it isn't obvious what should be done if a dramatic disparity is discovered, other than,

1 perhaps, to further examine the long run cost estimates in an effort to identify any errors or  
2 problems that might be causing the disparity.

3 We should not forget that forward-looking cost estimates are just that--estimates; there  
4 is always room for errors (or improvements) in the development of these estimates. Thus  
5 embedded cost data can potentially provide a useful benchmark for comparison to the forward-  
6 looking long run cost estimates, particularly when this comparison can be performed on an  
7 aggregate basis, without resorting to extensive allocations, adjustments or other manipulation of  
8 the embedded data. For instance, it is typically possible to compare the total investment (plant  
9 in service either before or after subtracting accumulated depreciation) and/or the expenses  
10 recorded within the major ARMIS account categories with the analogous costs developed  
11 within the forward looking long run cost studies.

12  
13 **Q. Does this mean that the long run cost estimates should be modified (e.g., extrapolated**  
14 **up or down) to match the ARMIS results?**

15 A. No. Costing methodology should not be confused with issues of rate design. In my opinion, it is  
16 preferable to calculate costs on a basis consistent with standard economic theory, even if the  
17 results do not closely match embedded costs. Then, if the Commission concludes that just and  
18 reasonable prices would not be equal to the forward looking, long run cost level, it can deviate  
19 from those costs in establishing prices--provided the deviation is justified and consistent with the  
20 public interest. Stated differently, given a choice between manipulating the economic cost  
21 estimates in order to derive a number which is acceptable (e.g., closer to embedded cost) and  
22 accurately calculating the true level of economic cost then setting prices somewhat above or  
23 below this cost level, I believe the latter, more explicit procedure is preferable.

1     **Q.     Do you recommend that UNE prices be reconciled with embedded costs in any**  
2     **formulaic way?**

3     A.     No. While I don't object to the Commission considering embedded cost levels, I don't think  
4     this should be accomplished on an across-the-board, formulaic manner. While the Commission  
5     could potentially conclude that some UNE rates should be set somewhat above or below the  
6     long run cost level, any such deviations should be analyzed on a careful, case-by-case basis,  
7     consistent with the public interest. It would not be appropriate to modify all of the forward-  
8     looking, long run cost estimates merely to align them with embedded cost patterns. Any such  
9     modifications should be accomplished selectively, after due consideration of all relevant factors,  
10    rather than on an automatic formula basis. I discuss this principle more fully in the context of  
11    Issue MA-0011 (see below).

12  
13    *Formula Pricing*

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15    **Q.     Finally, would you discuss Issue MA-0011? Are UNE prices typically based upon a**  
16    **formula that applies a uniform markup percentage above direct costs?**

17    A.     Yes. In my experience, most state regulators have set unbundled element prices at levels that  
18    approximately equaled the TELRIC cost estimates. Under the FCC's TELRIC approach, it  
19    includes an allocation of common costs, and thus the UNE rates effectively include a uniform  
20    allowance for common costs.

21

1       **Q.    Is it necessary for the Commission to set UNE prices that reflect a perfectly uniform**  
2       **allowance for common costs?**

3       A.    No. While this is typically what is done, it is not the only available option. The Commission has  
4       the authority to confirm just and reasonable rates, consistent with section 252 of the 1996  
5       Telecom Act, taking into account other state objectives and all of the relevant evidence. While  
6       a uniform markup amount or uniform allocation of common costs can be a reasonable  
7       approach, the Commission retains the flexibility to deviate somewhat from this uniform pattern  
8       in order to shape the UNE rate design to maximize the public interest. For example, in Mr.  
9       Lammers' testimony he has proposed that common overhead costs be recovered from loops  
10      based upon a uniform dollar amount per loop, rather than by applying a uniform percentage  
11      factor.

12                Traditionally, regulators have varied profit margins from service to service in order to  
13      advance public policy objectives. While the 1996 Telecom Act may not contemplate the full  
14      degree of pricing flexibility that has traditionally been exercised by the Commission, I see no  
15      reason why the Commission should feel constrained to slavishly follow the long run cost results  
16      without any deviation whatsoever. Certainly, the Commission has the discretion to include a  
17      somewhat higher percentage of common cost recovery in certain UNE rates and a somewhat  
18      lower percentage recovery of common costs in other rates, such as what Mr. Lammers is  
19      recommending

20                This does not mean SWBT should be given great freedom to vary the percentage  
21      markup in each rate. To the contrary, any deviations from a uniform standard should be  
22      designed to advance the public interest—not the corporate interests of one particular carrier.  
23      SWBT should not have the option of overpricing those elements which are of the greatest  
24      importance to competitors.

1       **Q.     How long should the UNE rates established in this proceeding remain in force?**

2       A.     It is reasonable to assume that productivity increases will neutralize inflation, making the need  
3           for immediate or periodic upward adjustments to these rate unlikely. Furthermore, to provide a  
4           degree of stability, and to enable CLECs to make “rent or build” decisions more rationally, it  
5           would be desirable to leave the UNE prices in effect for a fairly long period—say three to five  
6           years. Towards the end of that period, the rates could be revised based upon updated cost  
7           studies, or the Commission could receive evidence concerning whether costs have been  
8           trending up or down (considering the effects of productivity and inflation), as would typically be  
9           accomplished in a price-cap plan. Of course, the Commission should retain the power to  
10          modify rates on a limited, case by case, basis in response to a demonstrated need (e.g.,  
11          discovery of errors or unanticipated problems with the established rates). Similarly, it might be  
12          appropriate to look at further refinement of these rates (e.g. further deaveraging of rates to  
13          better reflect differences in costs between or within individual wire centers) within the next few  
14          years, as the opportunity arises.

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