ORIGINAL

BELLSOUTH TELECOMMUNICATIONS, INC.

REBUTTAL TESTIMONY OF ALPHONSO J. VARNER

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 990649-TP

(PHASE II)

AUGUST 21, 2000

Q. PLEASE STATE YOUR NAME, YOUR POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC. ("BELLSOUTH") AND YOUR BUSINESS ADDRESS.

A. My name is Alphonso J. Varner. I am employed by BellSouth as Senior Director for State Regulatory for the nine-state BellSouth region. My business address is 675 West Peachtree Street, Atlanta, Georgia 30375.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes. I filed direct testimony in this proceeding on May 1, 2000.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to policy issues addressed in the direct testimony filed on behalf of various intervenors as it pertains to the issues being addressed in Phase II of this proceeding. Specifically, I will respond to the testimony of AT&T and MCIWorldCom's witness Mr. Greg Darnell, Florida Cable

Television Association's ("FCTA's") witness Mr. William Barta, Florida Competitive Carriers Association ("FCCA") witness Mr. Joseph P. Gillan, Sprint's witness James W. Sichter, Bluestar, Covad and Rhythms Link's witness Ms. Terry Murray, and Supra's witness Mr. David Nilson filed with the Florida Public Service Commission ("Commission") on July 31, 2000. I will also address the July 18, 2000 Eighth Circuit Court ("Eighth Circuit") ruling.

Pricing Methodology

Q. WHAT VALIDITY IS THERE TO THE CLAIMS OF MS. MURRAY AND MR. GILLAN THAT THE EIGHTH CIRCUIT'S RULING MEANS THAT ILECS MAY NOT BE ABLE TO INCLUDE SHARED AND COMMON COST IN PRICES?

A. None. The portion of the FCC rules requiring inclusion of the shared and common costs was not vacated by the Eighth Circuit Ruling. Rule 51.503(a) requires rates to be established equal to forward-looking economic cost. Rule 51.505(a) defines forward-looking economic cost as the sum of (1) the total element long-run incremental cost of the element, as described in paragraph (b); and (2) a reasonable allocation of forward-looking common costs, as described in paragraph (c). Forward-looking common costs include shared and common costs as defined in Rule 51.505(c). As noted above, the requirement to include shared and common costs is in Rules 51.503(b), 51.505(a), and 51.505(c). None of these rules was vacated by the Eighth Circuit.

Part of the confusion here is related to the use of the terminology "Total Element Long Run Incremental Cost" ("TELRIC"). TELRIC is only a part of the economic cost referenced in Rule 51.505(a)(1) above. However, as an abbreviated reference, most people use the term "TELRIC" to refer to the sum of TELRIC as defined in FCC Rule 51.505(a)(1) plus the allocation of shared and common costs in accordance with FCC Rule 51.505(a)(2).

Q. PLEASE ADDRESS THE IMPACT OF THE EIGHTH CIRCUIT RULING ON THE FCC'S PRICING RULES.

A. The Court eliminated the requirement for the incremental cost (TELRIC) portion of prices as described in 51.505(a)(1) above to be based on the FCC's efficient network configuration standard. That standard is defined in Rule 51.505(b)(1) as "[t]he total element long run incremental cost of an element should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." The only portion of the FCC's pricing rules that the Eighth Circuit Ruling vacated and remanded was Rule 51.505(b)(1). The remaining portions of the FCC's pricing rules remain in effect and were not vacated by the Eighth Circuit Ruling as Mr. Gillan and Ms. Murray imply.

Regarding Rule 51.505(b)(1), the Eighth Circuit Ruling held that TELRIC "violates the plain meaning of the Act", finding that the Act requires that rates be based on "the cost ... of providing the interconnection or network element ... not the cost some imaginary carrier would incur by providing the newest, most efficient, and

least cost substitute for the actual item or element which will be furnished by the existing ILEC pursuant to Congress's mandate for sharing. Congress was dealing with reality, not fantasizing about what might be." This finding of the Eighth Circuit Court refutes several of the claims made by Mr. Gillan and Ms. Murray.

Q. IN ORDER TO COMPLY WITH THE REMAINING FCC RULES, WHAT SHOULD PRICES REFLECT?

A. Since all the Eighth Circuit did was eliminate the efficient network requirement, the remaining FCC rules require prices to reflect the total forward-looking cost of facilities actually used to provide a service. Unlike the Supreme Court's Remand of FCC Rule 51.319, which required the FCC to establish new rules, no new rules appear to be required to implement the Eighth Circuit's ruling. By eliminating Rule 51.505(b)(1), the Eighth Circuit left in place a set of rules that require prices to equal the total forward-looking cost of actually providing the services. Nonetheless, Mr. Gillan and Ms. Murray have attempted to not only retain the standard that the Eighth Circuit rejected, but to also have this Commission establish prices based on a more hypothetical framework than even the FCC previously required. Clearly, their attempts should be rejected.

Q. WHAT IS THE BASIS FOR THE RATES BELLSOUTH PROPOSED?

A. BellSouth's proposed rates equal the forward-looking economic cost as defined in the FCC's pricing rules before the Eighth Circuit's ruling. These rates equal the sum of (1) TELRIC (based on the efficient network requirement) plus (2) a

reasonable allocation of forward-looking common costs. The only reasonable interpretation of the Eighth Circuit's rationale for vacating and remanding the FCC's Rule 51.505(b)(1) is that the FCC went too far in its requirement that a hypothetical network be used to calculate TELRIC. Consequently, the rates BellSouth has proposed are below the level that the Eighth Circuit held was appropriate. As I explained in my direct testimony, BellSouth has maintained all along that the FCC's pricing rules did not permit full cost recovery. Obviously, the Eighth Circuit shares BellSouth's opinion.

Q. IS BELLSOUTH CHANGING THE RATES IT HAS PROPOSED IN THIS DOCKET BASED ON THE EIGHTH CIRCUIT'S RULING?

A. No. Whether or not the Eighth Circuit ruling is upheld, the ruling will certainly be challenged. Therefore, in order to continue to facilitate local competition until this matter is ultimately resolved, BellSouth is willing to have the Commission establish unbundled network element ("UNE") prices using BellSouth's cost study and proposed rates filed in this proceeding. Once the dust finally settles, it may be necessary for the Commission to revisit the prices it establishes in this proceeding.

Q. WHAT ROLE SHOULD THE EIGHTH CIRCUIT'S RULING PLAY IN THE COMMISSION'S EVALUATION OF BELLSOUTH'S PRICES?

A. As previously discussed, BellSouth's proposed prices are based on a methodology that produces costs that are below the level the Eighth Circuit deemed appropriate. The inputs to the model and the model itself are based on the FCC's efficient

network standard. Changes to BellSouth's inputs or operation of the model that drive prices even lower merely drive prices further below the level that the Eighth Circuit held was appropriate. In particular, the Commission should reject any attempt to base prices on a network standard that is even more hypothetical than the standard already reflected in Bellsouth's cost models.

Q. PLEASE RESPOND TO MR. GILLAN'S AND MS. MURRAY'S CONTENTIONS THAT ILECS WILL USE THE EIGHTH CIRCUIT RULING AS GROUNDS TO ABANDON ECONOMIC PRICING PRINCIPLES.

A. To the contrary, BellSouth believes that the Eighth Circuit's ruling reinforces economic pricing principles. Indeed, the Court's finding that TELRIC based on a hypothetical network violates the plain meaning of the Act makes clear that the Court does not view TELRIC based on a hypothetical network as a legitimate basis for setting prices. The fundamental fallacy the Eighth Circuit saw was that the FCC rules assumed the ILEC's existing network would be totally scrapped, and a totally new network would be immediately built using the newest technology. As the Eighth Circuit recognized, this is an unrealistic assumption, and certainly would not produce just and reasonable rates.

Q. ON PAGE 6, MR. GILLAN CONTENDS THAT THE ONLY DECISIONS THAT CAN AFFECT RESOURCE CHOICES ARE THOSE THAT OCCUR IN THE FUTURE. PLEASE RESPOND.

A. This is not true, but Mr. Gillan's error is irrelevant to the issue under discussion here. Past decisions have an effect on resource choices all the time. Typically, past decisions will narrow the scope of choices available in the future. For example, the choice of plant installed narrows the range of reasonable choices that can be made in the future as to how to provide a service. Let's say a carrier installs multiplexing equipment. That equipment will have two parts, one part is used for a number of lines and all of it must be purchased initially. The other part is installed as individual lines are ordered. Even if a newer technology becomes available, it still may be more economical to simply add to the existing system instead of buying both the common equipment and line equipment for the new system. Mr. Gillan would only permit cost recovery as if the new system were already installed and all you did was add to it. This is where the Eighth Circuit disagreed with Mr. Gillan, Ms. Murray, Mr. Barta, and the FCC. Clearly, assumptions about future investments are affected by past investment choices to some extent.

I agree with Mr. Gillan that knowledgeable people must make informed choices about what technologies and investments *would be* used in the future. However, the range of choices must be realistic. To some extent, the scope of choices is narrowed by past decisions. That was the fundamental fallacy of the FCC's efficient network standard. It assumed that the network would be completely remade with each new technological advancement and made no provision for the costs of such drastic turnover in plant. While selecting the most efficient technologies and investments choices is important, the most efficient choices are limited by the choices that are actually available. Scrapping the whole network each time technology changes is not an efficient choice.

No company completely overhauls its plant to instantaneously proliferate new technology. Such action is neither practical, possible nor economically efficient. If BellSouth did take such action, the resulting costs would be far higher than the costs the ALECs propose. The costs of drastically overhauling the network would properly include the remaining cost of the old technology plus the cost of the new technology. Of course, the ALECs don't want to pay for these remaining costs, but those costs don't simply vanish. Such costs must be borne by someone.

Q. DOES BELLSOUTH OBJECT TO USING A FORWARD-LOOKING COST METHODOLOGY TO SUPPORT PRICES, AS MR. GILLAN, MR. BARTA AND MS. MURRAY CONTEND?

A. No. However, BellSouth does disagree with their view of the role that forward-looking incremental costs should play and the way that those costs should be calculated. Long run forward-looking incremental costs define a level below which prices should not go, except in limited, temporary circumstances. However, they contend that forward-looking incremental costs define the highest price that should be charged. Indeed, the FCC's rules (before or after the Eighth Circuit's ruling) do not support this contention, and they can point to no economic theory for support. Of course, this Commission has historically recognized that long run forward-looking incremental costs establish the price floor, and the prices should also include a contribution to shared and common costs. For example, in establishing permanent rates in the AT&T/MCI/ACSI consolidated arbitration proceedings, the Commission determined in Order No. PSC-96-1579-FOF-TP dated December 31,

1996, that contribution above TSLRIC is appropriate, stating that "[t]he rates cover BellSouth's TSLRIC costs and provide some contribution toward joint and common costs." (Order, page 33).

Q. MS. MURRAY AND MR. BARTA CONTEND THAT A FORWARD-LOOKING COST ANALYSIS CANNOT CONSIDER HISTORICAL COSTS. PLEASE RESPOND.

A. Their discussion is irrelevant. BellSouth has not included historical costs either in its cost study or in its prices. However, the Commission should remember that BellSouth's proposed prices do not cover the actual cost of providing service.

Q. PLEASE RESPOND TO MS. MURRAY'S IMPLICATION THAT PRICES SHOULD EQUAL INCREMENTAL COSTS.

A. Ms. Murray is unable to directly say that price should equal incremental cost because she apparently knows it isn't true. In the example Ms. Murray provides on page 17, even the new firm recovers its total actual costs. Ms. Murray's statement that "competitive markets offer no leeway for recovering 'actual' costs that exceed efficient, forward-looking costs" is wrong because she implies that only incremental costs are recovered. She has been unable to identify any markets where her contention is supported. All she has succeeded in showing is that an efficient firm's costs get recovered in a competitive environment, but it is their total costs, and not just incremental costs, that get recovered.

Q. PLEASE RESPOND TO MR. GILLAN'S INTERPRETATION THAT THE EIGHTH CIRCUIT RULING SAYS THAT "AN APPROPRIATE COST ANALYSIS SHOULD ESTIMATE ONLY THE FORWARD-LOOKING COST OF THE NETWORK INCREMENT" AND THAT THE REMAINING FIXED COMPONENTS SHOULD BE IGNORED.

A. Nowhere in the Eighth Circuit's ruling did it limit cost recovery to a network increment. On the contrary, the Court concluded that the actual cost that will be incurred on a going-forward basis should be recovered. Even the FCC's pricing rules do not support Mr. Gillan's claim. As previously discussed, the FCC's pricing method that the Eighth Circuit addressed consisted of two parts – TELRIC plus an allocation of shared and common costs. The sum of these two costs was the price ceiling. The Eighth Circuit was addressing whether the proper forward-looking methodology was used in the TELRIC method mandated by the FCC. The FCC required use of a hypothetical network in the TELRIC part of their rules, and the Eighth Circuit said that the FCC was wrong. Indeed, the Eighth Circuit said that the incremental cost part of the price must reflect forward-looking actual costs. Mr. Gillan erroneously interprets the Eighth Circuit's criticism of the incremental cost part of the FCC's pricing rules to mean that the remaining parts, which the Eighth Circuit doesn't even address, are vacated. His view is completely without merit.

Q. PLEASE COMMENT ON MR. GILLAN'S RECOMMENDATION REGARDING WHICH COSTS TO INCLUDE AND WHICH COSTS TO EXCLUDE AS A "FIXED CONSTRAINT".

A. Mr. Gillan appears to be contradicting his own testimony and ignoring the Eighth Circuit's ruling. First, he says that a proper cost study would use a time horizon long enough such that all inputs are variable. But now, he claims the cost study should be done such that some inputs are fixed. He can't have it both ways. The italicized parts of the Eighth Circuit Ruling, as quoted by Mr. Gillan on page 12 of this testimony, also contradict his claims. The cost of facilities used by the competitors, whether "fixed" or "variable" under Mr. Gillan's chameleon-like use of the terms, should be recovered through the incremental cost portion of the prices. Furthermore, Mr. Gillan ignores the "actually used" standard as stated by the Court. Prices should not be limited to recovering the cost of the most efficient network as Mr. Gillan implies, but the network that will actually be used to supply the UNEs. Mr. Gillan is simply attempting to re-impose under a new theory the hypothetical network standard that the Eighth Circuit rejected.

Q. PLEASE COMMENT ON MR. GILLAN'S CONCERN THAT THE EIGHTH CIRCUIT RULING WILL CAUSE ILECS TO DELIBERATELY DEPLOY OBSOLETE OR INEFFICIENT NETWORKS IN AN EFFORT TO INCREASE ALEC'S COSTS.

A. Mr. Gillan is wrong again. There is nothing in the Court's decision pertinent to this so-called "issue". First, this allegation makes no sense because it would require the ILEC to increase its own costs to provide retail services. However, the ILEC must compete in the retail market with many non-ALEC providers. Second, even if BellSouth were inclined to engage in the irrational behavior postulated by Mr. Gillan, the nondiscriminatory obligations placed upon BellSouth prevent it from

engaging in such behavior. Third, if BellSouth were to act in an economically irrational manner and were to disregard its obligations under the law, an ALEC would certainly bring this to the Commission's attention long before such action could affect forward-looking costs. As such, Mr. Gillan's claimed concern has no effect on UNE price development.

Q. PLEASE RESPOND TO MR. GILLAN'S STATEMENTS ON PAGE 3 THAT BELLSOUTH'S "PERSPECTIVE ON UNE-PRICING WOULD TURN ECONOMIC THEORY ON ITS HEAD".

A. Mr. Gillan is viewing economic theory upside down. The problem here is that he is confusing the "ceiling" with the "floor". As I previously stated, long run forward-looking incremental costs provide the price floor, not the price ceiling. Nowhere in a competitive market can Mr. Gillan point to a place where incremental cost is properly equated to a price ceiling. Mr. Gillan is ascribing an improper role to incremental costs.

Q. IF FORWARD-LOOKING INCREMENTAL COSTS ARE NOT APPROPRIATE TO ESTABLISH THE PRICE CEILING, HOW SHOULD THE PRICE CEILING BE DETERMINED?

A. In a fully competitive marketplace, consumers establish the price ceiling by their decision to buy or not buy a product. In a less than fully competitive marketplace, regulatory agencies have used a number of proxies (e.g. fully allocated costs, competitive analogs, stand-alone costs) to mimic this price ceiling that customers

would otherwise create. The objective of these proxies is the same – to approximate a price that would be sustainable in a competitive marketplace, i.e., to mimic prices that allowed an efficient firm to recover its full costs. The important point is that actual costs must be recovered. Prudently incurred costs will be recovered in a competitive environment. These costs don't vanish simply because Mr. Gillan, Ms. Murray and Mr. Barta choose to ignore them.

Q. PLEASE RESPOND TO MR. GILLAN'S ALLEGATION THAT, DUE TO THIS COMMISSION'S HAVING SET UNE PRICES THAT ARE TOO HIGH, ONLY NEGLIGIBLE COMPETITION HAS RESULTED IN FLORIDA.

A. It is difficult to draw any conclusions about the degree of competition in Florida based upon UNE rates established by the Commission in the past. Mr. Gillan would have you ignore other events that have had significant bearing on the development of competition using UNEs. Some of these events include: (1) AT&T's decision to spend $100 billion to provide telephony over cable; (2) MCI's almost total rejection of the residence market for local service; (3) carriers' decisions to incorporate local service into their long distance special access services; (4) the level of existing retail rates; (5) IXC's desire to keep RBOCs such as BellSouth out of the long distance business; (6) carriers' decisions to utilize resale as their business entry strategy; and (7) consolidation in the industry that distracted potential competitors from market entry. Mr. Gillan apparently believes that none of these events has affected the development of competition in the past. In his incredibly myopic view, the only thing that mattered was the level of UNE prices.

Again, there is no rational way to equate the degree of past competitive development solely to UNE prices. However, I should point out that the significance of these events will likely be lessened in the future, so the level of UNE prices will have a greater impact going forward.

Q. PLEASE RESPOND TO MR. GILLAN'S CONTENTION THAT EXCESSIVE UNE PRICES WILL FORECLOSE COMPETITION, AND TO MR. BARTA'S INTERPRETATION OF YOUR TESTIMONY ON THAT SUBJECT.

A. They are being overly dramatic. The level of UNE prices that the Commission is considering here would not hamper, let alone foreclose, competition. They also misinterpret my testimony. What I said in my direct testimony was that UNE prices set too high would slow competitive entry, but would certainly not foreclose it altogether. Such a condition would cause competitors to enter via other methods. Of course, setting prices too high would give ALECs the maximum incentive to construct their own facilities and, in the long run, infrastructure competition would develop sooner. However, the incentive for the ALEC to compete by purchasing UNEs from the ILEC would be lessened. Of course, since the now-vacated FCC's pricing rules result in understated prices, setting prices too high is not currently a condition the Commission will encounter in this proceeding.

Q. PLEASE RESPOND TO MR. GILLAN'S CONTENTION THAT "LITTLE COMPETITION HAS EMERGED".

A. The accuracy of Mr. Gillan's contention depends on which segments of the market you examine. Obviously, facilities-based ALECs have focused their efforts on the more lucrative business markets and all but ignored the residential market. The hallmark reform of the Act, contrary to Mr. Gillan's claim, was removing the statutory barriers and creating a three-pronged means for competition to develop – build facilities, resale, and UNEs. ALECs have varied in their desire to use each of these means, so measuring competition based solely on UNEs is misguided. Mr. Gillan fails to point out how much local service is provided over the other technologies, constructing new facilities, special access, wireless, etc. All of these are facilities-based means to compete. The actual levels referred to in Mr. Gillan's Exhibit JPG-2 are misleading since ALECs start at a low base and ILECs start at a high base. In fact, on an annualized basis the growth rate for UNE loops was 120% while the growth rate for total ILEC lines was only just over 4%. Mr. Gillan's concerns that an ALEC's gain reflects growth and penetration is irrelevant if the point is to show the degree of competitive penetration. Competitive penetration is the same regardless of whether a competitor wins an existing customer or serves a new one.

Q. ON PAGE 18, MR. GILLAN CONTENDS THAT THE HIGH COST OF COMBINATIONS LIMITS ITS VALUE TO CUSTOMERS WHOSE SERVICES ARE COMPLEX AND EXPENSIVE. DO YOU AGREE?

A. No. Mr. Gillan is simply trying to provide an excuse for why facilities-based ALECs have focused almost exclusively on the urban business market. It is not the complexity of using UNE combinations that has driven their behavior; rather, it is

simple arithmetic. The margins are much higher in the urban business market than in other markets. That is the principal reason that competitors have concentrated on that market. In fact, Mr. Gillan's claim is belied by ALECs that claim the main reason they need UNE combinations – particularly the UNE platform ("UNE-P") - was to serve the mass market. His contention has also been contradicted by John Zeglis of AT&T when he stated that UNE combinations were just another form of resale. So AT&T obviously doesn't share Mr. Gillan's view about complexity.

Q. WHAT DOES MR. GILLAN'S UNE-P DATA FOR NEW YORK AND TEXAS SHOW?

A. First, his data doesn't show anything about the impact of UNE-P availability on local competition development in Florida, New York or Texas. UNE-P is available in all three states, so any disparity in ALECs' use of UNE-P in these states is not a result of availability. Second, Mr. Gillan conveniently ignores the most important factor that has driven increased UNE-P utilization in New York and Texas, which is not the availability of the UNE-P, but rather the imminent likelihood of an RBOC gaining interLATA relief. In New York, UNE-P has been available since mid-1998. Mr. Gillan's Table 3 shows that ALECs had 75,000 UNE-Ps in New York in June, 1999. By December 1999, just six months later, the number of UNE-Ps in New York had grown to 400,000. Interestingly, in September 1999, Bell Atlantic requested that the FCC grant it permission to provide interLATA service in New York. It was widely believed – even before Bell Atlantic's petition was filed - that Bell Atlantic would receive approval. The logical conclusion is that it was the

imminence of interLATA relief for Bell Atlantic in New York, not the availability of UNE-P that spurred the growth of UNE-P in New York.

Likewise, Mr. Gillan's data for the levels of UNE-P subscription in Texas follow a similar pattern. He quotes Texas data for December 1999 and January 2000. Of course, in January 2000, SBC requested that the FCC grant it permission to provide interLATA service in Texas. As with New York, the perception was that Texas had a high likelihood of succeeding. Indeed, Texas received interLATA relief in June 2000. Again, the high levels of UNE-P subscription in Texas are tied to the likelihood that interLATA relief was imminent for Texas. Based on his data, if Mr. Gillan wants to incent the growth of UNE-P utilization in Florida, one would think he would support BellSouth's entry into the interLATA market in Florida.

Q. ON PAGES 40-49, MS. MURRAY CONTENDS THAT ILECS SHOULD HAVE BASED ALL OF ITS COST STUDIES ON A SINGLE, CONSISTENT, FORWARD-LOOKING NETWORK ARCHITECTURE. PLEASE COMMENT.

A. First, I agree that a consistent forward-looking architecture should be reflected by the network. That is what BellSouth did. However, I disagree with Ms. Murray's claims about how prices must be established to reflect such an architecture. For example, Ms. Murray's contention that it doesn't matter whether costs are classified as recurring or nonrecurring is incorrect. Nonrecurring costs are incurred at the time of service connection and must be recovered regardless of how long the UNE is used or remains in service.

Furthermore, Ms. Murray incorrectly assumes that the same network components are reflected in both the recurring and the nonrecurring prices. Recurring and nonrecurring costs for services are costed differently because they use network components in different degrees or use different components altogether. Recurring prices recover one set of costs, e.g. depreciation, cost of money and maintenance. Nonrecurring prices recover a different set of costs. For example, the cost of the technician installing the circuit for used by the ALEC is recovered through a nonrecurring price. Again, this nonrecurring cost is fully incurred when the service is installed, and must be recovered regardless of how long the customer uses the service.

Finally, Ms. Murray attempts to reintroduce a hypothetical network as the basis for prices. At page 46 of her testimony, she claims that "an incumbent can always limit its total recurring and nonrecurring costs to the costs of owning and operating a new modern network." The only way this occurs is if the incumbent instantaneously rebuilds its network to incorporate each new technology as it becomes available. Using Ms. Murray's car analogy, she is proposing the equivalent of saying that when someone buys a new car, they can simply default on any remaining payments for the old car.

Q. DOES MS. MURRAY'S AUTOMOBILE ANALOGY ON PAGE 42 ACCURATELY SUPPORT HER CONCERNS REGARDING COSTING NETWORK MODERNIZATION?

A. No. Ms. Murray's analogy makes no sense at all. First, if the old car becomes unreliable or doesn't have features that the owner wants, the owner would buy a new car regardless of the monetary difference in the choices. Second, her analogy is simply incorrect. In the premise for the analogy, she assumes that the car owner is only being reimbursed for upkeep of the old car. She then claims that premise is similar to someone being reimbursed for both the up keep of the existing car and payments on the new one. She uses this nonsensical analogy to support her contention that BellSouth is doing something that, in fact, it is not doing. BellSouth is not asking ALECs to pay for two different means of providing the same service. For example, when an ALEC orders an unbundled loop, BellSouth is not asking the ALEC to pay the full cost of that loop provided with one technology plus the full cost of providing it with a different technology. BellSouth is not "mixing and matching," we are simply asking to recover the cost of the functions BellSouth actually performs to provide a UNE.

Again, Ms. Murray's concerns about BellSouth using an inconsistent network design to calculate UNE prices is misplaced. BellSouth considers the same network architecture to develop its recurring and nonrecurring costs.

Q. MR. BARTA APPEARS TO IMPLY THAT A FORWARD-LOOKING ECONOMIC COST MODEL INCLUDES A REASONABLE PROFIT. DO YOU AGREE?

A. It appears that Mr. Barta misinterprets my testimony. A forward-looking methodology can be used to determine costs. However, limiting prices to the level

of cost recovery does not provide an economic profit. Mr. Barta must certainly agree with that.

Q. HAS MR. BARTA CORRECTLY INTERPRETED YOUR TESTIMONY REGARDING RECOVERY OF BELLSOUTH'S SHARED AND COMMON COSTS?

A. No. Contrary to Mr. Barta's interpretation, what I said was that setting prices equal to forward-looking incremental costs does not permit recovery of shared and common costs. Mr. Barta obviously has not kept up with the opinions of others in the ALEC industry, since many ALEC's are claiming BellSouth is not allowed to recover shared and common costs.

Q. IS THERE ANY BASIS FOR MR. BARTA'S CONCERN ABOUT BELLSOUTH INCLUDING "SUPRA-NORMAL" PROFITS IN ITS PRICES?

A. No. BellSouth has not proposed to include any economic profits in its prices. I have simply pointed out that BellSouth's proposed prices do not include a reasonable profit even though it is permitted to do so under the Act.

Geographic Deaveraging

Q. PLEASE RESPOND TO MR. DARNELL'S STATEMENTS THAT BELLSOUTH'S DEAVERAGING METHODOLOGY IS NOT IN COMPLIANCE WITH FCC RULES.

A. Mr. Darnell is incorrect. As I discussed in my direct testimony, BellSouth's methodology for establishing deaveraged UNE prices is based on the geographic boundaries of the existing rate groups. The fact that retail rates have been established using a rate group structure does not "create non-cost based deaveraged UNE rates" as Mr. Darnell contends. Contrary to Mr. Darnell's contention, and consistent with FCC Rule 51.505(d), BellSouth's proposed deaveraging methodology does not include any costs associated with offering retail telecommunications services. BellSouth proposes to group wire center costs by the rate groups where the wire center is geographically located. One advantage of this approach is that it provides more consistency between the structure of retail, resale and UNE prices. Further, customers who are located in the same geographic area and who have similar calling areas will be in the same deaveraged zone for UNE pricing.

In fact, the FCC recognized that existing deaveraged zones for other services provide a proper basis for determining the geographic zones applicable to UNE rates. FCC Rule 51.507(f)(1) specifically grants state commissions the ability to establish geographically deaveraged prices using "existing density-related zone pricing plans described in § 69.123 of this chapter, or other such cost-related zone plans established pursuant to state law." (emphasis added) Section 69.123 as referred to in this rule is the existing zones that apply to special access services. Clearly, the FCC agreed that geographic zones that existed for retail services were a proper basis to establish such zones for UNEs.

Mr. Darnell is equally incorrect in his contention that BellSouth's rate group approach violates FCC Rule 51.505(d) by considering the revenues of other services in the development of its deaveraged UNE prices. BellSouth has used the existing rate groups to establish the zones to which the deaveraged UNE prices apply. BellSouth's retail service rates or revenues are not included in any of the cost development to establish deaveraged prices.

Q. PLEASE RESPOND TO MR. DARNELL'S DISCUSSION ON PAGES 14-15 CONCERNING WHETHER BELLSOUTH'S DEAVERAGING PROPOSAL PROTECTS BELLSOUTH'S EXISTING RETAIL RATE STRUCTURE.

A. First, the rationale for BellSouth's deveraging proposal is not to protect BellSouth's existing retail rate structure. As I have explained, BellSouth contends that its proposal appropriately recognizes the proximity of customers to each other. Of course, BellSouth has consistently maintained that geographic deaveraging should not precede the implementation of an appropriate universal service support mechanism and/or the implementation of adequate rate rebalancing. However, since neither universal support nor rate rebalancing are being addressed in this proceeding, the Commission's goal at this time must be to establish deaveraged rates for UNEs that will promote local competition, given the existing retail rate structure and levels.

Indeed, local competition for many residential customers is currently constrained because retail residence rates are artificially low. As the Commission is aware, implicit subsidies exist in BellSouth's retail business rates in order to subsidize

high-cost residential service. As a result of these implicit subsidies, ALECs will continue to focus on serving business customers and low-cost residential customers, such as multi-dwelling unit residents. Absent BellSouth's ability to "rebalance" retail rates, deaveraged UNE prices based on the existing rate group structure best correlates with the retail market environment in Florida, thereby promoting competition in all areas of Florida.

Q. DOES BELLSOUTH'S PROPOSED DEAVERAGING METHODOLOGY "INSULATE ITS RETAIL RATES FROM COST BASED COMPETITION" AS ALLEGED BY MR. DARNELL?

A. No. BellSouth's retail tariffed rate for business local exchange service in Rate Group 12 is $29.10. BellSouth's proposed deaveraged rate for an unbundled loop that would apply to customers in that rate group is $16.17 (based on a Service Level 1 ("SL1") loop). Obviously, a rate of $16.17 for this UNE loop, even when the costs of switching and transport are added, doesn't provide "insulation" for BellSouth's retail rates.

Now, comparing BellSouth's proposed deaveraged rate of $16.17 to BellSouth's retail tariffed rate of $10.65 for residence local exchange service in Rate Group 12 points makes clear the point I raised in my direct testimony concerning deaveraging of UNE rates absent retail rate rebalancing. Again, this Commission is well aware that residence local exchange rates have been established at an artificially low level in order to promote universal service. BellSouth's proposed deaveraged rates cannot – and should not – follow this same pricing anomaly. What should be

painfully obvious is that geographically deaveraged UNE rates will result in increasing the ALECs' incentive to serve business customers, which will further reduce the implicit subsidies that are used to support the artificially low residence rates. Nothing short of significant reduction of implicit subsidies will stop this downward spiral.

Q. PLEASE COMMENT ON SPRINT'S PROPOSED "BANDING CRITERIA".

A. Mr. Sichter proposes that there be no more than a 20% difference between the rate for a particular zone and the forward-looking cost of any wire center included in that zone. There is no rationale for this arbitrary criteria. His proposal results in eight zones. Indeed, all Mr. Sichter's proposal does is decrease the likelihood that customers in the high cost zones will enjoy competitive alternatives, and provide a windfall to ALECs serving customers in the lowest cost zones.

Reducing UNE prices in the lowest cost zones doesn't translate into increased competition or lower consumer prices in those areas. Obviously, since ALECs have already targeted business customers in the lowest cost zones, ALECs are competing for these customers at the state-wide average UNE rates. Deaveraged UNE rates will only provide additional margin for ALECs in the lowest cost zones. Therefore, all that is accomplished by having more than three zones is that the contribution margin for ALECs is increased in the lowest cost zones.

In the higher cost zones where ALECs have not chosen to compete, increasing the price of UNEs in those zones certainly will not incent them to compete using UNEs.

If ALECs aren't currently competing in those areas by purchasing UNEs at the state-wide average price, a higher deaveraged UNE price certainly won't increase the likelihood of their purchasing UNEs to compete.

BellSouth's proposal for deaveraged SL1 loop rates results in over 60% of lines being rated at $16.17, and no line is rated higher than $25.56. Conversely, Sprint's proposal results in only 23% of lines being rated below $17.77, and many lines would be rated between $32.51 and $115.81. Of course, Mr. Sichter states that he would not be opposed to a wider range of deviation in the highest cost zone in order to reduce the number of zones. However, this concession means nothing because ALECs have no incentive to serve customers in the high cost wire centers using UNEs.

Q. PLEASE ADDRESS THE DEAVERAGING PROPOSAL SET FORTH IN MR. DARNELL'S TESTIMONY ON BEHALF OF AT&T AND MCI WORLDCOM.

A. Mr. Darnell states that his proposal is based on Sprint's deaveraging methodology as described in Mr. Sichter's testimony. However, his Exhibit No. GJD-8 which purports to provide his deaveraging proposal does not produce rates that are consistent with Mr. Sichter's methodology. Of course, Mr. Darnell's proposed rates as shown on Exhibit No. GJD-8 are based on the adjustments AT&T and MCI contend should be made to BellSouth's study. Other BellSouth witnesses address the inappropriateness of these adjustments. However, in order to illustrate the flaws in Mr. Darnell's proposal, I will use Mr. Darnell's proposed rates.

Mr. Darnell proposes six zones, and he claims that page 1 of his Exhibit No. GJD-8 provides the minimum cost, the mid-point cost, the maximum cost and the average cost for each of these six zones. However, his claim is incorrect. First, most of the minimum and maximum wire center costs he shows on page 1 don't correspond to the cost for any wire center as shown on pages 2-9. Second, even if the costs he uses on page 1 were accurate, he uses the maximum cost for each zone as the minimum cost for the adjacent zone. Consequently, it appears that he puts the same wire center in two different zones. This makes no sense. A wire center belongs in only one zone – the cost associated with that wire center can't be shown as both the maximum cost in one zone and the minimum cost in the next zone. Third, his proposed average cost for Zone 6 is an amalgamation that does not result in a price that is limited to the 20% spread that he ostensibly believes is appropriate.

Q. PLEASE ADDRESS SUPRA'S PROPOSAL THAT LOOP-RELATED ELEMENTS BE DEAVERAGED BASED UPON LOOP LENGTH.

A. On the surface, Supra's proposal, as set forth by Mr. Nilson, appears to have merit since distance is one of the primary factors that affect loop costs. However, from a practical standpoint, Mr. Nilson's proposal would be extremely burdensome and would provide little, if any, competitive benefit over BellSouth's proposal. BellSouth's engineering database that contains loop make-up information is not integrated with BellSouth's ordering and billing systems. Therefore, implementing distance-sensitive pricing for UNEs would take considerable time. Also, because it would not be appropriate to have a distance-sensitive rate structure for UNEs while maintaining a flat-rate structure for retail rates, a complete restructure of retail rates

would also be necessary. In any event, the FCC was obviously satisfied that averaging costs using no more than three zones is sufficient to deal with cost variations.

Q. ON PAGE 7, MR. SICHTER PROVIDES A LIST OF THE UNES HE BELIEVES SHOULD BE DEAVERAGED. PLEASE COMMENT.

A. BellSouth has proposed deaveraged rates for loops and sub-loops, as well as for the loop component of UNE-P and the Enhanced Extended Link ("EEL"). BellSouth's proposed rates for dedicated and common transport are distance sensitive, as are the dark fiber rates, thereby eliminating the need for geographic deaveraging of these elements. BellSouth witness Ms. Daonne Caldwell will further explain why there is no need to deaverage the transport element. I would note that no other party to this proceeding supports Sprint's view that any elements other than loops, sub-loops and combinations that include loops require deaveraging.

Rates

Q. PLEASE COMMENT ON MS. MURRAY'S PROPOSAL THAT LOOP MAKE UP INFORMATION SHOULD BE PROVIDED FREE.

A. Such a proposal is ludicrous. The price for providing loop make up information to ALECs should include all the costs required to make this data available to ALECs in an electronic medium. Ms. Murray is proposing that BellSouth eat all of those development costs and charge only for the ongoing data processing costs. There is no rational reason for this proposal.

Q. MS. MURRAY CLAIMS HER PROPOSAL TO PROVIDE FREE LOOP MAKE UP INFORMATION IS SUPPORTED BY OTHER COMMISSION DECISIONS. DO YOU AGREE?

A. No. Ms. Murray's assessment of the two proceedings she references is incorrect. Both of the orders she references only established interim prices, so neither of those state commissions has decided what the price should be. In the Texas case, Ms Murray has only quoted the charge for processing the request for loop makeup information. She has not indicated whether other charges apply to cover the development costs.

Q. HAS MS. MURRAY CORRECTLY STATED THE CHARGES THAT BELLSOUTH PROPOSES FOR LOOP QUALIFICATION?

A. No. The charge BellSouth proposes for Loop Make Up information is dependent upon the means by which the ALEC obtains the information. If the ALEC requests the loop makeup information on a mechanized basis then the BellSouth proposed rate of $.6888 would apply per dip. If the ALEC requests the information manually, then the rates BellSouth proposes would be $132.82 without facility number reservation or $138.61 with facility number reservation. Ms. Murray's proposal that BellSouth should not be able to recover its costs for providing loop make up should be rejected.

Q. DOES MS. MURRAY'S POSITION THAT BELLSOUTH SHOULD NOT BE ALLOWED TO CHARGE FOR LINE CONDITIONING COMPORT WITH THE FCC'S UNE REMAND ORDER?

A. No. The FCC recognized that load coils, bridge taps, etc. are often present on loops, and that the ILEC incurs costs in removing them. At ¶193 of its UNE Remand Order, the FCC stated that "under our rules, the incumbent should be able to charge for conditioning such loops."

Q. DOES MS. MURRAY'S POSITION ON BELLSOUTH CHARGING FOR LINE CONDITIONING COMPORT WITH COVAD AND RHYTHM'S PETITION FOR RECONSIDERATION OF THE FCC'S UNE REMAND ORDER?

A. No. Apparently, Covad and Rhythm's recognize that BellSouth is currently allowed to recover its costs for line conditioning. Obviously, if they didn't believe this was the case, then they would not have been compelled to petition the FCC for reconsideration of the UNE Remand Order. A copy of their petition is attached to my testimony as Rebuttal Exhibit AJV-1.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

(#224651)

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers	)	CC Docket No. 95 -185

JOINT PETITION FOR RECONSIDERATION OF RHYTHMS NETCONNECTIONS INC. AND COVAD COMMUNICATIONS COMPANY

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Before the
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Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers	)	CC Docket No. 95-185

PETITION FOR RECONSIDERATION

Rhythms NetConnections Inc. ("Rhythms") and Covad Communications Co. (collectively "Petitioners"), by their attorneys, respectfully request that the Commission reconsider its decision on conditioning charges in the above captioned proceeding.[1]

INTRODUCTION

In order for any carrier to offer advanced services, that carrier must have access to "clean copper" or "conditioned" loops.[2] A conditioned loop is a loop in "its basic form."[3] In other words, a conditioned loop is a continuous metallic wire link unfettered by, among other things, load coils, repeaters and excessive bridge tap. While the ILECs have placed this equipment on loops to facilitate voice transmission, these devices "diminish the loop's capacity to deliver advanced services, and thus preclude the requesting carrier from gaining full use of the loop's

[1] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238 (rel. Nov. 5, 1999) ("*UNE Remand Order*"). The Petitioners also request that any revisions made to the *UNE Remand Order* pursuant to this petition apply to any subsequent Commission decisions that affect loop conditioning charges.

[2] Indeed, the very term "conditioning" is potentially misleading. The term "conditioning" in telecommunications parlance generally refers to the process of adding equipment to a circuit to improve its functionality. In contrast, ILECs that "condition" loops for DSL service are actually removing such equipment from the loop.

[3] *Id.* ¶ 172.

capabilities."[4] Therefore, the Commission has appropriately ordered ILECs to condition loops for requesting carriers by removing these devices.[5] In fact, the Commission has now included conditioning "within the definition of the loop network element."[6] Thus, when a CLEC requests a conditioned loop, the ILEC must remove any interfering equipment that it had previously placed on the loop and make that loop available as an unbundled element. The Commission's requirement that ILECs condition loops is clearly consistent with the procompetitive principles and statutory provisions of the 1996 Act.

The *UNE Remand Order*, however, violates these same principles and provisions. The Commission's rules properly mandate that any conditioning charges be based upon its forward-looking TELRIC pricing methodology. Notwithstanding the fact that in a forward-looking environment loops would already be conditioned for the provision of data services, the *UNE Remand Order* authorizes ILECs to charge CLECs for conditioning. Moreover, authorizing ILECs to impose conditioning charges solely on the basis that they will incur costs for removing this embedded equipment is directly at odds with TELRIC. Furthermore, according to Bellcore engineering rules, loops below 18,000 feet in the embedded plant should not require conditioning.[7] Thus, even under an embedded pricing methodology, ILECs should not be permitted to impose conditioning charges on loops below 18,000 feet. The Commission should correct these contradictions between its forward-looking pricing rules and the *UNE Remand Order's* reliance on embedded pricing principles.

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[4] *Id.*

[5] *Id.* ¶173.

[6] *Id.*

[7] *Id.* ¶ 193. It is important to recognize that the Commission's loop definition is not limited, or in any way qualified, by the length of a loop. The ILECs' loop obligations, including the obligation to provide conditioned loops capable of providing advanced services, applies to loops below 18,000 feet, as well as loops beyond 18,000 feet.

Finally, if the Commission affirms its decision to permit conditioning charges, it should find that state commissions have the authority to require that any conditioning charges be recovered through the ILECs' recurring charges.

DISCUSSION

I. Conditioning Charges are Inconsistent with TELRIC

The *UNE Remand Order* creates an irreconcilable contradiction between the Commission's rules, which explicitly require a forward-looking costing approach, and the Commission's conclusion that incumbents may impose conditioning charges, which takes an embedded costing approach. The Commission's rules clearly require that any conditioning charges comply with its TELRIC pricing methodology. TELRIC costs are calculated "based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers."[8] According to 47 C.F.R. § 51.319(a)(3)(B), recovery of line conditioning costs must be "in accordance with the Commission's forward-looking pricing principles promulgated pursuant to section 252(d)(1) of the Act." In addition, according to 47 C.F.R. § 51.319(a)(3)(C) any conditioning charges must be "in compliance with rules governing nonrecurring costs in § 51.507(e)." Section 51.507(e) provides that:

> State commissions *may*, where reasonable, require incumbent LECs to recover nonrecurring costs through recurring charges over a reasonable period of time. Nonrecurring charges shall be allocated efficiently among requesting telecommunications carriers, and *shall not permit an incumbent LEC to recover more than the total forward-looking economic cost of providing the applicable element.*[9]

The effect of these rules is that ILECs must base any conditioning charges on a forward-looking network design consistent with TELRIC. Clearly, a forward-looking network is one that

[8] 47 C.F.R § 51.501(b)(1).

supports both data and voice services. As the Commission recognizes, a loop can only be data ready if it is unencumbered by intervening devices such as load coils, excessive bridge tap, and repeaters.[10] In other words, a forward-looking network would not contain these devices. Indeed, to comply with TELRIC methodology, a cost study may not include costs, such as the addition of load coils and bridged tap, incurred by ILECs in the past and already included in their books. Those impedances are already paid for and booked and are not part of the forward-looking network design. Similarly, removing those impedances is a cost for which ILECs are already compensated as part of the monthly recurring loop rate – the recurring loop rate is based on the cost of an efficient loop, which does not include loop electronics such as load coils.[11]

Notwithstanding these pricing rules, the *UNE Remand Order* authorizes ILECs to recover the costs of removing load coils and other impediments that exist in the embedded plant, even though these devices would not exist in a forward-looking network. The use of a network design for pricing purposes that requires the removal of these devices in order to make functional use of the loop runs counter to TELRIC principles in that it is not forward-looking.[12] By permitting ILECs to impose a charge for a service that would not exist in a forward-looking network, the

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[9] 47 C.F.R. § 51.507(e) (*emphasis added.*)

[10] *UNE Remand Order* ¶ 172.

[11] In addition, per-unit (such as per-loop) costs must be divided "by a reasonable projection of the sum of the total number of units of the element that the incumbent LEC is likely to provide to requesting telecommunications carriers and the total number of units of the element that the incumbent LEC is likely to use in offering its own services, during a reasonable measuring period." 47 U.S.C. § 51.511. Thus, for example, when an ILEC technician removes load coils from that ILEC's loop plant, the technician does not remove one coil at a time; rather, the technician removes all of the load coils in an existing binder group of loops – any other practice would be inefficient. But if a competitive LEC requests a loop free of load coils, the ILEC will charge the competitor for each and every load coil removal, even as additional ILEC load coils are removed on that same truck roll. *See Petition of Dieca Communications d/b/a Covad Communications Company and Rhythms Links, Inc. for Arbitration to Establish an Interconnection Agreement With Southwestern Bell Telephone Company,* Arbitration Award, Texas PUC Docket No. 20272, ("*Texas Arbitration Award*") at 97-99 (Nov. 1999).

[12] Indeed, the FCC has prohibited the inclusion of loops configured with such electronic impedances in forward-looking economic cost studies, because such loops do not provide universal access to advanced telecommunications services. *Federal-State Joint Board on Universal Service, Report and Order,* CC Docket No. 96-45, 12 FCC Rcd 8776 (1997), (*Universal Service* Order) as corrected by *Federal-State Joint Board on Universal Service*, Errata, CC Docket No. 96-45, FCC 97-157 ¶ 250 (rel. June 4, 1997).

Commission threatens the integrity of its TELRIC pricing principle. Therefore, the Commission should reconsider its departure from TELRIC and prohibit ILECs from imposing conditioning charges.

II. The Commission's Justification for Permitting ILECs to Impose Conditioning Charges is Inconsistent with TELRIC

The *UNE Remand Order's* only justification for permitting conditioning charges is that under the Commission's rules because the ILEC "may incur costs in removing [these devices] . . . the incumbent should be able to charge for conditioning such loops."[13] In fact, just the opposite is true.

As explained above, the Commission's rules require that prices be based on a forward-looking, least cost, most efficient network. Permitting ILECs to impose conditioning charges simply because they will "incur costs" to make their outside plant compliant with existing Bellcore engineering guidelines is not consistent with the Commission's pricing rules. Indeed, the *UNE Remand Order's* methodology represents an embedded costing methodology, the antithesis of the Commission's TELRIC pricing rules. By relying on an embedded costing approach, the *UNE Remand Order* creates an internal contradiction with TELRIC. To correct this contradiction, the Commission should reverse its decision and affirm the integrity of its TELRIC pricing methodology by prohibiting ILECs from imposing conditioning charges.

III. Even Under an Embedded Pricing Methodology, the Commission Should Prohibit ILECs from Imposing Conditioning Charges on Loops Less than Eighteen Thousand Feet

At a minimum, the Commission should reverse its decision to allow conditioning charges on loops less than 18,000 feet. Even under an embedded costing methodology, conditioning charges are inappropriate for these shorter loops. As the Commission recognizes, "networks

[13] *Id.* ¶ 193.

built today normally should not require voice-transmission enhancing devices on loops of 18,000 feet or shorter."[14] Indeed, Bellcore resistance design standards dictate that loops under 18,000 feet should not contain such impediments. It is important to recognize that carriers requesting a conditioned loop below 18,000 feet are asking for nothing more than a loop "in its basic form"[15] that complies with accepted engineering rules.

To the extent that ILECs have placed interfering devices on loops less than 18,000 feet in length, they have violated widely accepted engineering rules and the ILECs, not the CLECs, should pay to remove this equipment. Just because the ILECs will incur costs for making their outside plant compliant with proper engineering rules is not sufficient justification for permitting them to pass those costs on to the CLECs. Even using an embedded, historical cost recovery methodology, charging CLECs for the removal of equipment that should not be present is inappropriate. Therefore, the Commission should reverse its decision and prohibit ILECs from imposing conditioning charges on loops less than 18,000 feet.

IV. The Commission Should Find that State Commissions May Require that Conditioning Charges be Recovered Through Recurring Charges

Furthermore, the Commission should revise its decision to find that under its rules line conditioning need not be recovered through a nonrecurring charge. In the *UNE Remand Order*, the Commission concluded that incumbent LECs "may have an incentive to inflate the charge for line conditioning by including additional common and overhead costs, as well as profits."[16] The Commission concluded, however, that state commissions should "ensure that the costs

[14] *Id.*
[15] *Id.* ¶ 172.
[16] *Id.* ¶ 194.

incumbents impose on competitors for line conditioning are in compliance with our pricing rules for nonrecurring costs."[17]

While Petitioners agree with the Commission's conclusion that state commissions have an important role to play in ensuring ILEC compliance with TELRIC pricing principles, we do not agree with the Commission's conclusion that state commissions *must* permit ILECs to recover conditioning costs as nonrecurring charges. Indeed, by dictating that conditioning charges are to be recovered as nonrecurring charges, the Commission belies its own conclusion that state commissions, not the FCC, shall determine the appropriateness of such charges. The Commission's rules clearly state that "[s]tate commissions *may*, where reasonable, require incumbent LECs to recover nonrecurring costs through recurring charges over a reasonable period of time."[18] While loop conditioning can be construed as a nonrecurring activity (that is, it is only performed once on a loop), it does not necessarily follow that the costs of loop conditioning must be imposed on competitive LECs as a nonrecurring charge. Therefore, Petitioners request that the Commission revise its decision and permit state commissions to order ILECs to recover their conditioning costs through their recurring charges.

Petitioners and other competitive LECs have argued in numerous state proceedings that loop conditioning charges proposed by ILECs are discriminatory, do not comport with TELRIC pricing methodology, and represent double recovery for conditioning costs. Yet competitive LECs will now be handicapped in making this argument before state commissions by the FCC's statement that incumbent LECs must be permitted to recover conditioning costs as nonrecurring charges. Thus, the FCC has foreclosed state commissions from concluding that the TELRIC

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[17] *Id.*

[18] 47 C.F.R. § 51.507(e) (*emphasis added*).

recurring monthly loop rate, which is based on the forward-looking network design that has no electronic impedances, already compensates incumbent LECs fully for removal of such devices.

This is not a mere hypothetical outcome: this very perverse result has actually occurred. In a recent arbitration award, the Texas Public Utility Commission arbitrators concluded, "consistent with FCC precedent, including the *Local Competition Order*," that SBC's loop rates in Texas must be TELRIC-based.[19] The arbitrators further found that "conditioning charges for the removal of repeaters and load coils should only apply to xDSL loops at or beyond 18,000 feet in length."[20] Yet the Texas arbitrators "recognize[d] that the FCC recently found that the incumbent, in this instance SWBT, should be able to charge for conditioning on loops at or less than 18,000 feet in length."[21] Thus, while the Texas arbitrators found in favor of Covad and Rhythms by specifically accepting their argument that conditioning charges should never apply to loops less than 18,000 feet in length, the arbitrators felt compelled by the FCC's *UNE Remand Order* to permit SBC to charge CLECs for the "costs" it incurs for loop conditioning on any loop. This perverse result could not have been the intention of the FCC: to support its conclusion that state commissions should make the final determination as to loop costs, the FCC should revise its conclusion that incumbent LECs are always entitled to recover loop conditioning charges as nonrecurring costs.

CONCLUSION

Petitioners urge the Commission to reconsider its decision to allow ILECs to impose conditioning charges. Since a forward-looking network design would not require conditioning, such charges are incompatible with the Commission's pricing rules. At a minimum, the Commission should prohibit ILECs from forcing carriers to pay conditioning charges on loops

[19] *Texas Arbitration Award* 84.
[20] *See id.* 95.

below 18,000 feet. In addition, the Commission should permit state commissions, in determining the level of conditioning charges, to order the ILECs to recover these costs through recurring charges where reasonable.

Respectfully submitted,

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[21] *See id.*

CERTIFICATE OF SERVICE

I, Stanley M. Bryant, do hereby certify that on this 21st day of January, 2000, I have served a copy of the foregoing document via * messenger and U.S. Mail, postage pre-paid, to the following:

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