

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

Illinois Bell Telephone Company)	
)	
Filing to increase Unbundled Loop and Nonrecurring Rates)	02-0864
)	

REPLY BRIEF OF SBC ILLINOIS

PUBLIC VERSION

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REPLY BRIEF OF SBC ILLINOIS

Illinois Bell Telephone Company (“SBC Illinois” or “the Company”), by its attorneys, hereby files its Reply Brief in response to the Initial Briefs filed by the Staff of the Illinois Commerce Commission (“Staff”); AT&T Communications of Illinois, Inc., CIMCO Communications, Inc., Forte Communication, Inc., McLeodUSA Telecommunications Services, Inc., RCN Telecom Services of Illinois, Inc., TDS Metrocom, LLC, Worldcom Inc. d/b/a MCI, and XO Illinois, Inc., filing jointly (“Joint CLECs”); the Citizens Utility Board (“CUB”); the People of the State of Illinois (“AG”); the United States Department of Defense and All Other Federal Executive Agencies (“DOD/FEA”); and TruComm Corporation, Data Net Systems L.L.C.; and the Illinois Public Telecommunications Association filing jointly.¹

I. Introduction and Summary of Position

This proceeding provides a much needed opportunity to review, reevaluate and update the rates SBC Illinois charges CLECs for UNE loops. As the 7th Circuit Court of Appeals recognized in the *AT&T Communications* litigation, SBC Illinois’ current rates are based on cost inputs that are now *six years* out-of-date.² SBC Illinois, its competitors and the citizens of the State of Illinois are entitled to updated rates that properly reflect the Federal Communications

¹ TruComm et al. simply joined in the brief filed by the Joint CLECs.
² *AT&T Communications of Illinois vs. Illinois Bell Telephone Co.*, 349 F.3d 402 (7th Cir. 2003) (“*AT&T Communications*”).

Commission's ("FCC") TELRIC principles and will accomplish the goals of the Telecommunications Act of 1996 ("the 1996 Act").

SBC Illinois' approach to implementing the FCC's TELRIC rules is principled and reasonable. All of the cost study inputs and modeling assumptions reflect a consistent forward-looking environment and assume use of the most efficient technologies available in the marketplace today. On the other hand, SBC Illinois generally uses real world data as a starting place, to ensure that its forward-looking assumptions are grounded in realistic constructs and that they can be reasonably audited and verified by third parties like the Commission Staff, the CLECs and consumer groups.

Staff, the Joint CLECs and other parties take a quite different, and internally inconsistent, approach. With respect to some inputs – particularly cost of capital and depreciation – they fall back on antiquated analytical models that might have been cutting edge in *1970s* rate proceedings, but certainly are not today. They ignore express direction from the FCC that more aggressive and up-to-date assumptions are required for forward-looking TELRIC studies. With respect to other inputs – particularly network design and construction – they assume a futuristic "Star Wars" world, where SBC Illinois' entire loop plant can be reconstructed instantaneously and perfectly at the push of a button. They ignore express direction from the FCC that network assumptions should be grounded in reality. The Joint CLECs are far more guilty of the latter error than the Commission Staff, but even Staff insists on using unrealistic assumptions in certain instances. Neither extreme is TELRIC-compliant.

SBC Illinois' UNE loop rates need to be increased. Many of the assumptions used by the Commission in 1998 to set these rates have not withstood the test of time, especially the use of extremely hypothetical fill factors. The cost studies used in that proceeding were based on data

that was *already* old and missing components. Although SBC Illinois prides itself on being an efficient carrier, the low UNE rates set in 1998 were not the reflection of that efficiency – they were the result of errors, omissions and overly aggressive input assumptions used in the cost study process. Costs have changed since that docket in any event: while some equipment costs may have declined, labor costs (which constitute the majority of UNE loop costs) have increased. Therefore, any cost estimates produced by parties to this proceeding that are equal to or lower than the rates approved in 1998 should be viewed with the greatest skepticism.

Finally, the parties to this proceeding continue to wring their hands over the potential impact of UNE loop rate increases on SBC Illinois' retail rates and the CLECs' ability to compete. These are make-weight concerns. There will be and need be *no* impact on SBC Illinois' retail rates as long as the Commission rejects the rigid and formulaic approach to imputation proposed by the parties that caused the problem in the first place. With respect to competition, the Joint CLECs are simply trying to maintain the extraordinary profit margins that they are currently enjoying in Illinois. Nothing in the 1996 Act, the FCC's TELRIC policies or economic principles supports their entitlement theory. For this marketplace to function properly over the long run, UNE loop prices must be fair to both the CLECs *and* SBC Illinois – the carrier responsible for providing high quality service to *all* of the customers in its service territory, not just the high end users that are so attractive to the CLECs.

Most of the issues raised by Staff and the other parties were addressed in SBC Illinois' Initial Brief. To minimize repetition, SBC Illinois will avoid restating positions and arguments to the maximum extent possible. Thus, failure to respond to every issue raised by another party in this reply brief should not be construed as agreement.

II. General Issues

A. Legal Requirements for Setting Rates

The Joint CLECs (at 2) use this section of their brief to argue that SBC Illinois has the burden of proof in supporting its proposed rates, and Staff (at 27-28) makes a similar statement. Whatever burden SBC Illinois may have here, it has carried it, as demonstrated throughout the testimony and SBC Illinois' Initial Brief. Staff also provides a discussion of TELRIC, primarily quoting FCC rules and portions of the *First Report and Order*. Staff Br. at 16-22. Again, this requires no real response because SBC Illinois has demonstrated throughout its testimony and Initial Brief that its cost studies and proposed prices are based on and fully consistent with TELRIC rules and principles. At pages 23-27 Staff outlines some of its disagreements with SBC Illinois' proposals. Those matters are addressed with respect to the specific costs and studies at issue throughout this brief and SBC Illinois' Initial Brief.

B. Economic/Policy Issues Associated with UNE Pricing (including benchmarking analyses and trends in communication costs)

As discussed in SBC Illinois' opening brief (at 20-23), it is important in setting forward-looking TELRIC-based prices to evaluate potential results against real-world costs as a gauge of overall reasonableness. Accordingly, SBC Illinois presented testimony, primarily from Dr. Aron and Mr. Sneed, to put the current unbundled loop prices and the proposals here into perspective and to compare them against standard benchmarks used when making forward-looking cost projections. As Dr. Aron and Mr. Sneed demonstrated, SBC Illinois' current UNE loop prices are far too low to reasonably recover forward-looking costs, and the proposals of the Staff and CLECs are even worse. SBC Ill. Br. at 20-23. Rather, the only proposal in line with both TELRIC and real-world guideposts is SBC Illinois' proposal.

1. Response to Staff

Staff begins with the accepted proposition that UNE rates should be set neither "too high" nor "too low." Staff Br. at 29. From there, however, Staff spends the next six pages listing the

alleged adverse effects of TELRIC-based prices that are “too high.” *Id.* at 29-35. SBC Illinois does not dispute that there could be adverse affects if UNE prices were truly set higher than the top of the range that TELRIC allows. But Staff misses the point. As Dr. Aron and Mr. Sneed showed, the problem in Illinois today is not that UNE prices are too high, but that they are too *low*. So low, in fact, that SBC Illinois loses \$8 a month in out-of-pocket costs on every unbundled loop. SBC Ill. Ex. 2.1 (Aron Rebuttal) at 27. As the FCC has recognized, irrationally low UNE prices send the wrong economic signals, discouraging efficient investment and undermining the goals of the 1996 Act, harms that are every bit as serious as those that might come from prices that are too high. *TELRIC NPRM*, ¶ 3. Those harms are occurring today, as Illinois CLECs continue to focus on the UNE-P in order to take advantage of UNE prices that give CLECs some of their highest margins in the country.

Staff inexplicably ignores this other side of the TELRIC coin, even though the public interest concerns are just as great as if UNE prices were too high. Staff may take this approach because it does not view Dr. Aron’s analysis as relevant. That view is mistaken. Dr. Aron did what investment analysts and others always do when projecting forward-looking costs – she used current costs as her starting point and conducted a detailed comparison to the current Illinois loop prices. And she found that current loop prices, and the even lower prices proposed by the CLECs, are so far out of line with current costs that they cannot represent a reasonably forward-looking network. SBC Ill. Ex. 2.0 (Aron Direct) at 8-16.

2. Response to CLECs

This section of the Joint CLECs’ brief is largely a cut-and-paste from Mr. Gillan’s testimony. Dr. Aron has already refuted each one of Mr. Gillan’s misrepresentations, errors, and

oversights in her detailed rebuttal and surrebuttal testimony (SBC Ill. Ex. 2.1 at 4-50) and there is no need to repeat that discussion in full here. A few points, however, bear mentioning.

All the witnesses agree that UNE prices must be based on forward-looking costs. The CLECs, however, are afraid to acknowledge that no one can know with certainty what the forward-looking costs of hypothetical firm that provides only UNEs would be, because no such firm exists. SBC Ill. Ex. 2.1 (Aron Rebuttal) at 2. Thus, parties rely on models and assumptions to project forward-looking costs for such an imaginary firm. That is fine, but the results of those models must be approached with respectful skepticism, and their results should be compared to real-world information to gauge whether they are reasonable. *Id.* For example, different models could project that a hypothetical firm, using SBC Illinois' switch locations and currently available technology, at either 10% of SBC Illinois' current cost or 80% of SBC Illinois' current cost. The former would strike almost anyone as sheer fantasy, while the latter might seem to at least be in the ballpark. The Joint CLECs, however, propose purportedly "forward-looking" costs that are less than one-third of what it costs SBC Illinois to build and operate a new loop today.

Because one cannot draw reasonable inferences about models of non-existent firms unless those models results are benchmarked against reality, Dr. Aron conducted such an analysis of SBC Illinois' current loop prices, current costs, and competing cost proposals. She found that the difference between SBC Illinois' actual costs and other parties' projected costs were huge – far more than could be ascribed to the mere use of new equipment. SBC Ill. Ex. 2.0 (Aron Direct) at 8-16. The Board of Public Utilities of New Jersey has previously rejected similar lowball CLEC proposals as being facially unreasonable (SBC Ill. Ex. 2.1 (Aron Rebuttal) at 17), and this Commission should do the same with the CLEC and Staff proposals here. A

TELRIC-based price still must reflect what an actual CLEC could actually do in the market today. *First Report and Order*, ¶ 679. No one, however, could seriously agree with AT&T that a LEC could place and operate a loop for \$4.00 a month when the latest available information shows that it cost SBC Illinois about \$14.91 to do the same thing in 2001. SBC Ill. Ex. 2.1 (Aron Rebuttal) at 9.

The CLECs also continue to claim that SBC Illinois' loop prices must go down because costs in the telecom industry are declining. Joint CLEC Br. at 23-29. SBC Illinois already refuted this claim in its opening brief (at 24-27) and the CLECs have added nothing new here. As before, they focus on generalities and statements about non-loop facilities, and thus never present anything to show that *loop* costs are declining. Such a showing is critical, because otherwise the CLECs have no way to overcome MCI's admission to the Supreme Court in *Verizon* that loop costs are increasing. See SBC Ill. Br. at 25.

Much as Staff and the CLECs might like to ignore Dr. Aron's and Mr. Sneed's benchmarking analysis, it is those analyses that put current loop prices and the competing proposals into a meaningful context. TELRIC presents enough hypotheticals and projections that there is every reason to look at real-world sanity checks and not, as the CLECs and Staff propose, ignore everything but the competing forecasts of the costs of a non-existent firm. And it is clear why CLECs and Staff want to avoid the use of real-world benchmarks, because they starkly illustrate the absurdity of the CLECs' proposals and the unreasonableness of Staff's proposal.

III. UNE Loop Recurring Cost Studies

A. Compliance with TELRIC Generally (including SBC Illinois' Loop Cost Analysis Tool, LoopCAT)

The Joint CLECs repeat the arguments made by their witnesses in support of their position that the LoopCAT model used to develop UNE loop recurring costs in this proceeding is “flawed and unreliable” and “not an improvement” over the AFAM model used to establish the existing rates. Joint CLEC Br. at 29-40. These arguments are without merit for the reasons that have already been fully addressed in SBC Illinois’ Initial Brief. SBC Ill. Br. at 33-38, 105-53. The Joint CLECs’ arguments in support of the specific adjustments they assert are necessary to correct LoopCAT’s alleged deficiencies are addressed in Section III.C of this Reply Brief, below.

1. The Joint CLECs Mischaracterize SBC Illinois’ Cost Studies And The TELRIC Standard.

The Joint CLECs contend that SBC Illinois “rejects the ‘forward-looking’ approach for its cost studies” and relies on the FCC’s TELRIC NPRM as its “chief defense for failing to comply with TELRIC.” Joint CLEC Br. at 45. The Joint CLECs then argue that SBC Illinois’ position, as so characterized, should be rejected because the “TELRIC methodology has not changed, and will not change, until the FCC actually issues an order that promulgates new TELRIC rules.” *Id.*

The Joint CLECs’ argument in this regard is a classic example of an attack on a “straw man.” As SBC Illinois made clear in its Initial Brief, the Company is *not* proposing to “reject” the “forward-looking” approach for its cost studies, and the cost studies it has presented in this case fully comply with the existing TELRIC rules, as they have been interpreted by the FCC and the courts. SBC Ill. Br. at 7-8, 31-38. Thus, for example, LoopCAT uses a forward-looking network design for the feeder plant that places fiber and digital loop carrier (“DLC”) equipment in the feeder portion for all loops longer than 12, 000 feet. The result of using this forward-looking network design is to include in the study extensive placement of fiber loop plant well

beyond that which exists in the current loop network. SBC Ill. Br. at 32-33, 36; SBC Ill. Ex. 4.0 (Smallwood Direct) at 5; SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 9; SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 15. In addition, LoopCAT calculates the forward-looking cable gauging for the copper cable remaining in the loop plant. *Id.* As another example, LoopCAT assumes the use of forward-looking Litespan DLC technology, even though the existing network contains numerous, older generation DLC facilities. *Id.*

Thus, the question here is not whether the cost studies comply with the TELRIC requirement that costs be based on the provision of service over a “forward-looking” network, taking into account the actual locations of SBC Illinois’ wire centers and actual locations of its customers, and constructed with the most efficient currently available technology. 47 C.F.R. § 51.505; *First Report and Order*, ¶ 685. The evidence clearly shows that SBC Illinois’ cost studies do comply with that requirement. Rather, the question is whether the TELRIC rules should be interpreted as requiring that all evidence regarding existing costs and the attributes of the existing network must be disregarded in developing forward-looking costs, as the Joint CLECs contend. The answer to that question is incontrovertibly “no,” as the 7th Circuit Court of Appeals recently stated:

True enough, TELRIC calls for a projection, but it does not demand that every ingredient be hypothetical. How could one know the long-run costs of the most efficient technology without understanding the costs of today’s most efficient producers? *AT&T Communications of Illinois v. Illinois Bell Telephone Co.*, 349 F.3d 402, 410-11 (7th Cir. 2003) (“*AT&T Communications*”).

In its TELRIC NPRM, the FCC also made it clear that the Joint CLECs’ excessively theoretical interpretation of the existing TELRIC standard is incorrect, stating that “the UNE pricing methodology, while forward-looking, must be representative of the real world and should not be based on the totally hypothetical cost of a most-efficient provider building a network from

scratch.” TELRIC NPRM, ¶ 53. This statement expresses the FCC’s current interpretation of the existing TELRIC standard, and not a proposed change to that standard. In fact, this statement is consistent with what the FCC told the D.C. Circuit in explaining the current TELRIC standard: “Indeed . . . the FCC itself [has] used historical data to estimate forward-looking costs . . . And [AT&T] could not plausibly contend that the ‘cost’ standard of Section 252(d)(1). . . prohibits taking such data into account.” FCC Br. to D.C. Circuit in *AT&T Corp. v. FCC*, Nos. 99-1538 and 99-1540, at 17-18 (D.C. Cir., filed March 6, 2000).

Thus, for example, LoopCAT’s use of existing network data on cable length does not, as the CLECs suggest, mean that LoopCAT improperly relies on “embedded data” in violation of TELRIC. To the contrary, using existing network characteristics simply reflects the fact SBC Illinois’ engineers have efficiently placed cable, that the existing rights-of-way (which determine cable lengths) would be the same rights-of-way that would exist in a forward looking network, and that speculating about hypothetical changes in cable placements and routing is unwarranted. The existing network data is then combined with the forward-looking equipment designs and forward-looking equipment costs to develop TELRIC loop costs. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 16.

Accordingly, there is no basis for the Joint CLECs’ suggestion that SBC Illinois is proposing to use a cost method “resembling the traditional embedded cost of service model of rate setting.” Joint CLEC Br. at 47, quoting TELRIC NPRM, ¶ 33. To the contrary, as discussed in Section III.B, below, it is the Joint CLECs who are proposing to improperly apply the “traditional embedded cost of service model of rate setting” to the calculation of depreciation and cost of capital, two of the most significant cost model inputs, in direct contravention of the existing TELRIC methodology as it has been interpreted by the FCC.

Finally, the Joint CLECs' contention that this Commission's should disregard all of the FCC's "tentative conclusions" in the TELRIC NPRM regarding the proper interpretation and application of the TELRIC standard is without merit, because it incorrectly assumes that those "tentative conclusions" represents a departure from the language of the existing TELRIC rule. That is not the case because, as the FCC expressly recognized, the language of the TELRIC standard is "general in nature" and provides "state commissions" with "wide latitude in applying the 'most efficient technology' standard under the current rules." TELRIC NPRM at ¶ 7. Thus, it is entirely proper for the Commission to be guided in this case by the FCC's "tentative conclusions" as to how this "general" standard should properly be interpreted and applied.

2. The Joint CLECs *Ad Hominem* Attack On SBC Illinois And Its Cost Study Witness Is Entirely Without Merit.

As discussed in SBC Illinois' Initial Brief, SBC Illinois recognizes that any study methodology can be improved based on inputs from other parties. Accordingly, during the course of the proceeding, SBC Illinois accepted certain cost study adjustments proposed by the parties (including AT&T) that represented valid refinements over existing methods. Proving the adage that no good deed goes unpunished, the Joint CLECs cite SBC Illinois' action in this regard as the basis for an improper attempt to impugn SBC Illinois' cost witness Mr. Smallwood's credibility and integrity for not implementing those revisions sooner. Joint CLEC Br. at 41. Specifically, the Joint CLECs assert that Mr. Smallwood became aware of the need to make revisions to LoopCAT in late 2002 and improperly ignored them in the cost study submitted with SBC Illinois' direct testimony. *Id.*

The Joint CLECs' *ad hominem* attack on SBC Illinois and Mr. Smallwood is completely unfounded, and should be rejected.

As the Joint CLECs recognize, the issues they refer to arose from CLEC criticisms in different state proceedings, and Mr. Smallwood first became aware of these issues in and around November/ December, 2002. *Id.* SBC, however, does not automatically modify its costing methodologies to address each and every CLEC criticism. Rather, SBC must investigate the merits of such criticisms and evaluate whether such criticisms have any validity and if so to what extent, and whether they are applicable only to a few states or to every state in the SBC territory. Obviously, this process of separating the wheat from the chaff takes time to complete, and cannot be accomplished overnight, especially in cost dockets such as this one, in which the CLECs filed over a thousand pages of direct testimony, with thousands of pages of attachments, proposing myriads of adjustments, the vast majority of which are not even remotely justified.

In this case, SBC Illinois completed and submitted its cost studies on December 24, 2003, during the time frame that Mr. Smallwood allegedly became aware of the Joint CLECs' criticisms at issue. At that point, SBC Illinois and Mr. Smallwood could not reasonably have completed their review of all of the CLEC criticisms of the LoopCAT methodology in the other states and anticipated every issue that would be raised in this proceeding regarding LoopCAT in this case. However, once the CLECs and other parties filed their direct testimony in this case, Mr. Smallwood used the first opportunity in his rebuttal testimony to address that testimony as it specifically relates to loop costs in Illinois, and agreed to adopt those revisions proposed by other parties which SBC Illinois found to be appropriate. Therefore, the Joint CLECs are wrong to attack Mr. Smallwood's credibility. Indeed, as noted above, SBC Illinois' willingness to modify LoopCAT consistent with certain of the Joint CLECs' recommendations demonstrates SBC

Illinois' commitment to achieving costs that are truly consistent with a forward-looking network.³

The fact that a party to a proceeding accepts certain adjustments to its case which are proposed by other parties is not grounds for impugning the integrity of the party for having failed to make those adjustments in its direct case. Presumably, Mr. Smallwood and SBC Illinois could have avoided the Joint CLECs' attack on their credibility entirely if SBC Illinois had stubbornly refused to acknowledge the validity of any of the criticisms presented by the other parties and simply "stuck to its guns" throughout the case on every issue. However, that is not the type of behavior that the Commission should be encouraging. Mr. Smallwood and the Company should be commended, not chastised, for responding in a positive manner to valid criticisms and recommendations made by other parties.

In stark contrast to the behavior of Mr. Smallwood and SBC Illinois, the Joint CLECs and their witnesses steadfastly refuse to ever change their positions on any issues, even in the face of evidence that they have made factual errors. For example, as will be discussed in more detail in Section III.C.1, below, Mr. White presented *unrebutted* testimony pointing out that AT&T's witnesses, Messrs. Pitkin and Turner, had erroneously failed to account for many of the activities that are needed to install aerial, buried and underground copper cable in their attempt to create a "bottoms-up" estimate of the cost of installing such facilities. The Joint CLECs, however, steadfastly refused to acknowledge Pitkin/Turner's mistake. Similarly, the Joint

³ The Joint CLECs also criticize SBC Illinois and Mr. Smallwood for not "alerting the Commission to the myriad of LoopCAT errors it now acknowledges" in Docket 03-0323, the proceeding initiated to implement the rate adjustments mandated by Senate Bill 885. This criticism is without merit for the same reasons as those discussed above. Furthermore, the Joint CLECs mischaracterize the manner in which the LoopCAT model was used in Docket 03-0323. Specifically, in accordance with Senate Bill 885, the loop cost study presented by SBC Illinois with its direct case in this proceeding was not used in Docket 03-0323 to establish the specific level of TELRIC costs. Rather, that cost study was used to isolate and measure the impact on the UNE costs approved in Docket 96-0486/96-0569 of changes in only two inputs: fill factors and depreciation rates.

CLECs continue to insist that the Alcatel performs the work of installing DLC equipment on behalf of SBC Illinois, despite overwhelming evidence to the contrary, including a statement by Alcatel itself, and a finding by the Indiana Commission that the Joint CLECs' position is based on a misinterpretation of the provisions of certain Alcatel contracts. Another example is the Joint CLECs' stubborn insistence that portions of the DLC installation costs are recovered through the land and building factors of SBC Illinois' cost study. As discussed by SBC Illinois in its Initial Brief, and as will be discussed again below, this assertion is simply wrong. If any party's credibility should be questioned in this proceeding, it is the Joint CLECs', not SBC Illinois'.

Finally, the Joint CLECs quote a passage from the order in the recent SBC Indiana cost proceeding, in which the Indiana Commission adopted criticisms of Mr. Smallwood made by CLECs in that case identical to those made by the same CLECs in this case. For the reasons previously discussed, those criticisms are entirely without merit, and the Indiana Commission's unfortunate decision to unfairly criticize Mr. Smallwood in its order should not be repeated by this Commission. In any event, it is noteworthy that, despite its criticism of Mr. Smallwood, the Indiana Commission ultimately adopted the LoopCAT model as the basis for establishing TELRIC rates and rejected all but a handful of the adjustments to that model proposed by the Joint CLECs' cost witnesses. As a result, the Indiana Commission rejected the CLECs' proposal to reduce SBC Indiana's UNE loop recurring rates by about half and instead approved a significant increase in those rates.

B. Major Inputs to Cost Studies

1. Fill Factors

SBC Illinois agrees with Staff that this proceeding presents a "...much needed opportunity for the Commission to review and reconsider the appropriate fill factor concept and

values. . .” to be used in developing SBC Illinois’ UNE loop costs. Staff Br. at 37. With the notable exception of the Joint CLECs, all of the parties to this proceeding are recommending significant changes in the approach adopted by the Commission in the 1998 TELRIC proceeding. The debate is over what that approach should be replaced *with*. SBC Illinois supports use of actual fill factors; Staff proposes use of “forward-looking actual fill” factors; the Attorney General and CUB recommend use of the fill factors implicit in the FCC’s universal service model; and DOD/FEA suggest a modified “target fill” approach, where the targets are reduced substantially from those in the 1998 order. Staff Br. at 55, 59-60; AG Br. at 8-9; CUB Br. at 18-20; DOD/FEA Br. at 16-17. SBC Illinois’ approach is the only one that is fully consistent with the FCC’s TELRIC methodology and it should be adopted.

a. SBC Illinois’ Approach

As SBC Illinois explained at length in its Initial Brief, the FCC has explicitly endorsed use of actual fill factors in TELRIC studies and many state commissions have set UNE loop rates using fill factors that are based on or approximate the ILECs’ actual fill rates. SBC Ill. Br. at 10-12, 39-42, 47-48. To the extent that the Joint CLECs are still trying to argue that the FCC’s TELRIC principles preclude use of actual fill factors, they are wrong. Joint CLEC Br. at 57-59. The FCC has made it clear that this is *not* the case and the 7th Circuit Court of Appeals has made it clear that this is *not* the case. The Joint CLECs are providing the Commission with no useful input when they persist in positions that became obsolete over the course of this proceeding.

The Joint CLECs contend that use of SBC Illinois’ proposed fill rates will increase UNE loop rates anywhere from \$4.72 to \$9.20 per loop, per month (depending on access area), based on SBC Illinois’ direct testimony in this proceeding. Joint CLEC Br. at 54. These numbers are out-of-date. SBC Illinois accepted numerous adjustments proposed by Staff and other parties,

which reduced its loop TELRIC costs substantially. Therefore, the impact of the fill rate assumption has been reduced commensurately. This is obvious from the rate comparison chart SBC Illinois presented in its Initial Brief, which shows that the average UNE loop rate in Illinois increases by only \$10.56 if the Commission accepts SBC Illinois' position *on every disputed issue in this proceeding* (not just the fill rate). SBC Ill. Br. at 4.

The Joint CLECs trot out their argument that the fill factors in TELRIC and LRSIC studies should be the same because only one network is used to provide both retail and wholesale services. Joint CLEC Br. at 59-60. This is beside the point. While the real world network used to provide retail and wholesale services is undeniably the same, what kind of theoretical cost study assumptions should be used to set rates is an entirely different question. The 1996 Act requires use of a hypothetical TELRIC network to set UNE rates, while the Illinois PUA requires use of a hypothetical LRSIC network to set a "floor" (i.e. a lower bound) for retail rates. Nothing precludes the use of different cost assumptions in different theoretical models to set different rates. SBC Ill. Ex. 14.1 (W. Palmer Surrebuttal) at 16. In fact, because TELRIC costs and LRSIC costs are used for entirely different purposes than LRSIC costs (i.e., as a cost ceiling vs. a cost floor), different study assumptions are both reasonable and appropriate. SBC Ill. Ex. 14.0 (W. Palmer Rebuttal) at 12-13.

The Joint CLECs make much out of the fact that SBC Illinois' proposal in this case is different than its proposal in the 1998 TELRIC proceeding. Joint CLEC Br. at 52-54, 66. This is regulatory ancient history. SBC Illinois explained at length why it proposed what it did in the 1998 proceeding and why a new approach is required. SBC Ill. Ex. 1.0 (Panfil Direct) at 17-19;

SBC Ill. Ex. 14.0 (W. Palmer Rebuttal) at 5-7.⁴ SBC Illinois readily admits that *it* got it wrong in the 1998 proceeding. Staff admits that *they* got it wrong in the 1998 proceeding. Staff Ex. 25.0 (Liu Rebuttal) at 7-8. As a result, the Commission got it wrong. The Joint CLECs cling tenaciously to the approach used in that proceeding merely because it produces extraordinarily low UNE loop rates that they wish to perpetuate.

The Joint CLECs argue that SBC Illinois' actual fill factors do not represent an efficient level of operations because it has changed from "multi-party lines and multi-appearance plant" to the more efficient CSA design over the last 30 years. Joint CLEC Br. at 67-68. This is true, but essentially irrelevant to the efficiency of SBC Illinois' current fill factors. SBC Illinois moved to the CSA design in the 1970s. Thus, the plant the Joint CLECs refer to is now old and represents a small percentage of SBC Illinois' total network. In fact, 30% of SBC Illinois' loop plant has been engineered and installed over just the last ten years. Tr. 304-06 (Aron). Moreover, as Mr. White explained, these older facilities were interfaced with newly designed plant in 1980 in a manner that made plant age a "non-factor" in cable fills. SBC Ill. Ex. 8.1 (White Rebuttal) at 9-10. Similarly, the Joint CLECs are simply incorrect when they contend that next generation digital loop carrier ("NGDLC") automatically increases fill rates. SBC Illinois' older non-NGDLC systems actually have higher fill rates than the new technology. *Id.* at 10-11.

Several parties contend that SBC Illinois' actual fill factors are not representative of an efficient, forward-looking network because its longstanding practice of installing 2.25 distribution pairs (lines) per household appears excessive in light of anticipated changes in

⁴ Similarly, the Joint CLECs point out SBC Illinois' recommendation in the Part 791 rulemaking proceeding that TELRIC and LRSIC cost assumptions be conformed. Joint CLEC Br. at 60-62. The CLECs have oversimplified that recommendation and the history of SBC Illinois' approach to recovery of spare capacity costs. SBC Ill. Ex. 14.0 (W. Palmer Rebuttal) at 11-12. SBC Illinois notes that, although the Joint CLECs describe the proceeding as "recent," its testimony in that case is now four years old.

demand for telephone service. Joint CLEC Br. at 77; AG Br. at 12-14; CUB Br. at 14-16. For example, they point to the fact that demand for access lines has been flat (or declining) on an overall network basis over the last couple of years, that increased use of DSL service will reduce the demand for second lines for Internet use, and that wireless growth may reduce the demand for wireline connections. Although SBC Illinois monitors changes in demand levels, the Company's long-standing design practice remains valid and will continue to be used in its outside engineering decisions for the foreseeable future. SBC Ill. Ex. 8.2 (White Surrebuttal) at 11-12. *First*, as even the Joint CLECs recognize, economic conditions have been extremely difficult over the last several years, and the telecommunications industry has been particularly hard hit. AT&T/Joint CLEC Ex. 1.2 (Starkey/Fischer Surrebuttal) at 39; AT&T/Joint CLEC Ex. 1.3 (Starkey/Fischer Supplemental Surrebuttal) at 24-25; see also SBC Ill. Ex. 12.0 (Avera Direct) at 23-24. These economic conditions have clearly impacted overall demand for telephone service, including network access lines. It remains to be seen whether demand will pick up as the economy recovers. *Second*, the growth in demand for DSL service does not impact the 2.25 lines/household planning assumption. This planning guideline has been in place since the 1970s, long before the advent of the Internet; it was not increased in the 1990s when Internet use took off and, therefore, does not need to be reduced now to reflect increased use of DSL. SBC Ill. Ex. 8.2 (White Surrebuttal) at 11-12. Although wireless demand has grown in aggregate, it has not translated into predictable changes in demand for wireline connections that can be reflected in network design. *Id.* Network capacity is designed on a community-by-community, route-by-route basis. Unless and until network engineers can confidently predict wireless substitution on an individual feeder and distribution route basis – and unless and until the Commission's standards of service rules allow for error in that regard, which they do not

today – SBC Illinois will continue to use the 2.25 pairs/household standard. Notably, it is *SBC Illinois* – not the Joint CLECs, not the Attorney General and not CUB – that is responsible for providing high quality service to its entire customer base and for meeting this Commission’s stringent service obligations. SBC Illinois has no financial incentive to install excessive network facilities – in fact, under price regulation it has every incentive to be as economical as possible. SBC Ill. Ex. 2.1 (Aron Rebuttal) at 85-86. Mere speculation by these parties that SBC Illinois should or could be making different planning decisions should not be accorded weight, when network engineers responsible for making these decisions in the field have concluded otherwise based on the best information available to them.

The Joint CLECs contend that SBC Illinois should assume that spare capacity in its network will be used up at some point in the foreseeable future. Joint CLEC Br. at 78. In fact, this spare capacity will not be used up. As fill rates increase in existing subdivisions, or along existing routes, as customers demand additional service, it is a fact of engineering life that new facilities will be installed to serve new subdivisions, or cables will be augmented along existing routes. Those cables will have very low fills. These two effects offset one another and explain why SBC Illinois’ overall fill rates do not change significantly over time on a network-wide basis. SBC Ill. Ex. 8.1 (White Rebuttal) at 3; SBC Ill. Ex. 8.2 (White Surrebuttal) at 2-3.

Finally, the Attorney General suggests that SBC Illinois’ network may contain excess spare capacity to so that it can serve all business customers with Centrex service. AG Br. at 10. The Attorney General is ignoring the record evidence. Competition between Centrex and PBX service dates back decades and SBC Illinois recognizes that most customers will choose a PBX solution. Therefore, SBC Illinois only installs the amount of capacity reasonably required to

serve the *actual* needs of business customers and most certainly does *not* install enough capacity so that all business customers can use Centrex. SBC Ill. Ex. 8.2 (White Surrebuttal) at 11.

b. Staff's Proposal

SBC Illinois addressed Staff's "forward-looking actual fill" approach in its Initial Brief. SBC Ill. Br. at 44-47. The Company agrees with Staff that the proper starting point in the analysis of appropriate fill factors is SBC Illinois' actual fill rates. However, SBC Illinois disagrees with Staff's upward adjustments to those fill rates that are ostensibly designed to remove "*ex post*" inefficiencies. Staff Br. at 59-60.

As explained in more detail in SBC Illinois' Initial Brief, Staff's proposal to remove "*ex post*" inefficiencies is fundamentally flawed, because, in effect, it requires the ILEC to make perfect network planning decisions. Staff limits the amount of spare capacity to what SBC Illinois would have installed if it had known at the time that each geographic area or route was originally engineered what it knows today. Staff Br. at 46. Notably, Staff cites to no FCC rule or order in support of the proposition that the FCC's TELRIC rules require clairvoyance and SBC Illinois is aware of none. SBC Ill. Ex. 14.0 (W. Palmer Rebuttal) at 6-7. In fact, both the FCC and the 7th Circuit have stated that such a standard is not required: the 7th Circuit's decision in *AT&T Communications* merely requires "efficiency" and the FCC's TELRIC NPRM proposed making use of actual fills – not fills adjusted to remove "*ex post*" inefficiency – mandatory on a nationwide basis. Notably, both Staff and the Joint CLECs go out of their way to emphasize that they are *not* suggesting that SBC Illinois' planning decisions were inefficient or imprudent at the time they were made. Staff Br. at 59-60; Joint CLEC Br. at 74-75. Therefore, Staff's adjustment is inappropriate and should not be adopted.

Moreover, as SBC Illinois stated in its Initial Brief, Dr. Liu's adjustments are too high as an absolute matter. There is no evidence in the record that 15% of SBC Illinois' distribution cable and 7.5% of its feeder cable is lying idle because it was installed to serve demand that did not materialize. In fact, Mr. White testified to the contrary, i.e., that these numbers far exceed what is likely in the real world. SBC Ill. Ex. 8.2 (White Surrebuttal) at 3; Tr. 674-75 (White). In effect, Staff's adjustment suggests that for every six homes that SBC Illinois expected would be built in any given geographic area, in reality, only five were built and that this happened across its *entire service territory*. This is not realistic. SBC Illinois does not build plant in a vacuum – for example, when designing distribution plant for a subdivision, SBC Illinois meets with the developers, obtains detailed plans for the construction, assesses the kinds of homes that are going to be built and compares those homes to comparable existing developments in the area. Tr. 659-60 (White). Both SBC Illinois *and* builders would have had to have terrible track records over the last 20-30 years to have been off by 15% on a state-wide basis. Thus, 15% and 7.5% are not valid adjustments.

Even if the Commission were to accept Dr. Liu's premise – which it should not – her adjustments did not take into account the impact of cable “breakage.” In other words, even if 15% of the homes planned for a given subdivision were not built, along many routes SBC Illinois would have installed the same size cable. For example, assume that SBC Illinois had forecasted demand for 800 pairs along a given distribution route and had installed a 900 pair cable (the appropriate size for 800 pairs). If it turns out that the forecast had been overstated by 15%, SBC Illinois would only have needed 680 pairs (800 less 15%). In this scenario, however, SBC Illinois would still have installed a 900-pair cable, because the next lower breakpoint is a 600-pair cable, which would have been too small. SBC Ill. Ex. 8.2 (White Surrebuttal) at 4.

The same analysis holds true for feeder facilities, where Dr. Liu assumed a 7.5% *ex post* demand error rate. Based on SBC Illinois' analysis, even if one assumed a 15% "innocent mistake" level for distribution facilities overall, there would have been only a 5% impact on total distribution facility costs. SBC Ill. Ex. 14.1 (W. Palmer Surrebuttal) at 10. The equivalent value for feeder facilities would be 3%. *Id.* at 11.

A separate analysis would have to be performed for the impact of "innocent mistakes" on installation costs. That is because the majority of the work activities involved in placing cable such as trenching, closure, restoration, and opening manholes do not vary with the size of the cable placed. The only significant placement-related costs that vary with the size of the cable placed are splicing costs. Therefore, SBC Illinois quantified the incremental impact of splicing costs on total job costs when smaller cables are placed, based on actual data. On average, going to the next smaller cable size only decreased splicing hours by 9.7 percent and only 62 percent of total job hours were even splicing-related. Therefore, under Dr. Liu's theory, the capacity adjustment factors applicable to feeder and distribution labor should be 1 percent and 0.5 percent respectively (not 7.5% and 15%). *Id.* at 11.

The Joint CLECs complain that Staff's approach should be rejected in its entirety because it is "...totally lacking in either explanation or empirical basis." Joint CLEC Br. at 84-86. Although SBC Illinois has its own issues with Staff's proposal, the Joint CLECs' position is akin to the pot calling the kettle black. Having proposed two fill approaches that are not TELRIC-compliant at all (i.e., usable capacity and target fill) and a third approach that is even more

arbitrary that Staff's (i.e., their "Top 20" wire center analysis), the Joint CLECs are hardly in a position to be arrogant or condescending to Staff.⁵

c. The Joint CLECs' Proposals

The Joint CLECs continue to argue, in order, for the following approaches to fill factors: (1) usable capacity; (2) target fill (as the Commission implemented it in the 1998 TELRIC proceeding)⁶; and (3) their "Top 20" wire center analysis. Joint CLEC Br. at 48-49. The deficiencies in all three approaches are fully addressed in SBC Illinois' Initial Brief and Staff's Initial Brief. SBC Ill. Br. at 47-54; Staff Br. at 46-55, 60-64.

Although the CLECs contend that their "Top 20" wire center proposal is a "more accurate" implementation of Dr. Liu's theoretical construct, it is nothing of the kind. Joint CLEC Br. at 86. They simply picked the wire centers with the highest fill levels for each of the four network loop components (i.e., copper distribution, copper feeder, DLC chassis and plug-ins) and claimed that these offices should be considered "efficient." Nowhere did they offer any empirical analysis as to *why* the fills in these offices are high or that the rest of SBC Illinois' loop network could or should be expected to operate at this level of utilization. It is ludicrous to suggest, for example, that the Joint CLECs' top wire center for distribution fill – a tiny rural wire center which serves all of 181 lines – is a benchmark for *anything*. SBC Ill. Starkey/Fischer Cross Ex. 48P; Tr. 1852-53 (Starkey). Absent a showing that the distribution and feeder fill factors in the remaining 258 wire centers *not* included in the Joint CLECs' analysis have lower fills because of "innocent mistakes" which SBC Illinois made in the initial planning process,

⁵ The Joint CLECs criticize Staff for not having presented its proposal "in a timely manner in this case" because it was filed in the February 20 rebuttal round. They then turn around and tout their own "Top 20" office analysis that was presented in the final March 5 rebuttal round, subsequent to Staff's proposal.

⁶ DOD/FEA recommend use of an adjusted target fill approach. DOD/FEA Br. at 16-17. Their proposed adjustment, however, is based on no empirical evidence and represents little more than a middle-ground between competing proposals.

then the Joint CLECs' analysis has nothing whatsoever to do with Dr. Liu's conceptual model and certainly does not "implement" it.

In fact, their analysis is meaningless in terms of addressing the "efficiency" question at any level. That is because the Joint CLECs made no attempt to evaluate *why* their "Top 20" offices had unusually high fills. All they have demonstrated is that, in any averaging process (which is what SBC Illinois' actual fill data represents), there will be some wire centers with higher fills than others. This is hardly news and the fact that one can calculate an average using just the top 20 wire centers certainly does not constitute a basis for setting fill factors for the total network.

d. AG/CUB Proposal

The Attorney General has injected yet another fill proposal into this proceeding and CUB now joins in the Attorney General's proposal. AG Br. at 8-9; CUB Br. at 18-20. The Attorney General suggests that the Commission rely on the fill factors that are implicit in the FCC's universal service model ("HCPM") and appliqué them on top of SBC Illinois' LoopCAT model.⁷ AG Br. at 18. The Attorney General's witness Mr. Regan presented this proposal, along with the calculations of the fill factors that would result, for the first time in the Attorney General's surrebuttal testimony. AG Br. at 9.⁸

⁷ The model used by the FCC to estimate the relative cost of providing universal service is variously referred to as the Hybrid Cost Proxy Model ("HCPM"), the Synthesis Model or the Universal Service Cost Model. Although the names vary, the model is the same.

⁸ As SBC Illinois stated in its Initial Brief, it was procedurally improper for the Attorney General to introduce this proposal so late in the process. Admittedly, the specifics of Staff's proposal to use "forward-looking actual fill" were not available until the February 20, 2004, rebuttal round of testimony. However, it had been clear since January 20, 2004, that Staff was not going to support continued use of the fill factors approved by the Commission in the 1998 TELRIC proceeding, the position which the Attorney General had supported up to that point. This new proposal to use the FCC's HCPM model inputs/outputs could have and should have been introduced in the February 20, 2004, round of testimony so that the other parties could have had an opportunity to address it in surrebuttal testimony.

Use of inputs from the FCC’s universal service model is not a viable alternative. As SBC Illinois pointed out in its Initial Brief, the universal service cost model was constructed for an entirely different purpose (i.e., establishing high cost support levels). As CUB acknowledges, the FCC itself has stated that it should *not* be used for other purposes, particularly to establish TELRIC costs for UNEs. While the FCC decided in the *Universal Service Inputs Order*⁹ that it would base fill factors “on current demand . . . rather than on ultimate demand,” it did *not* conclude that an efficient carrier would not deploy capacity for ultimate demand. Rather, it merely determined that *for universal service purposes* such capacity should be excluded. *See TELRIC NPRM*, ¶ 73; *Id.* at n.118 (“[T]he fact that the industry may build distribution plant sufficient to meet demand for ten or twenty years does not necessarily suggest that these costs should be supported by the federal universal service support mechanism” (quoting *Universal Service Inputs Order*, ¶ 199)). The FCC took pains to contrast its determination in the *Universal Service Inputs Order* with its TELRIC fill factor rules, making clear that its TELRIC rules do not foreclose establishing fill factors based on projected future demand. *See id.*, ¶ 73; *see also Kansas 271 Order*, 16 FCC Rcd. 6237, ¶ 78 (rel. Jan. 22, 2001) (“If a fill factor is set too high, the particular element will have insufficient capacity to accommodate *anticipated increases in demand* or service outages.”) (emphasis added). Moreover, the FCC has cautioned that universal service subsidies are based on a special model that “should not be relied upon to set rates for UNEs.” *Kansas 271 Order*, ¶ 84. Indeed, the D.C. Circuit has chastised AT&T for attempting

⁹ Tenth Report and Order, CC Docket No. 96-45, 97-160 (FCC rel. October 21, 1999) (“*Universal Service Inputs Order*”); Memorandum Opinion and Order, Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration, CC Docket No. 00-218, DA 03-2738 (rel. Aug. 29, 2003) (“*Virginia Arbitration Order*”).

to apply the *Universal Service Inputs Order* to TELRIC rates. *AT&T Corp. v. FCC*, 220 F.3d 607, 619 (D.C. Cir. 2000).

The Attorney General's proposal is deficient on other grounds as well. *First*, the input values Mr. Regan started with are overstated. The "input" cable sizing values used in his analysis are not consistent for several cable sizing cells with those presented by Mr. Palmer in his rebuttal testimony. Compare SBC III. Ex. 14.0 (W. Palmer Rebuttal) at 21-22 with AG Ex. 1.3 (Regan Surrebuttal), Schedule WDA-14.¹⁰ *Second*, Mr. Regan does not explain in his testimony or schedule how the input fills were converted into effective fills. However, based on a review of Schedule WDA-14, it appears that each input fill factor was simply adjusted by the same gross factor to calculate an effective fill, because each one shows an approximately identical -7.8% change in value. This methodology is overly simplistic. In the HCPM model, the effective fill factors result from applying input fill factors to route-by-route, customer-specific location data for the entire study network. *Tenth Report and Order*, ¶ 195. This is the process described in Mr. Palmer's rebuttal testimony for the HAI model:

The HAI methodology applies cable sizing factors to compute cable sizes required to serve customer demand and then places the next larger cable size. For example, given demand for 200 customer lines and an objective or input fill of 80%, the methodology assumes that 250 pairs are required. The next available cable size is 300 pairs so the HAI model assumes investment in a 300 pair cable. Thus, the "achieved" fill for this single cable scenario is 67% or 200 customer lines/300 pairs. Said another way, the HAI model output fill is always lower than its input fill.

SBC III. Ex. 14.0 (W. Palmer Rebuttal) at 18. Such complex modeling would not have produced exactly the same adjustment for every cable sizing cell. Since the Attorney General obviously did not engage in the analysis required by the HCPM, there is no reason to believe that the

¹⁰ Although the factors used by Mr. Regan are those adopted by the FCC in its 1999 order, they are not the factors used in the current version of the HCPM model, which are those shown in Mr. Palmer's testimony.

effective fill rates presented by the Attorney General are even representative of what would come out of the FCC's model.

Finally, the Attorney General and CUB are picking and choosing between elements of a cost model that the FCC developed as an integral whole. When, for example, the Wireline Competition Bureau used the HCPM model in the *Virginia Arbitration Order* proceeding, it used the *entire* model – not just the fill factors implicit in it. Although some changes were made to make the model more current or more Virginia-specific, each change was separately evaluated by the Bureau to ensure that the integrity of the model would not be compromised. See e.g., ¶¶ 169, 177, 182, 189. Whatever value there might be to the FCC's model in the context of a TELRIC proceeding – and SBC Illinois does not believe that there is *any* – it is clearly inappropriate to selectively use only those inputs that produce a lower result. As SBC Illinois demonstrated in its rebuttal testimony, the FCC's HCPM model would produce a state-wide average UNE loop rate of \$14.60 – not the Attorney General's proposed rate of \$8.81. SBC Ill. Br. at 4; SBC Ill. Ex. 14.0 (W. Palmer Rebuttal) at 38. Due to the conservative assumptions underlying the HCPM model, any TELRIC-compliant UNE loop rate would substantially *exceed* this level. *Id.* at 34-37. It would be arbitrary and capricious to borrow one input from the FCC to produce a UNE loop rate that is only 60% of what the FCC would undoubtedly acknowledge is a conservative cost estimate and one that is too low for TELRIC purposes.

2. Depreciation

The basic dispute here is whether, for depreciation purposes, the Commission should use the equipment lives that SBC uses for financial reporting purposes (as SBC Illinois propose) or the regulatory lives that the FCC prescribes for other purposes (as Staff, the CLECs, and others propose). Contrary to the CLECs' claim (at 100), TELRIC neither mandates the use of FCC-prescribed lives nor prohibits the use of financial reporting lives. In the abstract either one could

be TELRIC-compliant. *Triennial Review Order*, ¶ 688. In 1998 the Commission adopted the FCC-prescribed regulatory lives from 1995, which at the time (but no more) were viewed by the FCC as an appropriate default. *First Report and Order*, ¶ 702; SBC Ill. Br. at 66. That decision does not bind the Commission and must be revisited. The question, then, is whether financial reporting lives or FCC regulatory lives best reflect the annual decline in the economic value of an asset in the fully competitive market that TELRIC assumes. *Id.*, ¶¶ 688-89.

SBC Illinois presented depreciation testimony by Dr. Lawrence Vanston, a nationally recognized depreciation expert. Dr. Vanston, who continually studies depreciation rates in the telecom industry, predicted depreciation lives even shorter than SBC uses for financial reporting, but SBC Illinois has conservatively decided to keep proposing those financial reporting lives.

The CLECs' overarching objection to the use of financial reporting lives is that it will "increase the annual depreciation rate and expense associated with a UNE." Joint CLEC Br. at 92. But nowhere do they sufficiently explain why an appropriate increase in depreciation rate—from a rate that is now too low for the competitive environment in which SBC Illinois operates and which the *Triennial Review Order* requires parties to recognize—is a problem. The FCC does not mandate that the economic lives of assets be as long as possible; in fact, its directive that the "rate of depreciation over the useful life should reflect the actual decline in value that would be anticipated in the competitive market that TELRIC assumes" (*Triennial Review Order* ¶ 689), shows that the FCC explicitly recognizes that the depreciation rate may have to rise to properly mirror the accelerated decline in economic value caused by the competitive market. The CLECs' brief tries to make the financial reporting lives that SBC Illinois proposes seem outlandish. In reality, SBC Illinois' proposal is conservative. The FCC has expressly sanctioned accelerated depreciation to allow for faster recovery of costs during the early years an asset is in

use in order to recover the actual decline in the value of an asset in a competitive market. *Id.*, ¶ 690. Although it is still using straight-line depreciation, SBC Illinois is, just as the FCC suggested, proposed shorter lives be used in that straight-line framework as an “alternative method of capturing this decline.” *Id.*, ¶ 691.

a. Depreciation Lives Must Reflect The Actual Decline In Value Caused By The Competitive Market.

Despite the CLECs’ and Staff’s claims to the contrary, the Commission should not readopt the FCC-prescribed lives ordered in 1998. There simply is no support for the Staff’s argument that those lives “reflect the rapid rate of technological change that has occurred in the past and is likely to occur in the future.” Staff Br. at 65.

The telecommunications environment was a very different place six years ago than it is today. As the Indiana Commission correctly noted in its recent Order:

Technological advancement continues at a rapid pace, leading to faster obsolescence of all types of telecommunications equipment. If anything, the pace of technological advancements should only increase as unbundling and pricing determinations are brought more in line with the goals of the 1996 Act in the wake of the 1999 Biennial Order, the Triennial Review Order, and the TELRIC NPRM, and as the incentive for facilities-based investment and innovation increases. . . . We also note the increase in competition faced by SBC Indiana, both intermodal and intramodal, compels use of shorter depreciation lives. (*Triennial Review Order*, ¶ 685).

*Indiana UNE Order*¹¹ at 60-66.

The CLECs argue (at 95) that the FCC’s regulatory projection lives are forward-looking and rely on “future-oriented studies.” This argument rings hollow: FCC-prescribed lives were set years ago when competition was much less of a factor, they over-rely on past retirements of assets, and they do not recognize the telecommunication marketplace’s proximity to the major

¹¹ January 5, 2004 Order, Cause No. 42393 (Indiana Utility Regulatory Commission) (“*Indiana UNE Order*”).

technology shift. SBC Ill. Ex. 13.1 (Vanston Rebuttal) at 8. Simply because FCC-prescribed lives are less than what a retirement analysis alone would indicate does not show that the rate of depreciation reflects the actual decline in *economic value* anticipated in the competitive market. In order to meet that standard, asset lives must reflect anticipated technology obsolescence, likely competitive impacts, and future equipment cost improvement. *Id.* at 37. The CLECs' proposed lives do not do so. The CLECs' data "confirm[ing]" the viability of the outdated projection lives—for example, that "the 2002 retirement rates in SBC Illinois' underground buried cable account imply lives of over 100 years for the equipment" (Joint CLEC Br. at 96), carries no weight. *Retirement rates* have little to do with *economic value*, which is governed by factors such as technology change and competition. SBC Ill. Ex. 13.1 (Vanston Rebuttal) at 48. The life of underground, buried cable depends not on historical retirements, but instead on how quickly SBC Illinois converts to fiber, how fast competition strands ILEC access lines, and how soon current generation fiber is replaced. SBC Ill. Ex. 13.2 (Vanston Surrebuttal) at 20.

Nor can the CLECs' argument that "growth in the depreciation reserve as a percentage of plant in service in a time of significant plant growth indicates that plant is being depreciated over shorter lives than the actual in-service lives of the plant" carry water. Joint CLEC Br. at 96. Whether the reserve level is adequate depends on expectations for the future. A relatively high reserve level is completely appropriate given the technological and competitive impacts in store. Further, the depreciation reserve cited by the CLECs is the theoretical reserve—that is, the accumulated depreciation that would be calculated using a given set of lives and salvage values (in this case, the FCC prescriptions from the mid-1990s.) Thus, it is not the FCC-prescribed *lives* that produce the reserve level, but rather the FCC depreciation *rates*. To keep the

depreciation rate that achieved this reserve ration would require lives significantly shorter than the FCC-prescribed lives. SBC Ill. Ex. 13.1 (Vanston Rebuttal) at 46.

The 1999 Forbearance Report and Order, FCC 99-397, did not hold that state commissions should indefinitely rely on the FCC-prescribed asset-life ranges in place in 1999. It merely stated its intention to maintain those ranges on a continuing basis for the benefit of state commissions that chose not to determine depreciation lives themselves. Likewise, the CLECs' statement (at 100) that the *Virginia Arbitration Order* provides "a clear view of FCC thinking. . . concerning the appropriateness of ILEC financial lives versus FCC prescription lives in setting TELRIC-based rates," is deliberately misleading. As FCC Commissioner Kevin J. Martin noted, the Wireline Competition Bureau's opinion in the *Virginia TELRIC Arbitration Order* "may not reflect the direction and spirit" of the FCC's view of TELRIC. *TELRIC NPRM*, Statement of Commissioner Kevin J. Martin at 1. Second, the Virginia Order is inconsistent with the basic finding of both the *Triennial Review Order* and the *TELRIC NPRM* that *both* financial reporting lives *and* regulatory lives are acceptable TELRIC inputs. Third, the FCC purposely left each state wide latitude in deciding whether financial reporting or regulatory lives are most appropriate. *Triennial Review Order*, ¶ 688. The CLECs' claim that the FCC *requires* regulatory lives is incredible given the FCC's unambiguous decision not to impose any such requirement and its decision to remove those lives from their prior "default" status. *See* SBC Ill. Br. at 66.

b. SBC Illinois' Proposed Financial Reporting Lives Are Forward-Looking And Reflect The Actual Decline In Value Caused By The Competitive Market.

The Staff and CLECs argue that the GAAP principle of conservatism that governs SBC's financial reporting lives does not offer adequate protection to ratepayers. Joint CLECs Br. 102; Staff Br. at 65. The criticisms of GAAP's effect on financial reporting lives are overstated. The

CLECs misleadingly imply that the FCC views financial reporting lives as overly conservative, Joint CLECs Br. at 103, but they completely ignore the FCC’s even stronger criticisms of regulatory lives. Much more recently than any FCC decision discussing GAAP, the FCC has questioned whether regulatory lives sufficiently “reflect the competition and technology assumptions required under a forward-looking costing methodology” (*TELRIC NPRM*, ¶ 36), and has noted that “it has been almost a decade since the Commission first established” regulatory lives. *Id.*

The Staff’s and CLECs’ contention that the use of financial reporting lives will require “ratepayers who don’t subscribe to broadband, or who obtain broadband from the cable companies, to pay higher telephone rates just to make the telephone companies better able to compete in the broadband market,” Joint CLECs Br. 104-105, is unfounded. The voice market is extremely competitive, including not just ILEC and CLEC offerings, but also wireless telephony, cable telephony, and VoIP. SBC Ill. Ex. 13.1 (Vanston Rebuttal) at 26. The price for voice service will be determined by competition, and will reflect the lowest cost alternative—which is unlikely to be the ILEC network. *Id.* It is also important to note that TELRIC is not a rate-of-return methodology. As the FCC has made perfectly clear, TELRIC depreciation must reflect the loss of economic value of assets. *Triennial Review Order*, ¶ 689. Because technological advances in the high-speed broadband sphere will strand copper loops, the future displacement of copper by fiber must be recognized regardless of whether that recognition raises UNE rates. SBC Ill. Ex. 13.2 (Vanston Surrebuttal) at 13.

The CLECs suggest that the substitution analysis on which Dr. Vanston’s testimony relies, which recommends lives based on a prediction of replacing current technology with advanced technology, is irrelevant unless it is known that a new technology will replace, not

supplement, older technology. Joint CLEC Br. at 105-106. They further contend that TFI's methodology is speculative and historically inaccurate. *Id.* at 107. These claims are simply incorrect. First, deployment of a technology in supplemental applications is a strong indicator that the new technology will ultimately replace the old. SBC III. Ex. 13.1 (Vanston Rebuttal) at 50. Although forecasts must often be made before that ultimate replacement begins, it is possible to determine whether it is likely to occur. If so, substitution analysis is appropriate. *Id.* Moreover, while it is true that TFI's method of determining the expected economic lives of current technology requires assumptions about the future, this is inherent in the nature of *any* forward-looking analysis, regardless of methodology. *Id.* at 52; *see* Indiana Order in Cause No. 40611 (“we *anticipate* technological advances to continue at a rapid pace”) (emphasis added). The nature of forecasting does demand an evaluation of the reasonableness of underlying predictions. SBC III Ex. 13.1 (Vanston Rebuttal) at 52. It is clear, however, that TFI's forecasts rely on documented, well reasoned, and conservative assumptions. *Id.*

Second, the CLECs' claim that because “TFI's previous forecasts. . .have consistently been overstated,” the current study lacks credibility is without merit. Joint CLECs Br. at 106. Dr. Vanston's past studies have been largely accurate. The CLECs rely on two feeder forecasts from 1988 and 1994, but these forecasts are not directly comparable to the 2002 forecast at issue here because they include loops that are too short to involve feeder facilities but were forecasted for distribution fiber conversion. SBC III. Ex. 13.1 (Vanston Rebuttal) at 52. Attachment LKV-R2 to Dr. Vanston's Rebuttal shows a corrected version of the CLECs' witness, Mr. Majoros, Attachment MJM-14 using comparable data. *Id.* The 1994 feeder forecast was reasonably reliable. *Id.* That forecast predicted that the 2001 level of 33% would be reached in 2000. This amounts to only a one-year discrepancy over the course of 7 years—about a 15% difference. *Id.*

This is much too small to support the CLECs' position that TFI's forecasts are consistently too aggressive. Further, the 1988 forecast was performed to produce a forecast of the carrier for non-carrier substitution that could be used to compute an average remaining life ("ARL"). *Id.* at 55. The resulting ARL for the 1988 late scenario was 12.9 years as of January 1, 1988. *Id.* Computing the ARL for the same year but using subsequent actual data and the 2002 forecasts would result in an ARL of 13.7 years for an accelerated scenario and 14.8 years for a base scenario. *Id.* The 1988 scenario translates a difference of only 6% to 15% over a 15-year period. *Id.* The 1997 forecast, which the CLECs' mention in passing, predicts that actual 2001 33% level of feeder cable almost exactly. *Id.* at 52-53.¹²

None of these alleged errors is nearly large enough to support the CLECs' position that TFI's forecasts are consistently wrong. In fact, the most important comparison for depreciation is the life that was forecast compared to what *would have been calculated knowing the actual data.* *Id.* at 26. A comparison of metallic feeder cable lives estimated in 1994, for example (8.5 years), with the lives that would have been calculated using subsequent actual data and the 2002 base forecast (10.1 years) amounts only to about a 10% difference. *Id.* at 26-27. In any case, the metallic cable lives proposed by SBC Illinois (15 years) are much higher than those suggested by the TFI forecasts (6.6 to 8.4 years), which allows for a percentage error much higher than 15%

¹² At page 16 of its brief, the AG asserts that in a 1988 study, Dr. Vanston made two inconsistent projection for the deployment of fiber. Specifically, the AG asserts that while Dr. Vanston in his testimony pointed to a 1988 forecast of fiber in 3.3% of the residential loops by 2003, another page of the 1988 report forecasted that 100% of subscriber pairs would be fiber only with no remaining metallic cable by the year 1997. Dr. Vanston, however, made no such forecast. The AG cites AG Cross Ex. 33, which contains excerpts from the 1988 report. The AG is apparently referring to a figure on page 17 of the study. The discussion on pages 133-134, however, clearly states that this chart illustrates the results of an industry wide survey. That chart does not represent the results of TFI's 1988 study, which are described in the Executive Summary of the report. Page viii of the ES states refers to TFI's scenario for fiber penetration, which is shown in Exhibit ES.5, and concludes that "if the scenario holds true, the demise of copper in the outside plant will be complete by the early 2020s."

Moreover, contrary to the CLECs' and Staff's claims, Dr. Vanston's study takes into account the *current* role of DSL in predicting the financial life of copper plant and circuit switching. To meet the advanced services needs that customers will have in the future will require upgraded circuit equipment and fiber much deeper into the network. SBC Ill. Ex. 13.1 (Vanston Rebuttal) at 20. Much of the fiber currently in use, moreover, is becoming obsolete because it does not take advantage of dense wavelength division multiplexing, a technology that today greatly increases capacity by allowing many wavelengths to be simultaneously carried on the same fiber. SBC Ill. Ex. 13.0 (Vanston Direct) at 48. Even with this evidence, however, SBC Illinois has taken a conservative approach to depreciation, electing to propose depreciation lives that are longer than what Dr. Vanston found to be appropriate. *Id.* Schedule LKV-2 at 5.

SBC Illinois' proposed depreciation lives take into account the need for implementation of new technology as well as current and growing competition, reflecting future changes in the value of assets. SBC Ill. Ex. 13. 1 (Vanston Rebuttal) at 4. In order to allow SBC Illinois to recover the "true changes in the economic value" of plant over time (*First Report and Order*, ¶ 703), this Commission should adopt SBC Illinois' proposed lives.

3. Cost of Capital

It is not easy to establish a cost of capital, nor is it a wholly scientific task. There are different ways to approach the issue and, as shown by the divergent proposals here, different methodologies can yield very different results. There are, however, legal ground rules and guidelines that help distinguish an appropriate, realistic analysis from an inappropriate one. Many such rules and guidelines have developed over the past decades in the rate-of-return context for "natural monopoly" utilities. For example, in that context it is common to determine a utility's capital structure based on book values alone. It is also common to assume no competitive risk factor.

The Joint CLECs and Staff rely heavily on such rate-of-return concepts. The CLECs, for example, base their proposed capital structure largely on book values (Joint CLEC Br. at 124), and Staff assumes a marketplace with only minor competition (Staff Br. at 93 (Staff assumed “a level of competition somewhere between that of fully regulated monopolies and unregulated industrial companies”)). Given this approach, it is not surprising that the Joint CLECs and Staff propose cost figures that are similar to the approved cost of capital for traditional regulated utilities like gas and electric companies. See SBC III. Ex. 12.1 (Avera Rebuttal) at 7, 34, 50. The fundamental error in any such approach, of course, is that the Commission is establishing a forward-looking cost of capital under *TELRIC* rules, not *rate-of-return* rules. The 1996 Act specifically forbids the CLECs’ and Staff’s heavy reliance on rate-of-return principles when setting UNE rates, stating that such prices “must be determined without reference to a rate-of-return or other rate-based proceeding.” 47 U.S.C. § 252(d)(1)(a)(i). The Supreme Court interpreted this as “an explicit disavowal of the familiar public-utility model of regulation.” *Verizon Comms., Inc. v. FCC*, 535 U.S. 467, 489 (2002).

Thus, in setting a cost of capital under *TELRIC*, the Commission must assume a marketplace with full facilities-based competition and all the attendant competitive risks, which drive up the cost of capital. *Triennial Review Order*, ¶¶ 680-81. Consistent with that requirement, the Commission must establish a capital structure based on *market values* of debt and equity, not book values. *Virginia Arbitration Order*, ¶ 103. And the costs of equity and debt within that capital structure must reflect the true perceptions of investors, who undeniably will demand higher returns before investing in ILECs in the ever-changing world of telecommunications as opposed to more stolid and insulated gas and electric companies. The

Joint CLECs and Staff, however, propose costs of capital that would, if accepted, make it nearly impossible for SBC to attract investment.

That view cannot be squared with the *Triennial Review Order*'s requirements, with the market data, or with common sense. Anyone who seriously thinks SBC Illinois faces less risk today than in 1998 has not been using e-mail and the Internet to communicate, has not counted the cell phones on the train, has not received pitches from the cable company for phone service, has not seen the explosion in UNE-P and other competition from CLECs, and has not paid attention to SBC's stock price or the consistent statements of leaders in the investment industry like Value Line, Standard & Poor's, Moody's, and Ibbotson and Associates, all of whom confirm the increased risk faced by ILECs today. Dr. Avera quoted numerous sources confirming the significant risk faced by incumbent LECs today (*e.g.*, SBC Ill. Ex. 12.0 at 11-13, 15, 20-22, 25; SBC Ill. Ex. 12.1 at 30-31), and TELRIC requires that an even riskier market be assumed. *Triennial Review Order*, ¶ 681 (rejecting AT&T's view that a state commission could consider only "the actual competitive risk the incumbent LEC currently faces" and "future competition must be considered is assessing risk"). When risk goes up, so does the cost of capital. *Id.*, ¶ 680.

The following chart summarizes the main proposals on the table:

PARTY	COST OF EQUITY	COST OF DEBT	CAPITAL STRUCTURE	OVERALL COST OF CAPITAL
SBC Illinois	13.00%	7.18%	86% equity/ 14% debt	12.19%
Staff	12.44%	4.99%	51% equity/	8.62%

			49% debt	
Joint CLECs	9.46%	5.60%	66% equity/ 44% debt	7.54%

Of these proposals, only SBC Illinois’ is anywhere close to the proper return in a competitive market.

a. Capital Structure

i. Response to Staff

The main reason for the difference between SBC Illinois’ proposed cost of capital and Staff’s proposed cost of capital is capital structure. SBC Illinois proposes 86% equity/14% debt and Staff proposes 51% equity/49% debt (including both short-term and long-term debt). The fundamental and fatal flaw in Staff’s approach is that it violates TELRIC by not assuming a fully competitive market, which the *Triennial Review Order* (¶¶ 680-81) requires. While Staff witness McNally opined that “the cost of capital adopted in this proceeding should not reflect a fully competitive market” (Staff Ex. 31.0 (McNally Rebuttal) at 6) and thus based his capital structure on a “partially rate-regulated company” (*id.* at 12), the *Triennial Review Order* requires just the opposite:

“[T]he risk-adjusted cost of capital used in calculating UNE rates should reflect the risks associated with a competitive market” (p. 14)

“[W]e clarify that a TELRIC-based cost of capital should reflect the risks of a competitive market.” ¶ 680

“The objective of TELRIC is to establish a price that replicates the price that would exist in a market in which there is facilities-based competition.” *Id.*

“[W]e now clarify that states should establish a cost of capital that reflects that competitive risks associated with participating in the

type of market that TELRIC assumes,” which is one “in which there is facilities-based competition” and “all facilities-based carriers would face the risk of losing customers to other facilities-based competitors, and that risk should be reflected in TELRIC prices.” *Id.*, ¶¶ 680-81.

Staff defends its refusal to follow this TELRIC requirement by claiming that the cost of capital need only reflect “*some* unspecified level of competitive risk,” that the level of risk to be assumed is completely in the “discretion of state Commissions,” and that “the *Triennial Review Order* does not purport to alter the TELRIC rules in away, and in fact does not do so.” Staff Br. at 95 (Staff’s emphasis).¹³ All three claims are wrong.

The *Triennial Review Order* does not refer to assuming merely “some” level of risk. Rather, it requires an assumption of “*the risks of a competitive market.*” *Triennial Review Order*, ¶ 680 (emphasis added). There was no “discretion” left to the state commissions on that score. To the contrary, the FCC took pains to state that it was removing any discretion to assume the existence of only “some” competition (as Staff has done) and was, in fact, changing the law from the *First Report and Order*:

Even if the *Local Competition Order* could be read to suggest that a TELRIC analysis should consider only the current competitive risk faced by an incumbent LEC, we now *modify* that requirement as described in the text. We think this modification is necessary to send appropriate economic signals as addressed in [¶ 682].

Id., n.2048 (emphasis added). The FCC added that merely assuming “some” competitive risk (*e.g.*, just the actual competitive risks faced by the ILEC today) was insufficient because it

¹³ Staff also implies that the cost-of-capital requirements in the *Triennial Review Order* should be given less weight because the D.C. Circuit recently reversed many aspects of the *Triennial Review Order*. Staff Br. at 95. That argument is frivolous. No party challenged the cost-of-capital requirements in the *Triennial Review Order*, and the D.C. Circuit therefore did not even address them. They remain the valid and binding law today.

“would reduce artificially the value of the incumbent LEC network and send improper pricing signals to competitors” by setting an “unreasonably low cost of capital.” *Id.*, ¶ 682.¹⁴

Staff’s refusal to follow the *Triennial Review Order*, and its decision to instead assume that SBC Illinois faces only a limited amount of competition and should have the same capital structure as a “partially rate-regulated” company, doom Staff’s capital structure proposal. A proposal that concededly is not based on the controlling legal standard cannot be adopted.

There are other significant flaws in Staff’s proposed capital structure. Two direct ways to determine capital structure are by examining the book value or market value of the firm’s (or a group of comparable firms’) debt and equity. SBC Illinois used the market value approach and the Joint CLECs used a hybrid of book value and market value. Staff witness McNally, however, used neither. Instead, he tried to determine capital structure *indirectly* by relying on a desired “interest coverage ratio.” Staff Br. at 93. Staff’s theory was that this would produce a capital structure that is “consistent with the financial strength necessary to access capital markets at reasonable cost.” *Id.* at 92. SBC Illinois agrees that a capital structure should meet that goal, but Staff’s proposal does not. Far from allowing SBC Illinois to maintain reasonable financial strength, Staff’s 51% equity capital structure would undeniably lead rating agencies to *downgrade* SBC’s standing and could well lead to it being de-rated altogether. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 23, 25. By contrast, *direct* sources for determining capital structure show that for SBC to maintain its current single-A rating, it needs to maintain a capital structure with a percentage of equity that is far above the proposals of both Staff and the CLECs. *Id.*

¹⁴ Staff also cites the Commission’s Comments in the FCC’s *TELRIC NPRM* proceeding. Staff Br. at 96. Those advocacy comments, however, obviously do not trump the *Triennial Review Order*, and, as discussed in the text, any cost of capital that does not reflect a fully competitive market flatly violates the currently binding federal law.

SBC Illinois based its capital structure on market values, rather than book values or an interest coverage ratio, because that is what investment analysts do for competitive companies. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 63-64; SBC Ill. Ex. 12.2 (Avera Surrebuttal) at 13. Furthermore, the FCC's Wireline Competition Bureau held in the *Virginia Arbitration Order* (¶ 102) that market value is what TELRIC requires: "In calculating TELRIC prices, the theoretically correct capital structure is based on market values of debt and equity." Staff criticizes SBC Illinois by claiming that "it scarcely needs to be said that the *Virginia Arbitration Order* is not binding on the Commission." Staff Br. at 97. Whether binding or not, that decision is certainly entitled to weight as the FCC Wireline Bureau's *legal* interpretation of the *Triennial Review Order* (*i.e.*, not simply an interpretation of the facts in that case, but of the basic legal principles governing cost of capital), and Staff has provided nothing that refutes the Bureau's legal interpretation.

Staff also criticizes SBC Illinois' reliance on market values to establish capital structure by claiming that, under TELRIC, a capital structure must reflect "marginal capital," *i.e.*, the mix of debt and equity that the carrier would raise going forward, and that market values do not reflect that mix. Staff Br. at 97. SBC Illinois witness Dr. Avera already refuted that claim:

In fact, market values provide the most objective benchmark for the mix of capital that is appropriate to support the business risks of a competitive enterprise. Looking to the prices of capital assets (*i.e.*, common stock and bonds) in secondary markets provides the most direct representation of the proportions of debt and equity used to finance the total value of the firm. Moreover, investors expect to earn their required rate of return on the market value of this incremental investment, or they would be unwilling to purchase the shares.

SBC Ill. Ex. 1.2 (Avera Surrebuttal) at 10. Furthermore, Mr. McNally's "interest coverage ratio" approach has no relationship to capital market realities at all, and thus hardly qualifies as an indicator of the likely mix of "marginal capital." SBC Ill. Ex. 12.1 (Avera Rebuttal) at 26.

Staff's method of criticizing SBC Illinois' market-value approach underscores Staff's unlawful belief that traditional rate-of-return principles control here. Specifically, on pages 98-99 of its brief, Staff cites court decisions discussing rate-of-return concepts and the interests of "ratepayers" and recovery of costs for "used and useful" investments in the gas and electronic industries. Staff's reliance on such cases and concepts has absolutely no relevance to the *TELRIC* context or to the post-*Triennial Review Order* rules for cost of capital, under which the FCC's Wireline Competition Bureau has already held that SBC Illinois' market value approach is the right one.

Staff also argues that its proposed capital structure of 51% equity would enable SBC Illinois to maintain a single-A investment rating. Staff Br. at 99-100. As Dr. Avera showed, however, SBC is rated single-A at its current capital structure of 81% equity, and "two rating agencies have warned of a potential downgrade if SBC Communications increases its debt burden above present levels." SBC Ill. Ex. 1.1 (Avera Surrebuttal) at 16-17. If increasing debt levels above 19% leads to warnings of a downgrade from single-A status, adopting Staff's proposal of 49% debt would guarantee a significant downgrade, thus endangering SBC Illinois' financial stability. *Id.* at 17. *See also* SBC Ill. Ex. 12.1 (Avera Rebuttal) at 23, 25, 29. Finally, Staff argues that short-term debt should be included in the capital structure. Staff Br. at 100-02. Staff's theory is that excluding short-term debt from the capital structure is necessary because depreciation effectively reduces the lives of UNE assets. Dr. Avera, however, fully refuted that claim, which rests on the mistaken view that short-term debt is used to pay off long-term assets. SBC Ill. Ex. 12.2 (Avera Surrebuttal) at 19.

For all of these reasons, the Commission should reject Staff's proposed capital structure and adopt SBC Illinois' proposal.

ii. Response to CLECs

The Joint CLECs recommend a capital structure with a higher percentage of equity than Staff's (66%) but still include far too high a percentage to debt to reflect the increased risks of the competitive marketplace that must be assumed under TELRIC. As discussed in SBC Illinois' opening brief, the CLECs' primary error is their reliance on a 50/50 hybrid of book values and market values for equity, and use of book values alone for debt. Joint CLEC Br. at 123-24. The CLECs' use of that approach is somewhat surprising given the Wireline Competition Bureau's express rejection of it, just a few months after the *Triennial Review Order*, in the *Virginia Arbitration Order* (¶ 103): "[W]e give no weight to the portion of AT&T/WorldCom's proposal that is based on incumbent LECs' book value capital structure." As the Bureau explained:

The book value of [the ILEC's] existing network is irrelevant for [capital structure] purposes. Investors would not earn the return they require if a cost of capital that is based on book value is applied to the economic value of their assets, given that rational investors value these assets at market value. Thus, the use of a capital structure based on market values, rather than book values, represents a departure from traditional ratemaking, but one that is entirely appropriate under the Act

Id., ¶ 102 (approving 80% equity/20% debt capital structure in ¶ 103).¹⁵

Besides this plain legal error in the Joint CLECs' approach, they also rely heavily on a logical error. CLEC witness Ms. Murray purported to "focus[] on the capital structure that best approximated SBC's own *target* capital structure." Joint CLECs Br. at 123 (CLECs' emphasis). SBC, however, has no "target" capital structure, as Staff acknowledged: "A company's target capital structure could be assumed, but SBC and its subsidiaries do not manage their capital structures to exact targets." Staff Br. at 97. Thus, Ms. Murray's theory – that SBC has a target

¹⁵ In the 1998 TELRIC Order the Commission based SBC Illinois' cost of capital entirely on book values, relying on outdated concepts from rate-of-return cases. 1998 TELRIC order at 10-12. Given the new TELRIC guidance under the *Triennial Review Order* and *Virginia Arbitration Order*, that approach must change here.

capital structure, that a firm's actual capital structure tends to move toward its target capital structure, and that the best prediction of a target capital structure incorporates both market value and book value information – is flawed in its major premise, and therefore invalid from the start.¹⁶

b. Cost of Debt

i. Response to Staff

SBC Illinois recommends a cost of long-term debt of 7.18%. Staff recommend 4.99% and the Joint CLECs recommend 5.60%. Staff and the CLECs also recommend including short-term debt in the overall cost of capital, while SBC Illinois does not.

Staff contends that its proposed cost of long-term debt is reasonable because, it alleges, bond interest rates have been trending downward and yields on bonds with shorter term maturities have been decreasing. Staff Br. at 73-74. Staff also claims that SBC Illinois based its proposed cost of debt on bond yields from 1999 and that such figures are outdated. *Id.* at 73-74. These claims are erroneous.

Under TELRIC, the cost of debt must be forward-looking. Staff, however, based its cost of debt on bonds that have already been issued, which “are not necessarily indicative of the forward-looking maturity that corresponds to the economic life of UNE facilities or the long-run horizon under TELRIC.” SBC Ill. Ex. 12.1 (Avera Rebuttal) at 16. More importantly, forecasting services that Mr. McNally viewed as credible, and relied on in other contexts, predict bond yields over the next ten years of about 7.3%, slightly higher than what SBC Illinois has proposed. *Id.* at 17. This fact also shows that SBC Illinois' proposal is not outdated, but rather

¹⁶ DoD/FEA witness Gildea proposes a capital structure of 35% debt. DoD/FEA Br. at 10. Like the CLECs, however, Mr. Gildea relied on book value rather than market values, and his proposal is therefore flawed.

is consistent with current investor expectations, which should always be the bottom line in establishing a cost of capital.

ii. Response to CLECs

AT&T/MCI witness Ms. Murray based her proposed cost of debt on the assumption that interest rates will continue to decline significantly over the next ten years from their already historically low levels. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 60. This runs counter to widely referenced forecasts by the sources relied on by Mr. McNally. *Id.* Further, the values Ms. Murray relied on “differ significantly from widely reported capital market data for long-term bonds.” *Id.* Accordingly, the CLECs’ proposal is not consistent with a forward-looking cost of debt and should be rejected.

c. Cost of Equity

SBC Illinois proposes a cost of common equity of 13.00%; Staff proposes 12.44%; and the Joint CLECs propose 9.46%.

i. Response to Staff

Although SBC Illinois has methodological disagreements with Staff’s approach to the cost of equity, their proposals are ultimately not that far apart – and both are far more reasonable than the CLECs’ proposal. SBC Illinois’ disagreements with Staff on the cost of equity are spelled out in its opening brief and need not be repeated here. However, it is worth noting that Value Line, a source respected by all the cost of capital witnesses, expects investors to earn about 13% on the companies in Staff witness McNally’s own Telecom Sample group – not the 12.44% projected by Staff. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 8. This fact further supports SBC Illinois’ proposal. Similarly, once one excludes the irrational single-digit equity estimates

from Mr. McNally's DCF analysis (estimates that fall well below the rate of return for fully regulated utilities), Mr. McNally's own method produces a cost of equity of 13.09%. *Id.*¹⁷

ii. Response to CLECs

SBC Illinois witness Dr. Avera determined the cost of equity by conducting both a Discounted Cash Flow ("DCF") analysis and a "risk premium" analysis and averaging the results. SBC Ill. Ex. 12.0 (Avera Direct) Sch. WEA-1 at 19. Somewhat similarly, CLEC witness Ms. Murray conducted a DCF analysis (albeit a different kind) and a Capital Asset Pricing Modal ("CAPM") analysis, which involves an analysis of risk premiums. AT&T/MCI Joint Ex. 2 (Murray Rebuttal) at 21-33. As discussed below, however, Ms. Murray's methods and sources were quite different for Dr. Avera's, and thus produced an irrationally low cost of equity.

Before diving into the details, it is important to note that Ms. Murray made no real effort to conduct a sanity check on her sources. For example, she repeatedly relied on sources that produced a cost of *equity* that was roughly equal to the return on *bonds*. *See, e.g.* SBC Ill. Ex. 12.1 (Avera Rebuttal) at 54, 56; SBC Ill. Ex. 12.2 (Avera Surrebuttal) at 26, 28, 30. No rational investor would buy equity, with its attendant risk, when she could get virtually same return with the security of a bond. SBC Ill. Ex. 12.2 (Avera Surrebuttal) at 28. Yet Ms. Murray uncritically accepted figures that would indicate such irrational behavior. Similarly, Ms. Murray accepted figures that would have SBC Illinois, with all the risk it faces in the real world and the risk that must be assumed under TELRIC, having a return on equity *lower* than that of traditional,

¹⁷ CUB states (at 23) that "[t]he Commission should not allow SBC to include in the cost of equity the level of risk associated with business plans that incorporate advanced services unnecessary to the provision of UNEs. Aside from the fact that the *Triennial Review Order* (§ 683) allows for reflection of such risk in the cost of capital, CUB points to no place where SBC Illinois has actually increased its cost of capital to account for such risks.

regulated gas and electric utilities. SBC III. Ex. 12.1 (Avera Rebuttal) at 34, 50. That too defies the FCC's requirement to set a cost of capital that reflects a competitive market with its attendant riskiness. *Triennial Review Order*, ¶¶ 680-81.

(a) DCF Analysis

Dr. Avera's DCF analysis produced a cost of equity ranging from 12.20% to 14.30%, based on universally respected sources (Value Line and I/B/E/S) and established methods. SBC III. Ex. 12.0 (Avera Direct) Sch. WEA-1 at 19. Ms. Murray's DCF analysis, by contrast, produced a cost of equity of just 9.72%. AT&T/MCI Joint Ex. 2 (Murray Rebuttal) at 24-25. Dr. Avera described the numerous flaws in Ms. Murray's approach:

- Ms. Murray used a “three-stage” DCF model – precisely the model the FCC's Wireline Bureau rejected in 2003, finding that “[t]here is no basis on which to find that AT&T/WorldCom's three-stage DCF model produces a reasonable cost of equity capital estimate, given the lack of support for their dividend growth rate assumptions.” *Virginia Arbitration Order*, ¶ 75.
- Ms. Murray relied on a three-firm sample of BellSouth, SBC Communications, and Verizon, even though the FCC's Wireline Bureau has held that such a sample understates the risks associated with providing UNEs in the competitive market assumed under TELRIC. *Id.*, ¶ 93 (reliance on these holding companies “likely understates the risk of selling UNEs in a competitive market”).
- Ms. Murray made no effort to reflect the actual expectations of investors. Instead, Ms. Murray's DCF analysis employs a “mechanistic approach” just like that used for a “traditional regulated utility.” SBC III. Ex. 12.1 (Avera Rebuttal) at 42.

The CLECs tried to respond by claiming that Dr. Avera's DCF analysis relied on a sample of companies whose projected growth rates had dropped since the cost of capital study was conducted. *See* Joint CLECs Br. at 130. As Dr. Avera explained, however, it is not possible

to mechanistically “update” the results for his sample group, as Ms. Murray purported to do, because “[p]rofound changes in the competitive and economic environment for telecommunications firms . . . [such as] volatile capital market conditions, major acquisitions and mergers, and ongoing concerns over corporate liquidity essentially preclude a simple ‘update’” of his DCF analysis. SBC III. Ex. 12.0 (Avera Direct) at 26. Indeed, mergers had “reshaped five of the seven firms examined” in his study, “with Qwest facing intense liquidity concerns and ongoing controversy over its accounting practices.” *Id.* Thus, Ms. Murray’s purported “update” of Dr. Avera’s analysis is meaningless. Further, Dr. Avera showed that while DCF analyses rely on near-term projections, those projections understate the long-term expectations for the telecom industry, and that long-term expectations (as measured by the “b x r” approach) still support a cost of equity of more than 14%. *Id.* at 26-28.

(b) CAPM Analysis

The three inputs to a CAPM analysis are (i) the “beta,” which essentially measures the variability of a given stock’s return versus the overall market; (ii) the “equity risk premium,” which is the additional return that investors expect to receive for buying equity rather than a riskless asset; and (iii) the rate of return on a “riskless” asset. Using these inputs one determines the cost of equity by multiplying the beta times the risk premium, and then adding the result to the riskless rate of return. Ms. Murray’s beta of 0.917 is flawed, but not worlds away from Dr. Avera’s beta of 0.96. The more significant difference is between Ms. Murray’s purported risk premium of 5% (AT&T/MCI Joint Ex. 2 (Murray Direct) at 31-32) and Dr. Vanston’s risk premium of 7.5% to 9.1%. SBC III. Ex. 12.0 (Avera Direct) Sch. WEA-1 at 18.

Once again, Dr. Avera demonstrated the serious flaws in Ms. Murray’s approach. Ms. Murray based her risk premium on academic and historical studies and the *Survey of*

Professional Forecasters. The historical studies provide no legitimate basis for a risk premium because they cover only a few selected periods of time (which Ms. Murray asserts is more representative of future results). SBC III. Ex. 12.1 (Avera Rebuttal) at 46. That approach runs counter to the purpose of using historical studies, which, according to Ibbotson Associates, is “to provide a period long enough to include most or all of the major types of events that investors have experienced and may experience in the future.” *Id.* (quoting Ibbotson Associates, 2003 *Yearbook* at 27). The FCC’s Wireline Bureau recognized this: “Realized returns may vary substantially from anticipated returns over short periods, but the two coincide over very long periods, such as from 1926-present.” *Virginia Arbitration Order*, ¶ 85. The Bureau rejected shorter periods, like those selectively examined by Ms. Murray, by stating that

it is appropriate to use the longest period for which reliable return data are available to calculate the risk premium in a CAPM analysis. Giving weight to shorter periods than 1926-present produces a smaller risk premium and a lower cost of capital compared to the use of the longer period.

Id.

Ms. Murray did not heed this finding, and instead relied on studies covering periods much shorter than 1926-present. That alone is reason to reject her proposal. But there is more. Ms. Murray’s historical studies produce a cost of *equity* of 5.43%, which is below current yields on industrial *bonds*. SBC III. Ex. 12.2 (Avera Surrebuttal) at 26. Relying on such numbers makes no sense. Moreover, Ms. Murray’s own sources recognized that “academic financial economists generally accept that the equity risk premium is around *eight percent*, based on the performance of the U.S. stock market since 1926” which is in line with Dr. Avera’s estimate and Mr. McNally’s estimates, but far above Ms. Murray’s estimate. SBC III. Ex. 12.1 (Avera Rebuttal) at 48 (quoting Claus, James and Thomas, Jacob, “Equity Premia as Low as Three Percent? Evidence from Analysts’ Earnings Forecasts of Domestic and international Stock

Markets,” *Journal of Finance* (Oct. 2001) at 1662) (emphasis added). Indeed, that established 8% figure, plus Ms. Murray’s riskless rate of return of 5%, is exactly the 13% return on equity that SBC Illinois proposes.

Ms. Murray’s reliance on the *Survey of Professional Forecasters* is similarly misplaced. That is not an investment advisory publication. SBC Ill. Ex. 12.2 (Avera Rebuttal) at 25. Nor is it used as a resource for stock market investors. *Id.* Further, that document implies an expected return on the S&P 500 of 6.48%. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 47. That number is essentially equal to the yields available on corporate *bonds*, and thus is facially unreasonable as a return on *equity*. *Id.* As Dr. Avera put it, Ms. Murray’s reliance on these “benchmarks” “fail[s] even the most rudimentary tests of economic logic. . . .Why would rational investors buy a bucket of common stocks, and assume all the inherent risk, when they could earn the same expected return with certainty by buying a bond? The answer, of course, is that rational investors would not.” SBC Ill. Ex. 12.2 (Avera Surrebuttal) at 28.

Ms. Murray tried to attack Dr. Avera’s risk premium by claiming he relied on a single study. Joint CLEC Br. at 131-32. But in fact Dr. Avera reviewed a variety of studies in assessing the equity risk premium in his original analysis, and continued to review and cite various other more recent sources confirming that a cost of equity of 13% is, if anything, conservative under TELRIC and in the telecom industry. *See* SBC Ill. Ex. 12.0 (Avera Direct) Sch, WEA-1 at 16-18.

Ms. Murray’s beta value in her CAPM analysis also is flawed. Dr. Avera used Value Line’s beta values, which are “perhaps the best indicator of the risk investors are likely to associate with telecommunications companies like SBC Communications,” and which Staff’s Mr. McNally used without making any of the unnecessary adjustments or “relevering” proposed

by Ms. Murray. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 55. Moreover, Dr. Avera used a beta of 0.96 even though SBC Communications' current Value Line data is 1.05, which would have produced a higher risk premium (as would the 1.00 beta adopted in the *Virginia Arbitration Order*, ¶ 90). Thus, Ms. Murray's claim that Dr. Avera should have levered/relevered the Value Line beta is inaccurate; if anything, the beta should have been higher. Joint CLEC Br. at 131.

Some parties (*e.g.*, CUB Br. at 23) claim that the *Virginia Arbitration Order* rested on a stale record and therefore has no relevance here. That claim fails. To begin with, the Virginia Order clearly reflects the need, under the *Triennial Review Order*, to assume the existence of a competitive market, which increases risk (and thus the cost of capital) in all circumstances. Further, the result in the Virginia case would be little, if any, different today. As Dr. Avera explained, bond yields have declined approximately 1.7% since June 2000, which implies that the cost of equity has declined by about 85 basis points. Subtracting 85 basis points from the 14.37% cost of equity approved by the Wireline Competition Bureau results in a revised cost of equity of 13.52% — far above Ms. Murray's recommendation and even above SBC Illinois' recommendation of 13.00%. And even if one accounted only for the drop in bond yields (without the offsetting increase to the equity risk premium) the adjusted cost of equity in the Virginia case would be 12.67%, still well above Ms. Murray's proposal and above Staff's proposal.

d. Assessment of the Overall Cost of Capital

As noted at the outset, setting a cost of capital can be complex. But in doing so it is important not to lose sight of the forest for the trees. To that end, and to thoroughly rebut the Staff's and CLECs' facile assertions that his cost of capital study was "too old" to be useful, Dr. Avera presented substantial evidence corroborating the present and continued reasonableness of

his proposed cost of capital. The Commission should keep these benchmarks in mind as it settles on a new, forward-looking, risk-adjusted -- and necessarily higher -- cost of capital for SBC Illinois, as proposed by Dr. Avera:

OVERALL COST OF CAPITAL

11.25%	FCC's default value (<i>First Report and Order</i> , ¶ 702; SBC Ill. Ex. 12.2 (Avera Surrebuttal) at 34-35) (explaining that FCC still uses 11.25% today)
12.19%	SBC Illinois' proposal
12.37%	Pennsylvania PUC in post- <i>Triennial Review Order</i> decision (cited in SBC Ill. Br. at 72)
13.068% (12.95% adopted under baseball arbitration)	Adopted in <i>Virginia Arbitration Order</i> , ¶ 104
15%	AT&T proposed cost of capital for CLECs in a competitive market. SBC Ill. Ex. 12.2 (Avera Surrebuttal) at 36 (citing AT&T <i>ex parte</i> to FCC)

CAPITAL STRUCTURE

76% equity/24% debt	Value Line projection for Verizon. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 68 and Sch. WEA-6.
80% equity/20% debt	Adopted in <i>Verizon Virginia Order</i> , ¶ 103.
82% equity/18% debt	Standard & Poor's survey of 970 U.S. industrial companies. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 68.
83% equity/ 17% debt	Value Line projection for SBC Communications. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 68

86% equity/14% debt	SBC Illinois' proposal
86% equity/14% debt	Value Line projection for Verizon. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 68.

COST OF EQUITY

11.37% and 11.38%	Average authorized rates of return for gas and electric utilities in the first half of 2003. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 7.
13%	SBC Illinois' proposal
13%	Approved in 2002 by the Wisconsin and Missouri state commissions reviewing Dr. Avera's study. SBC Ill. Ex. 12.1 (Avera Rebuttal) at __.
13.1%	Value Line projection of returns for Mr. McNally's Telecom Sample group. SBC Ill. Ex. 12.1 (Avera Rebuttal) at 8.
14.37%	Adopted in <i>Virginia Arbitration Order</i> , ¶ 104.

C. Other Loop Recurring Cost Modeling and Input Issues

1. Cable and DLC Installation costs/factors

a. Response To Staff

Staff argues that the burden was on SBC Illinois to “demonstrate in the first instance why the method it has chosen [to calculate cable installation costs] develops costs that are forward-looking and reflects the costs of an efficient carrier.” Staff Br. at 108. SBC Illinois has met that burden. SBC Illinois used installation factors developed on the basis of fully audited general ledger data for the recent three year period of 1999 through 2001. The evidence shows that use of a three year period is reasonable because it provides a sample of project sizes sufficient to ensure that the resulting installation factors accurately represent the normal ongoing relationship

between the cost of installing cable facilities and the cost of cable materials. The installation factors are also representative of the equipment currently being installed and were developed specifically for each type of cable (i.e., either copper or fiber and for aerial, burial and underground). The factors were then applied to the current prices for cable material included in LoopCAT's forward-looking network to develop reasonable estimates of the forward-looking costs of installing each type of cable. SBC Ill. Br. at 78-80; SBC Ill. Ex. 4.0 (Smallwood Direct) at 29; SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 49-64; SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 31-37.

The resulting estimates are actually conservative, in light of the fact that labor costs have been increasing, and continue to increase, year-over-year, due to factors such as wage increases attributable to union contractual obligations and rising benefit costs. SBC Ill. Ex. 17.0 (Dominak Rebuttal) at 30. As a result, there has generally been a trend toward increases in the ratio of installation costs to material costs, as demonstrated by the fact that cable installation factors calculated on the basis of data more recent than that available at the time SBC Illinois performed its cost study are higher than those used in the study. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 61.

The factor method used by SBC Illinois to develop cable installation costs, as described above, is the same method used to develop the TELRIC costs approved by this Commission in Docket 96-0486/96-0569. The Indiana Commission also approved this method in its recent UNE cost proceeding, finding it to be TELRIC compliant. *Indiana UNE Order* at 44. The Commission should approve the method again in this case.

Staff argues that the data used by SBC Illinois to calculate the cable installation factors represent “inefficient cost relationships rather than efficient forward-looking cost relationships.”

Staff Br. at 105. In support of this argument, Staff suggests that the “set of costs considered by the Company” only included “costs of expanding or reinforcing existing capacity rather than the costs of developing a new network.” *Id.* In fact, the cost data used by SBC Illinois was *not* limited to costs associated with such reinforcement, or “augmentation,” jobs. Rather, SBC Illinois used the costs associated with all cable installation projects during the three year period, including the costs of constructing new facilities in areas of new development, as well as the costs of reinforcement jobs in areas that are already developed.

Contrary to Staff’s assertions, the inclusion of costs associated with reinforcement projects in the development of cable installation factors does not result in “cost inefficiency.” Staff Br. at 105 As discussed in SBC Illinois’ Initial Brief, in an efficient network there will always be a need to augment or reinforce facilities on a forward-looking basis. SBC Br. at 81; SBC Ill. Ex. 8.1 (White Rebuttal) at 14-15. This conclusion is not contradicted by Mr. White’s statement that “it is more cost effective to install spare capacity at the outset, than to continually augment existing facilities,” as Staff suggests. Staff Br. at 105. Consistent with that statement, SBC Illinois’ network engineering guidelines for sizing distribution plant are designed to include an adequate amount of spare capacity and to minimize the number of augments that may be needed. As Mr. White also explained, however, no carrier, including SBC Illinois, can forecast with absolute certainty the level of future demand in every area of its network. Without significantly oversizing every lateral of cable in the distribution plant, there is no way to avoid the need for some amount of augmentation in the distribution network. SBC Illinois would only be able to avoid the need for “augmentation,” or reinforcement, projects in a forward-looking network by constructing far more spare capacity than is economically efficient or called for by the network engineering guidelines. SBC Ill. Ex. 8.1 (White Rebuttal) at 15-16. The amount of

costs associated with “reinforcement” or “augmentation” projects included in the three years of data used by SBC Illinois to calculate its installation factors is consistent with the economically efficient level of spare capacity reflected in SBC Illinois’ actual fill factors and, therefore, represents an efficient forward-looking level of such costs. *Id.*

In short, Staff cannot have it both ways. It cannot insist, for installation cost purposes, that the loop cost study should assume only construction projects that install the most capacity possible, which would result in fill factors *lower* than the actual fill factors used by SBC Illinois, and at the same time, insist on fill rates *higher* than those which SBC Illinois has been able to achieve.

Staff argues that the Commission should ignore the evidence discussed above and indulge in the fiction that the entire network could be built overnight from scratch by a carrier with perfect information regarding future demand in every part of the network. Staff Br. at 109. Staff cites no authority to support the proposition that TELRIC should be applied in such an unrealistic manner. Contrary to Staff’s assertion, its position is not supported by the FCC’s statement that TELRIC models are designed to produce the cost that would be incurred by a carrier to “construct and maintain” an “efficient network” built today. Staff Br. at 109 (quoting TELRIC NPRM at ¶ 49). As previously discussed, even an efficient carrier would be unable to forecast with precision future demand in every part of its network, and, therefore, if such a carrier were to “build an efficient network today” and include in it a cost effective level of spare capacity, there would still be a need to augment and reinforce network plant facilities over time. As the FCC has expressly recognized, “the UNE pricing methodology, while forward-looking, must be representative of the real world and should not be based on the totally hypothetical cost of a most efficient network provider building a network from scratch.” TELRIC NPRM at ¶ 53.

Furthermore, even if one were to adopt Staff's unrealistic interpretation of TELRIC, there is no basis to assume that existing man-made impediments to construction, such as buildings, roads, bridges, streets, driveways, and sidewalks have all suddenly disappeared. Building an entire network from scratch in this real world environment would require SBC Illinois to tear up streets in urban areas, bore under all existing driveways and sidewalks, and perform all the other construction activities that accompany the installation of network plant facilities in an established area. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 63-64. The costs incurred to build such a network would more closely resemble the costs of augmenting or reinforcing existing plant than the cost of building network facilities from scratch in a new, previously undeveloped area, such as a new subdivision. *Id.*

For all the reasons discussed, SBC Illinois has met any burden it has of proving that its installation factor method "develops costs that are forward-looking and reflect the costs of an efficient network." (Staff Br. at 108). On the other hand, Staff has identified no cogent basis for its proposal to calculate the factor for each type of cable equipment based on data for whichever year happens to produce the lowest result. Staff's approach is completely arbitrary and would deprive SBC Illinois of any opportunity to recover the forward-looking TELRIC costs of installing cable facilities.

b. Response To Joint CLECs' Argument Regarding Installation Factors Generally

For the most part, SBC Illinois has already fully responded to the arguments made by the Joint CLECs in opposition to the installation factors approach used by SBC Illinois and in support of the "bottoms-up" approach proposed by AT&T witnesses Pitkin and Turner. SBC Ill. Br. at 82-101. As SBC Illinois explained, the Joint CLECs' proposed bottom-up approach is inappropriate because it fails to account for all of SBC Illinois' installation costs, and thus serves

to understate SBC Illinois' loop costs. In addition, as discussed in SBC Illinois' Initial Brief, and in the above response to Staff's arguments, the evidence demonstrates that SBC Illinois' installation factors are consistent with TELRIC and represent the most reliable method in the record to compute average installation costs across the entire network, and to account for the myriad of work activities and circumstances that can and do occur within the network. *Id.*

The evidence refutes the Joint CLECs' claims that installation factors violate TELRIC because they are based on embedded data. Joint CLEC Br. at 139. As discussed above, factors are established using SBC Illinois' recent data that reflect the relationship between what SBC Illinois pays for equipment and the total costs to install equipment. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 49-51, 64. Moreover, in creating installation factors, SBC Illinois used costs that were taken directly from SBC Illinois' general ledger, which is subject to substantial annual auditing. *Id.*; SBC Ill. Ex. 17.0 (Dominak Rebuttal) at 28-30. The Joint CLECs also claim that installation factors are an unreliable method for determining loop installation costs because there are variations in material and labor costs from year to year. Joint CLEC Br. at 144. As previously discussed, however, SBC Illinois developed installation factors using data for a three-year period in order to address any anomalies in installation costs. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 62.

The Joint CLECs further assert that SBC Illinois' use of installation factors must be rejected because such factors "are inherently unreliable, as there is no evidence of any linear relationship between the material costs and installation cost – i.e., [sic] a \$1,000,000 Picasso painting takes the same time to hang on the wall as a \$20 Velvet Elvis." Joint CLEC Br. at 138-39. However, that simplistic example misses the mark because it is not analogous to a real-world network, where a multitude of various work activities would be required to accommodate the

different circumstances that can and do occur in SBC Illinois' network and which SBC Illinois has no way of accurately predicting. Even Joint CLECs' simple "Velvet Elvis" hypothetical can be used to illustrate this point. For example, if every art collector displayed his art in rooms with 8 foot ceilings, then the Joint CLECs' contention that it costs the same to hang both the \$20 Velvet Elvis and the \$1,000,000 Picasso may have some merit. But, common sense and real-world experiences establish that that would not be the case; *i.e.*, the art collector with the \$20 Velvet Elvis may display his art in his basement apartment with 8 foot ceilings, whereas the art collector with the \$1,000,000 Picasso may display his art high on the walls of his mansion with soaring 23 foot ceilings. Or, the walls on which the Picasso is displayed could consist of a material more architecturally significant than drywall, such as marble, granite or slate. Under those circumstances, there would necessarily be additional costs to install the Picasso – which would not be accounted for under the Joint CLECs' proposed bottom-up costing methodology. Joint CLECs' bottom-up approach should be rejected because it would not account for the costs related to the work activities necessary to accommodate the various circumstances that occur in SBC Illinois' network.

Joint CLECs also argue that installation factors should be rejected because installation costs may not have an exact relationship to material costs for certain selected projects. Joint CLEC Br. at 141-43. That argument is beside the point, because the evidence in this proceeding unequivocally demonstrates that the use of installation factors is the best method available for computing SBC Illinois' *total* average loop costs across the *entire network*. There is no soothsayer in SBC Illinois' engineering or cost group who can predict the different circumstances and costs of each and every different type of job. That does not mean, however, that SBC Illinois should be required to forego recovery of those costs. Yet that would be the

consequence of Joint CLECs' proposed bottom-up methodology. As the Indiana Commission stated in its recent TELRIC proceeding:

In analyzing this dispute we are guided by the recognition that TELRIC does not preclude the use of total, long-run averages. That is, installation costs have to be computed as average costs across a variety of situations in order to be usable in setting generally applicable rates.

The Commission reaffirms that SBC Indiana's use of linear loading factors is reasonable. We disagree with Messrs. Pitkin and Turner that linear loading factors are inconsistent with TELRIC principles because such factors purportedly rely upon embedded data. We reject the CLECs' view that SBC Indiana's use of its current costs and current engineering practices in and of itself somehow violates TELRIC principles. Even a forward-looking network must have some basis in reality, and it is reasonable for SBC Indiana to use its most current, audited costs to determine the relationship between major material investments and the cost of installation. Similarly, we reject AT&T's claims that linear loading factors violate TELRIC principles by overlooking economies of scale. TELRIC assumes that a forward-looking network will be constructed over time, not instantly, and networks placed over time will include construction projects of all shapes and sizes.¹⁸ SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 58.

c. Response To Joint CLECs' Argument Regarding Use of JAM

The Joint CLECs argue that SBC Illinois' Job Administration Management Tool ("JAM") provides the best data to use for calculating SBC Illinois' loop costs from the bottoms-up. As fully discussed in SBC Illinois' Initial Brief, however, it is inappropriate to use JAM for this purpose because it is not designed, and cannot be used, to produce estimates of the total cost of a project; rather, its purpose is to track job progress, construction productivity, material ordering and inventory. SBC Ill. Br. at 87-88. Moreover, while JAM can be used to estimate a portion of the costs on a job-by-job basis, the estimates it produces will vary greatly based on the

¹⁸ *Indiana UNE Order* at 44.

details of the particular job being examined. For these and other reasons, installation factors based on accounting data are far more useful and reliable than incomplete cost estimates culled from JAM. SBC Ill. Br. at 86-92.

Moreover, as discussed by SBC Illinois in its Initial Brief, the cost estimates developed by AT&T witnesses Pitkin and Turner, and proposed by the Joint CLECs, inexplicably fail to account for many steps needed to install aerial, buried and underground cable. SBC Ill. Br. at 90-91; SBC Ill. Ex. 8.1 (White Rebuttal) at 24-34, Sch. RSW-R1, R2, R3. For each of these facilities, Pitkin/Turner developed installation cost estimates using functional time increments (“FTIs”) from JAM for only two tasks: placing and splicing. As Mr. White explained, however, the installation of such facilities requires, at a minimum, numerous additional tasks for which there are FTIs in JAM, but which Pitkin/Turner failed to use in developing their cost estimates. *Id.*

Incredibly, the Joint CLECs attempt to blame SBC Illinois for Pitkin/Turner’s mistakes, asserting that SBC Illinois provided AT&T with the “JAM estimates” relied upon by Pitkin/Turner. Joint CLEC Br. at 154-55. In fact, AT&T did not request, and SBC Illinois, therefore, did not provide, “JAM estimates” of the cost of performing complete aerial, buried or underground copper installation jobs. Tr. 680 (White). SBC Illinois did, however, provide AT&T with the entire list of activities and associated functional time increments (“FTIs”) (and, in some cases, JAM estimates of the costs of performing specific tasks) which Pitkin/Turner could have used to develop JAM estimates for a complete aerial, buried and underground cable installation jobs. *Id.*¹⁹ To perform a proper JAM estimate for such jobs, Pitkin/Turner would

¹⁹ The Joint CLECs assert that “SBC, in its own words, provided AT&T with JAM estimates ‘as an engineer would use the JAM system,’” citing an email contained in AT&T Cross Exhibit 20. As the record makes clear, however, that email was responding directly to an email from AT&T in which AT&T requested JAM estimates for a list of
(cont’d)

have been required to use, at a minimum, FTIs for a myriad of tasks described by Mr. White in his rebuttal testimony and identified on the JAM estimator reports set forth in Schedules RSW-R1, R2, and R3, in addition to the FTIs for splicing and placing cable. Pitkin/Turner's failure to do so was an apparent result of their lack of knowledge and experience with respect to the installation of outside distribution plant facilities. Tr. 1604-09 (Pitkin/Turner); Tr. 1677 (Turner) ("we did not get to the installation phase in that work while I was still an employee at AT&T").

The Joint CLECs also assert that Mr. White's criticisms of Pitkin/Turner's "analysis" is "baseless" because the costs of "pole and conduit placement" are accounted for by LoopCAT in factors separate from the cable installation factors. Joint CLEC Br. at 154-56. This argument is extremely misleading because it suggests that the only tasks identified by Mr. White as having been omitted from Pitkin/Turner's analysis are those tasks for which the costs would be accounted for through the pole and conduit factors. This suggestion is false. While Mr. White did identify certain activities for which costs are booked to Functional Reporting Code ("FRC") 1c (a pole account) and FRC 4c (a conduit account), the vast majority of the missing activities (and associated time and costs) identified by Mr. White are those accounted for in FRCs 22c, 45c and 5c, which contain the costs used by SBC Illinois to develop installation factors for aerial, buried and underground copper cable, respectively. *Id.*; SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 50.

For example, with respect to aerial cable, Pitkin/Turner failed to take into account the following activities, none of which are accounted for by the pole or conduit factors:

- Strand placement, which is required to physically attach the cable;

(... cont'd)

projects *that did not include the installation of aerial, buried or underground copper cable*. Tr. 678-80. In fact, AT&T *never* requested that SBC Illinois provide a "JAM estimate" of the cost of performing an entire copper cable installation job.

- Tree trimming, which is required to create a path for cable placement;
- Conformance testing, which is required to validate pair appearance for service and database accuracy;
- Additional required splicing;
- Pair credit.

SBC Ill. Ex. 8.1 (White Rebuttal) at 25; SBC Ill. Ex. (White Rebuttal), Sch. RSW-R1 at 2-3. As shown in Schedule RSW-R1, the costs associated with each of the above-listed activities are charged to 22C, the account which contains the costs used by SBC Illinois to develop its aerial copper cable installation factor. Pitkin/Turner did not take these activities into account in developing their JAM estimate of the cost of installing aerial cable, thereby understating the cost estimate that would be produced by JAM for even the relatively simple job represented by the scenario shown in Schedule RSW-R1. Moreover, depending upon the complexity of a particular aerial cable installation job, additional time and cost estimates would be produced by JAM beyond the time and cost estimates for the scenario illustrated in Schedule RSW-R1. For example, if aerial cable were installed along a street that is curved, or has a greater number of trees than were assumed in the scenario (thereby requiring more tree trimming), the time and associated cost estimates produced by JAM would be greater.

Similarly, Mr. White identified the following tasks which Pitkin/Turner failed to account for in developing their JAM estimate of the cost of installing underground copper cable, none of which are covered by the pole and conduit factors:

- Additional splicing;
- Conformance testing, required to validate pair appearance for service and database accuracy;
- Testing manhole water to comply with federal mandates;

- Buffering four separate locations to prevent cable from becoming wet during the work operation;
- Existing pair credits.

SBC Ill. Ex. 8.1 (White Rebuttal) at 30, Sch. RSW-R3 at 2-3. The costs associated with all of these activities are accounted for in FRC 5C, which contains the costs used by SBC Illinois to develop its underground copper cable installation factors. Pitkin/Turner failed to account for these activities, thereby significantly underestimating costs that would be produced by JAM, even for a relatively uncomplicated job such as that illustrated in Schedule RSW-R3. In that scenario, the JAM estimated hours for all the required activities would be [*****], compared to Pitkin/Turner's estimated [*****]. SBC Ill. Ex. 8.1 (White Rebuttal) at 30-32, Sch. RSW-R3 at 2.²⁰

The evidence further shows that Pitkin/Turner failed to account for the vast majority of the activities necessary to install buried cable. These activities are listed at page 91 of SBC Illinois' Initial Brief and include, but are not limited to, directional boring under driveways, inspection of contract work, trenching in rock, placing pedestals, and restoring grass areas. SBC Ill. 8.1 (White Rebuttal) at 27, Sch. RSW-R2 at 2-3. The costs associated with all of these activities are accounted for in FRC 45C, the account which contains the cost data used by SBC Illinois to develop its buried copper cable installation factors. *Id.* None of these activities or their associated costs are accounted for by the pole and conduit factors.

In their rebuttal testimony, Pitkin/Turner made no attempt to refute the evidence presented by Mr. White, as summarized above. In light of that evidence, the Joint CLECs' claim

²⁰ While Mr. White identified certain underground cable installation tasks which are accounted for in FRC 4c, those tasks are performed by outside contractors in the Schedule RSW-R3 scenario and are not included in the total SBC Illinois labor time estimate of [*****]. SBC Ill. Ex. 8.1 (White Rebuttal), Sch. RSW-R3 at 2-3.

that there is no “credible evidence that Messrs. Pitkin/Turner’s use of JAM’s installation estimates exclude costs” is beyond comprehension.

Moreover, the Joint CLECs continue to ignore the fact that even properly performed JAM estimates, such as those shown in Schedules RSW-R1, R2 and R3, will not account for additional hours and costs that frequently result from “unforeseen” circumstances, such as the following:

- Traffic conditions, including congestion causing delay getting to and from the location and cars parked in the work area under the cable;
- Inclement weather, including heavy snow requiring removal before starting to work and rain or lightning while working around joint poles with power;
- Municipal rules such as restricted hours of operation, limited hours of work during rush hour commuting, rules requiring breakdown and setup in alleys for city services (e.g., garbage collection), and noise ordinances;
- Equipment breakdown, such as placing vehicle hydraulic leaks or mechanical breakdown;
- Material defects including factory defects with cable;
- Accessibility areas involving items such as fences, garages and customers wanting access to the work area;
- Tracking/boring obstructions such as rock frost, unknown utilities, underground abandoned structures;
- EPA issues, such as contaminated soil.

SBC Ill. Ex. 8.1 (White Rebuttal) at 26, 29, 31-32. These types of conditions cannot be coded in JAM and are not always known at the time the job is developed. Encountering these conditions will add hours and costs to installing aerial, buried and underground cable. *Id.*

The Joint CLECs argue that the average cost estimates produced for JAMs “take into account the different circumstances that might be found on differing jobs.” Joint CLEC Br. at 154. This argument reflects a misunderstanding of JAM. As Mr. White explained, the time estimates, or functional time increments (“FTIs”), included in JAM are developed based on the

average time to complete each task assuming *normal* working conditions and the average technician performance using standard tools. The FTIs are not, as the Joint CLECs suggest, calculated based on the average amount of time *actually* spent to complete tasks on actual projects. Accordingly, the FTIs in JAM do not reflect additional hours that can, and almost always do, result from the types of abnormal and unforeseen field conditions previously discussed. SBC Ill. Ex. 8.2 (White Surrebuttal) at 21-22.

For example, site setup includes travel, work area protection, manhole opening, communications with property owners for accessibility, environmental testing (i.e., air quality, etc.), purging and ventilation, and loading and unloading work tools. The time allocated in JAM for site setup is based on *normal* conditions and does not include additional time for dealing with the abnormal field conditions, such as handling contaminated soil, or the travel time associated with abnormal traffic conditions. SBC Ill. Ex. 8.2 (White Surrebuttal) at 22-23.

The Joint CLECs also assert that SBC Illinois “refuses to pay for jobs that overrun JAM estimates.” Joint CLEC Br. at 154. This assertion, for which the Joint CLECs provide no supporting record citation, is simply wrong. The Joint CLECs are apparently referring to a procedure which they describe elsewhere in their brief as “us[ing] JAM to check that invoices do not exceed project costs.” Joint CLEC Br. at 152 (citing Tr. at 499-501). As Mr. White explained, however, the *only* invoices subject to this procedure are invoices from vendors for certain types of electronic equipment accounted for in the PICS/DCPR system. This procedure does *not* apply to the costs of installing outside plant, such as aerial, buried and underground copper cable. As Mr. White stated, “vendors submit bills – for example, we have all kinds of vendors that submit their bills for the outside plant work that they do for us and none of them

have limits set in JAM. They do not . . . those bills come in are paid but they are not paid in JAM and JAM does not put a criterion on it.” Tr. at 502 (White).

The Joint CLECs also argue that their use of JAM to develop the installation costs for use in a TELRIC study is supported by the testimony of an SBC witness in a completely unrelated Wisconsin proceeding which does not involve review of a UNE loop cost study. Joint CLEC Br. at 156-58. The testimony of that witness, which the Joint CLECs quote out of context, supports no such conclusion. Rather, that witness simply confirmed that JAM is a tool which is reliable in performing the tasks for which it was intended. For all the reasons discussed by SBC Illinois above and in its Initial Brief, however, JAM is not an appropriate tool for developing installation costs for use in a TELRIC study, and the Wisconsin testimony quoted by the Joint CLECs does not in any way contradict that conclusion.

d. Response To Joint CLECs’ Arguments On DLC Installation Costs

As discussed in SBC Illinois’ Initial Brief, application of the Company’s revised plug-in and hardwire factors produces a total installation cost for a 2016 line DLC remote terminal of approximately [*****] and a total installed cost of a 2016 cabinet of [*****]. SBC Ill. Br. at 92-93, 99-100; SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 71; Tr. 633-34 (Pitkin). For the reasons fully discussed in SBC Illinois’ Initial Brief, the DLC installation factors, and the costs which they produce, are reasonable and fully supported by the evidence. Staff and the Attorney General have accepted the Company’s revised DLC installation factors. Staff Br. at 106-07; AG Br. at 20-21.

In their brief, the Joint CLECs misstate the DLC installation cost estimates included in SBC Illinois’ revised loop cost study. Specifically, the Joint CLECs assert that the total cost of the 2016 DLC-RT (without cards) is [*****]

installation costs, citing Pitkin/Turner's March 5, 2004 surrebuttal testimony (AT&T Ex. 2.2). Joint CLEC Br. at 161. Pitkin/Turner, however, arrived at these inflated numbers by incorrectly adding to the costs summarized in the preceding paragraph, amounts calculated by applying the LoopCAT model's land and building factors. Pitkin/Turner were apparently under the false impression that costs associated with certain installation activities, such as installation of the pad on which the RT is placed, are accounted for in LoopCAT through the land and building factors. AT&T Ex. 2.0 (Pitkin/Turner Direct) at 69; AT&T Ex. 2.1 (Pitkin/Turner Rebuttal) at 63. As SBC Illinois has pointed out, however, that is simply not the case. SBC Ill. Br. at 99, 36; Tr. 808-10 (Smallwood). All of the DLC installation costs at issue (including site preparation, pad material and installation and power pedestal installation) are costs assigned to functional reporting code ("FRC") 257c (circuit electronic equipment) and, therefore, are reflected in the development of the plug-in and hard-wire factors used to calculate DLC-RT installation costs. Thus, the land and building factors have nothing to do with the cost of installing DLC facilities. Tr. 808-810 (Smallwood).

Of the amount by which the Joint CLECs improperly inflated their calculation of the total installed DLC-RT costs included in SBC Illinois' revised cost study, 99% (or \$68,917.59) is attributable to the building factor. As stated above, the building factor is *not* intended to recover any portion of the costs of installing a DLC-RT. Rather, the building factor is intended to recover investment in the buildings which house electronic equipment. Tr. 809-810 (Smallwood). As SBC Illinois discussed in its Initial Brief, even though remote terminals are generally not housed in building, application of the building factor to the entire investment in electronic equipment (including remote terminals) is appropriate because of the way in which the building factor was developed. Specifically, the building factor is a ratio of building investment

to the total investment to electronic equipment, including remote terminals. SBC Ill. Br. at 118-19. Accordingly, in developing a TELRIC level of building investment, it is appropriate to apply the building factor to all of the forward-looking investment and circuit equipment, including remote terminals.²¹

The Joint CLECs' arguments in opposition to SBC Illinois' revised DLC installation factors should be disregarded because they are premised almost entirely on the misstatement of DLC installation costs discussed above. For example, the Joint CLECs argue that the total installed cost of a 2016 DLC-RT included in SBC Illinois' cost study is outside the range of \$120,000 to \$150,000 discussed by an SBC Illinois employee, John Trott, in a Texas proceeding, asserting that this range is "substantially less than the LoopCAT assumed cost of a 2016 DLC-RT *excluding* line cards of [*****]. Joint CLEC Br. at 161-62 (emphasis in original). As discussed above, however, the installed cost of a 2016 DLC-RT reflected in SBC Illinois' revised cost study is actually [*****], which falls squarely within Mr. Trott's cost range.

The Joint CLECs further argue that Mr. Trott's cost range should be reduced to back out the costs of line cards from Mr. Trott's estimate in order to provide an "apples to apples" comparison between the remote terminal costs found in LoopCAT and the total installed costs indicated by Mr. Trott. Joint CLEC Br. at 162. Mr. Trott's estimate, however, included only the cards needed for initial turn-up and approximately six months' worth of growth. SBC Ill. Ex. 8.1 (White Rebuttal) at 45. The Joint CLECs have backed out the cost of 200 additional line cards

²¹ The Attorney General takes issue with the manner in which the Company has calculated and applied the building factor to electronic equipment, including remote terminals. The dispute between SBC Illinois and the Attorney General is addressed in Section III.C.3.e of this Reply Brief. However, the Attorney General, like SBC Illinois, recognizes that the building factor issue has nothing to do with the issues concerning the appropriate method of calculating DLC installation costs, or the appropriateness of the hardwire and plug-in installation factors used by SBC Illinois to develop those costs for its revised loop cost study. In fact, as previously discussed, the Attorney General has accepted SBC Illinois' revised DLC installation factors.

which were not included in Mr. Trott's cost estimate to begin with. SBC Ill. Ex. 8.1 (White Rebuttal) at 44-45. Accordingly, the Joint CLECs' alleged "apples-to-apples" comparison is no such thing and should be disregarded.

The Joint CLECs also argue that "SBC has acknowledged the inappropriateness of the very loading factors it has applied to DLC equipment in Illinois" in a Wisconsin proceeding. This argument is extremely misleading. As discussed in SBC Illinois' Initial Brief, Ameritech Wisconsin's proposal in that case was based upon a misinterpretation of the terms of new SBC Illinois/Alcatel contracts that became applicable to Ameritech in November 2000 during the course of the Wisconsin proceeding. SBC Ill. Br. at 97; SBC Ill. Ex. 15.0 (D. Palmer Rebuttal) at 16-20; SBC Ill. Ex. 15.1 (D. Palmer Surrebuttal) at 9-12. Specifically, Ameritech Wisconsin incorrectly assumed that certain language in the new Alcatel contract should be construed to mean that the prices included the cost of additional installation and services to be provided by Alcatel. As is fully discussed in SBC Illinois' Initial Brief, this assumption is incorrect. SBC Ill. Br. at 95-98. In fact, Alcatel does not perform services to physically place and install DLC equipment in the field, and the Alcatel contract prices modeled in LoopCAT do not include any of the costs associated with such installation activities. *Id.* Moreover, the factor of [*****] applied to DLC equipment in the Wisconsin proceeding was actually the factor calculated for plug-in equipment, and is comparable to the [*****] plug-in factor applied to plug-in equipment by SBC Illinois in its revised cost study. It is completely inappropriate to apply a plug-in factor to *hardwire* DLC equipment. SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 36.

The Joint CLECs assert that "SBC's current cost study is particularly disconcerting because the Wisconsin Commission relied upon the same contract provision referenced above

from the Alcatel Master Agreement to justify its conclusion.” Joint CLEC Br. at 165. In fact, a the Wisconsin Commission did *not* rely on this clause at all, but merely noted the CLECs’ argument regarding Section 10.14 of the Master Agreement in its discussion of this issue. For the reasons fully discussed in SBC Illinois’ Initial Brief, Section 10.14 of the Master Agreement does not apply to the Alcatel equipment at issue in this proceeding. SBC Ill. Br. at 95-96.²²

2. Copper/fiber Crossover Point

Staff’s brief confirms the fact that its proposal to use an 18kft copper/fiber crossover point is based entirely on the mistaken assumption that an 18kft crossover point “produces a network design capable of provisioning the services that SBCI plans to offer for the foreseeable future.” Staff Br. at 114, 116. This assumption is directly contrary to the evidence, which shows that SBC *already provides*, and will continue to provide, advanced services for which the crossover point cannot be greater than 12kft, the crossover point modeled in LoopCAT. SBC Ill. Br. at 102-103; SBC Ill. Ex. 8.2 (White Surrebuttal) at 32; SBC Ill. Ex. 4.1 (Smallwood) at 19.²³ Contrary to Staff’s assertion, therefore, the network design it proposes clearly *will* “impede advanced services.” Moreover, the evidence also shows that a 12kft crossover point is the most efficient forward-looking network design for the provision of other types of services, such as DS1. SBC Ill. Br. at 101-02; SBC Ill. Ex. 8.1 (White Rebuttal) at 60; SBC Ill. Ex. 4.1 (Smallwood Surrebuttal) at 19.

²² The Joint CLECs assert that SBC Illinois “admitted that the cost of installing different sizes of DLC remote terminals (RT) are the same, despite the fact that the larger DLC is more expensive to purchase.” Joint CLEC Br. at 142. As support for this assertion, the Joint CLECs cite a portion of Pitkin/Turner’s testimony in which they quoted an SBC Illinois data request response with the proposition that installation cost estimates produced by JAM for the 672 DLC and the 2016 DLC size RTs are the same. AT&T Ex. 2.0 (Pitkin/Turner Direct) at 47. In the very next sentence of the data request response relied upon by Pitkin/Turner, however, SBC Illinois stated that “JAM produces estimates which do not necessarily reflect actual costs.”

²³ For example, the design objective originally developed for Project Pronto was to provide advanced services with speeds up to 1.5 mbs. *Id.* To support speeds of 1.5 mbs or greater, the crossover point cannot be greater than 12kft. Today, SBC sells advanced services with speeds up to 6 mbs. *Id.*

For these and all other reasons fully discussed in SBC Illinois' Initial Brief (pp. 101-104), Staff's arguments in support of an 18kft crossover point are unsupported. Staff has failed to identify any valid basis for making such a significant change in the network design assumptions of the cost model used in the 1998 TELRIC case, which assumed a crossover point between 9kft and 12kft. Tr. 1860-61 (Balke).

The only other party to question the 12kft crossover point is CUB. Unlike Staff, which at least recognizes the need to efficiently design a network capable of providing multiple services, including voice and data, CUB argues that the Commission should ignore reality and pretend as if the network is used only to provide voice service over "basic UNE loops." CUB Br. at 24-25. CUB, therefore, proposes that the Commission adopt a completely theoretical network design which is contrary to recognized engineering guidelines and would *never* be implemented by an efficient carrier in the real world. CUB cites no authority for such a proposal.

3. Other DLC Investment Cost Issues

a. Remote terminal cabinet sizes

Staff continues to recommend that SBC Illinois be required to "produce LoopCAT runs" to determine the "impact" of including each of a number of DLC remote terminal cabinet types allegedly offered by Lucent, a vendor with which SBC has no contractual relationship for the purchase of DLC equipment. Staff Br. at 118-122. For the reasons fully discussed in SBC Illinois' Initial Brief (pp. 118-22), Staff's proposal is (i) unnecessary, because SBC Illinois' cost study already reflects DLC-RT sizes representative of those that would be deployed in an efficient forward-looking network; and (ii) impossible to implement, because SBC Illinois does not have actual contract prices for the different RT sizes to incorporate into this study.

Staff's recommendation is based in large part on a fundamental misconception, i.e., that SBC Illinois' inclusion of the 448 line RT cabinet in its revised cost study presented on rebuttal

caused a decrease in overall RT equipment costs as compared to the loop costs produced by the Company's original study, which included only the larger, 2016 and 672 line cabinets. Staff Br. at 121. In fact, as SBC Illinois and the Joint CLECs have both pointed out, the overall decrease in RT equipment costs observed by Staff resulted primarily from the reduction in the DLC RT installation factors used to develop the total installed cost of the RT equipment, not from the introduction of the smaller size 448 line cabinet. SBC Ill. Br. at 109, n. 44; SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 110; Joint CLEC Br. at 166-67; AT&T Ex. 2.1 (Pitkin/Turner Rebuttal) at 50-53.²⁴ Including the 448 line cabinet did not reduce RT equipment costs because (i) the per unit investment for small DLC systems is higher than the investment for larger systems; and (ii) the average DLC chassis utilization, or fill, rate assumed in the study did not change as a result of including the smaller size cabinet. SBC Ill. Br. at 109; SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 76, 78; SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 18.

This does not mean, however, that the revised loop cost study “does not reflect least cost, most efficient network configurations,” as the Joint CLECs suggest. Joint CLEC Br. at 167. To the contrary, as Mr. Smallwood testified, the mix of DLC-RT sizes (including the 448 line cabinet) incorporated into the revised loop cost study was based on the Company's analysis of the mix that would be deployed in an efficient forward-looking network. SBC Ill. Br. at 108; SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 17, 21-22. As explained in SBC Illinois' Initial Brief, the average DLC chassis fill rate did not change when the 448 line cabinet was introduced (and, therefore, the cost per loop did not decrease) because that fill rate *already* reflects the

²⁴ The inclusion of controlled environmental vaults (“CEVs”), which are underground vaults, also contributed to the reduction in overall RT equipment costs in the revised loop cost study, taking into account the CEV equipment cost, the adjustment to the conduit factor to account for structure cost, and the fact that the building factor is not applied to CEV structure investment. SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 21. These factors indicate that the impact of including CEVs in the study is not reflective of the potential impact of including different sizes of above-ground, remote terminals into the study.

average utilization of all of the DLC systems actually deployed in SBC Illinois' network, many of which are older, smaller systems, such as the SLC 96, which has only 96 lines (and, therefore, are even smaller than the 448 line system). SBC Ill. Br. at 106-07, 109-10. While smaller DLC systems are more costly than larger systems in terms of investment per unit of capacity, they are likely to be capable of achieving higher utilization rates than larger systems because they have fewer lines. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 78. As a result, the initial cost study *understated* the cost per loop to the extent that it applied to the efficient, larger size systems modeled in the studies, an average fill rate higher than the fill rates specific to those systems. *Id.* Contrary to the Joint CLECs' contention, therefore, the fact that including the 448 line cabinet does not increase the fill rate, and thereby reduce loop costs, does not justify removing that cabinet from cost study.

b. Alcatel Discounts

The Joint CLECs argue that the already discounted Alcatel DLC equipment prices modeled in LoopCAT should be reduced by two additional discounts of [*****] each, which were to have become effective on September 1, 2003 and September 1, 2004, respectively, under the terms of Amendment No. 3 to the Litespan Purchasing Agreement. Joint CLEC Br. at 167-68. Initially, it should be noted that *no* witness in this case proposed an adjustment to include the second of these two discounts. The only CLEC witnesses to address the discount issue were AT&T witnesses Pitkin and Turner, who expressly proposed to reduce the DLC equipment prices only by the amount of the first discount, on the grounds that the "first discount will be in effect at the time TELRIC rates are set in this proceeding." AT&T Ex. 2.0 (Pitkin/Turner Direct) at 133, 136; AT&T Ex. 2.1 (Pitkin/Turner Rebuttal) at 60-61. Even if the second discount were to become effective in accordance with the terms of Amendment No. 3 (and it will not, for reasons discussed below), it would not be until September 1, 2004, after TELRIC rates are set in

this proceeding. Accordingly, the Joint CLECs' proposal to include the second discount is unsupported by any testimony and should be summarily rejected.

In any event, as Mr. Donald Palmer testified, neither the first nor the second discount is currently effective; nor will either be applied to the DLC equipment prices in the future. SBC Ill. Ex. 15.0 (D. Palmer at 24). As discussed in SBC Illinois' Initial Brief, this is because SBC and Alcatel have negotiated a cancellation of the discounts in exchange for other concessions from Alcatel that do not affect the current contract price of the equipment modeled in LoopCAT. SBC Ill. Br. at 111; SBC Ill. Ex. 15.1 (D. Palmer Surrebuttal) at 5.

Contrary to the Joint CLECs' insinuations (Br. at 169-70), there is not now, and never has been, any dispute about whether SBC expects to "receive something of a least comparable value" in exchange for cancellation of the discounts, and Mr. Palmer's acknowledgement of that obvious fact cannot fairly be characterized as an "admission." What SBC Illinois does dispute is the Joint CLECs' absurd suggestion that the negotiations affecting the Amendment No. 3 discounts were somehow part of an elaborate plot to "inflate loop prices." Joint CLEC Br. at 171. In reality, the negotiations were undertaken for valid business reasons, [*****

.....
.....

***]. Tr. 1376-77 (D. Palmer). SBC, therefore, prudently took the opportunity to negotiate the cancellation of those discounts

[*****

.....

***]. Tr. 1365-66 (D. Palmer).²⁵

Thus, rejection of the Joint CLECs' proposal to reduce the DLC equipment prices by nonexistent discounts will not deprive CLECs of any "savings" to which they are entitled. To the contrary, the concessions made by Alcatel in exchange for canceling the Amendment No. 3 discounts will enable SBC Illinois to avoid substantial future costs that would otherwise have *increased* the forward-looking cost of the DLC equipment modeled in SBC Illinois' cost study. As a result, CLECs *will* realize the benefit of those concessions. On the other hand, if the Commission were to adopt the Joint CLECs' proposal, they would realize a double recovery of those benefits: once, through the avoidance of future costs that would otherwise be properly reflected in the forward-looking cost of the Alcatel equipment, and again, through the reduction in current prices resulting from inclusion of the nonexistent discounts.

c. Mix of Universal Digital Loop Carrier ("UDLC") and Integrated Digital Loop Carrier ("IDLC") facilities

The Joint CLECs' proposal that LoopCAT be adjusted to assume 100% IDLC technology (Joint CLEC Br. at 171-73) should be rejected. For the reasons fully explained in SBC Illinois' Initial Brief (pp. 112-16), it is not always more efficient and less expensive to use IDLC, rather than UDLC facilities, as the Joint CLECs incorrectly assume. In particular, as the extensive (and largely unrefuted) testimony of SBC Illinois' expert network witness, Mr. White, demonstrates, IDLC cannot effectively support non-switched special services or stand-alone unbundled loops. SBC Ill. Br. at 113-16. This is because, in the IDLC, individual circuits are grouped together at the DS1 level for routing directly to the central office switch. As a result, individual customer

²⁵ The Joint CLECs make an unwarranted attack on Mr. Palmer's credibility by falsely accusing him of "insinuating" in this direct testimony that Amendment No. 3 had been formally "terminated" or "amended" as of the first discount date. Joint CLEC Br. at 168. In fact, Mr. Palmer expressly stated that "the current contract has not yet been modified to reflect" cancellation of the discounts and that "a formal amendment will eventually be executed when these negotiations are completed." SBC Ill. Ex. 15.0 (D. Palmer) at 24.

lines are not physically or electronically accessible at the connection to the switch. *Id.*

Accordingly, there is no way for SBC Illinois to efficiently or economically unbundled an IDLC-served loop for a CLEC's use. *Id.*²⁶ Mr. White also explained that, while it might be technically possible to provide a limited number (i.e., three to five percent) of CLECs with DS1 "interfaces," there are a myriad of problems with this approach, not the least of which is that it would still deprive the remaining 95 to 98% of CLECs (which would only be able to interface at the DS0, or individual circuit level) any ability to access unbundled stand-alone loops if the network were 100% IDLC. SBC Ill. Ex. Br. at 115; SBC Ill. Ex. 8.2 (White Surrebuttal) at 28-30.

The Joint CLECs cite no evidence (and there is none) which refutes these facts. Rather, they quote language from the FCC Wireline Competition Bureau's decision in the *Virginia TELRIC Arbitration Order* for the proposition that it is technically feasible to unbundle an IDLC system. Joint CLEC Br. at 172. Orders issued by the *FCC* itself, however, directly contradict the *Virginia TELRIC Arbitration Order*. For example, in the *Virginia 271 Order*, the FCC expressly recognized that "it is not technically feasible to unbundle an IDLC loop."²⁷ *See also UNE Remand Order*, ¶ 217, n. 418 (FCC found that methods to unbundled IDLC systems "have not proven practicable.") In addition, the FCC has found that TELRIC does not require 100% IDLC technology. In the *Georgia 271 Order*, ¶ 50, the FCC stated:

²⁶ This fact can be illustrated by comparing IDLC to an extension cord. Instead of using separate cords and electrical outlets for each piece of electrical equipment in a recreation room, one can group the TV, stereo and karaoke machine on an extension cord that plugs into a single outlet. But if a CLEC wants to "unbundle" the karaoke machine, SBC Illinois cannot give the CLEC the whole extension cord, because the extension cord would also include the TV and stereo.

²⁷ *In the Matter of Application by Verizon Virginia, Inc., Verizon Long Distance Virginia, Inc., Verizon Enterprise Solutions Virginia, Inc., Verizon Global Networks Inc., and Verizon Select Services of Virginia, Inc., for Authorization to Provide In-Region, InterLATA Services in Virginia*, WC Docket No. 01-214, ¶ 148 (rel. Oct. 30, 2002).

[N]o commenter provides any cost analysis to show that IDLC is less expensive from UDLC for stand-alone loops and ports, and we are not persuaded, based on the record before us, that a correct application of TELRIC would require 100 percent use of such technology for that purpose. Commenters did not present persuasive evidence that the use of IDLC would be cheaper for pricing stand-alone loops and ports. Indeed, there is some evidence that technical limitations associated with unbundling a stand-alone loop from an IDLC system may make IDLC more expensive than UDLC in some circumstances. In the *UNE Remand Order*, for example, the Commission specifically discussed this difficulty of using IDLC in conjunction with stand-alone loops and ports. Several technical alternatives for using IDLC were reviewed in that context, including “side door grooming” (i.e., “hairpinning”), multiple switch hosting, integrated network architecture, and digital cross connect grooming. The Commission stated that some of these options are “very expensive.” The Commission also concluded that each option has limitations and that “such methods have not proven practicable.” Thus, not only have commenters failed to offer persuasive evidence, but prior Commission orders have recognized that at least certain IDLC alternatives would likely be more expensive. Therefore, we find no error, on the present record, in either state commission’s approval of BellSouth’s employment of UDLC for stand-alone loops. *See also In the Matter of Joint Application by BellSouth Corp., BellSouth Telecommunications, Inc., And BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Alabama, Kentucky, Mississippi, North Carolina, and South Carolina*, WC Docket No. 02-150, ¶ 62, (rel. Sept. 18, 2002) (FCC specifically rejected WorldCom’s argument that TELRIC requires 100% IDLC technology).²⁸

Because SBC Illinois is unable to efficiently unbundle IDLC systems, the Joint CLECs’ recommendation to assume 100% IDLC technology would also be inconsistent with the FCC’s rule requiring that TELRIC rates be based on technology that is “currently available.” 47 C.F.R. § 51.505(b)(1). Moreover, even if SBC Illinois could theoretically solve the unbundling issues with IDLC at some point in the future, the FCC noted in its *Triennial Review Order*, ¶ 670, n. 2020, that it is not appropriate for a TELRIC analysis “to consider technologies that may be available in the future but are not currently available.”

²⁸ The Joint CLECs (Br. at 172) also assert that, in its recent TELRIC Order, the Indiana Commission “followed this FCC precedent,” referring to the Wireline Competition Bureau’s decision in the Verizon Arbitration proceeding. As discussed above, however, the Wireline Competition Bureau is not the “FCC” and the Indiana Commission’s decision should not be followed here, in light of the extensive evidence and precedent supporting SBC Illinois’ position.

For these reasons, and for the reasons explained in SBC Illinois' Initial Brief, it is entirely appropriate for LoopCAT to assume a mix of both IDLC and UDLC.

d. Number of remote terminals per COT

This issue is fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 116-18.

e. Calculation and Application of Building Cost Factor

The Attorney General argues that because LoopCAT applies the building factor to all investment in electronic equipment (which includes investment in DLC remote terminals), the model “inflates UNE loop rates by including costs for buildings at locations where there are no buildings.” AG Br. at 20. As SBC Illinois has explained, however, the building factor is the ratio of *all* building investment to *all* electronic equipment investment and, therefore, represents the *average* ratio of building investment to electronic equipment investment. Accordingly, to accurately calculate the *total* forward-looking investment in buildings that house electronic equipment, it is appropriate, and necessary, to apply that ratio to all investment on electronic equipment. The fact that this investment includes certain electronic equipment, i.e., remote terminals, that is not located in buildings does not mean that SBC Illinois' methodology “inflates” loop costs. SBC Ill. Br. at 118-19.

Citing AG Schedule WDA-S1 and AG Cross Exhibit 29P, the Attorney General asserts that it was able to identify the investment associated with remote terminals and delete that amount from the denominator of the building factor, thereby producing a factor that can be applied only to electronic equipment housed in buildings. AG Br. at 18, 19. As SBC Illinois explained in its Initial Brief (pp. 118-20), however, what the AG actually did was determine the percentage of 257c electronic equipment represented by remote terminal equipment investment as calculated by LoopCAT for one particular cost study (the 2-wire analog loop study). The AG then reduced the total amount of the electronic investment included in the denominator of the

building factor by that percentage. This approach, however, would only have produced a meaningful result if the denominator of the building factor included only the amount of 257c investment calculated for the 2-wire analog loop study to begin with. That is not, however, how the building factor was developed. Rather, because the building factor is used to develop building costs for all of the different loop types at issue in this case, it includes in the denominator actual investment in all 257c and 357c equipment, including equipment related to those other loop types, such as DS1 and DS3 loops. Tr. 813-14 (Smallwood).

As discussed in SBC Illinois' Initial Brief (p. 119), there is no way to accurately recalculate the building factor in the manner attempted by the Attorney General because the accounting system is not designed to track data based on a building/no building distinction. Contrary to the Attorney General's contention (Br. at 3), this fact does not represent a failure by SBC Illinois to meet its "burden of proof." Rather, it is simply a reflection on the fact that, in some situations, the most reasonable and accurate way to capture forward-looking costs is through the application of factors that reflect the average costs across a variety of situations – in this case, the average amount of building investment per amount of investment in a variety of different types of electronic equipment. The method used by SBC Illinois to calculate this average building investment is reasonable and consistent with the method used to develop the currently effective UNE loops in Docket Nos. 96-0486/96-0569. SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 53. It should be approved again in this case.

The Joint CLECs contribute nothing to a proper resolution of the debate over the proper calculation and application of the building factor. Rather, they attempt to confuse matters and mislead the Commission by erroneously suggesting that this debate has something to do with the issue of DLC installation costs. Joint CLEC Br. at 173-74. As discussed in Section III.C.1,

above, the building factor has absolutely nothing to do with DLC installation costs. The Attorney General understands this fact, as indicated by its acknowledgement that SBC Illinois, AG and Staff are now in agreement on the proper amount of DLC installation costs included in the cost study. AG Br. at 21.²⁹

f. Allocation of Shared DLC Components

In this subsection of its Initial Brief, SBC Illinois discussed the issue of what factor to use in allocating investment in DLC facilities to DS1 services. SBC Ill. Br. at 120-21. The Joint CLECs, which addressed that issue under subsection III.C.3.g of their Initial Brief, argue that their proposed allocation factor is appropriate and should be adopted “assuming the Commission follows the lead of the FCC and orders the use of 100% IDLC in SBC’s TELRIC cost study.” Joint CLEC Br. at 177.³⁰ As discussed in Section III.C.3.c, above, the Joint CLECs are confusing the FCC’s Wireline Competition Bureau, which adopted the Joint CLECs’ position on IDLC in the *Virginia Arbitration Proceeding*, with the FCC itself, which has found in a number of orders that stand-alone loops cannot be effectively unbundled, and that TELRIC does not require the “use of 100% ILDC” in UNE loop cost studies. For the reasons previously discussed, the Commission should reject the Joint CLECs’ proposal to require the use of 100% IDLC. Even if the Commission were to adopt the Joint CLECs’ proposal on IDLC, however, its

²⁹ The Joint CLECs’ assertion (Br. at 174) that adoption of the Attorney General’s proposal on the building factor is “critical to bringing SBC’s DLC installation costs in line with estimates provided by every other party” is not only wrong, it is highly disingenuous in light of the fact that the amount of [*****] which the Joint CLECs represent to be their proposed total installed cost of 2016 DLC-RT, includes an amount of [*****] calculated by applying the building factor. The Joint CLECs cannot in good faith argue, in one breath, that its proposed DLC-RT investment costs are reasonable and should be adopted in lieu of the costs proposed by SBC Illinois, Staff and the Attorney General, and then, in the next breath, argue that a significant amount of its proposed costs should be disallowed by eliminating application of the building factor to remote terminal investment.

³⁰ In subsection III.C.3.f of their Initial Brief, the Joint CLECs argued in support of their proposal to reduce the investment in DLC remote terminals by 25% to reflect an allocation of such investment to data services. SBC Illinois responds to those arguments in subsection III.C.3.g, below.

proposed factor for allocating DLC costs to DS1 services should be rejected for the other reasons discussed in SBC Illinois' Initial Brief (pp. 120-21).

g. Remote Terminal Investment Cost Allocation

For the reasons fully discussed by SBC Illinois in its Initial Brief (pp. 122-25), the Commission should reject the proposal of Staff and the Joint CLECs to reduce DLC remote terminal investment by 25%, to reflect an allocation of that investment to DSL services. Contrary to the assertions of Staff and the Joint CLECs, their proposal is inconsistent with “cost causation principles.” As the FCC has explained, costs are “causally related” to network elements if those costs are “incurred as a *direct result* of providing the network elements, or can be avoided, in the long run, when the company ceases to provide them.” *First Report and Order*, ¶ 691 (emphasis added). It is undisputed that (i) all of the “common” DLC remote terminal equipment modeled in the study is necessary to provide voice service over fiber fed loops and (ii) the study does not include any of the incremental costs associated with the additional equipment that would be necessary to make the DLC system capable of providing DSL service. Moreover, as Mr. White explained, the decision to add DLC remote terminals in a particular area of the network is based on the voice needs of the neighborhood. SBC Ill. Br. at 124; SBC Ill. Ex. 8.1 (White Rebuttal) at 48. Currently, in fact, only [*****] of SBC Illinois' RTs are DSL capable. *Id.* at 49. Thus, all of the common DLC-RT equipment costs included in the study are incurred as a “direct result” of the provision of voice service, not DSL service, and can be avoided in the long run only if SBC Illinois were to cease to provide voice service. The “common” DLC-RT equipment costs are, therefore, “causally related” to voice service, not DSL service.

That the common remote terminal equipment is “causally-related” to voice service should be obvious from the fact that, while one can configure a voice-only DLC system, and later incur incremental costs to make that system DSL capable, there is no such thing as a DLC system capable of providing only DSL service for which incremental costs can be incurred to provide voice service. SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 25. Thus, the cost of the common RT equipment is an incremental cost of providing voice service, not an incremental cost of providing DSL service. In accordance with the goals of TELRIC, one of which is to provide appropriate price signals by assigning to UNEs the long run *incremental* cost of providing those UNEs, it is inappropriate to allocate any portion of the common RT equipment costs to DSL service.

By analogy, assume that after building a new home, the owner must decide whether it is economical to add another bathroom. In making that decision, the owner would not rationally consider any portion of the cost of the line from the home to the sewer system to be an incremental cost incurred as a “direct result” of the additional bathroom, even though the sewer line would “serve” that bathroom as well as the existing bathrooms in the home. Rather, the owner would consider the cost of the sewer line to have been incurred as a “direct result” of building the home. Similarly, in deciding whether it makes economic sense to add the equipment necessary to make an RT capable of providing DSL service in a particular area, SBC Illinois takes into account only the incremental cost of the equipment, not the cost of the common RT equipment necessary to provide voice service.

For these reasons, there is no basis for allocating to DSL service any portion of the cost of remote terminals needed in SBC Illinois’ cost study, all of which is “causally-related” and incremental to the provision of voice service. This conclusion is supported by the Commission’s

treatment in Docket 00-0393 of costs associated with using loops for the provision of data service over the high frequency portion of the loop (“HFPL”). As discussed in SBC Illinois’ Initial Brief (p. 125), the Commission in that case found that, because “the ILEC bears no additional incremental cost for provisioning [the HFPL],” the “economic principles adopted by the Commission dictate that it should be priced at zero.” *Order*, Docket 00-0393 at 86-87 (March 14, 2001). Similarly, in this case, SBC Illinois’ cost study includes “no additional incremental cost for provisioning” DSL service and, therefore, “the economic principles adopted by the Commission dictate” that DSL service be assigned no costs in this case.³¹

Staff and the Joint CLECs also suggest that 25% of the investment in RT common equipment must be removed in calculating UNE loop costs in order to prevent a “double recovery” of DSL related costs through UNE loop rates and through prices charged for DSL services. This argument is unsupported by any evidence. As the Joint CLECs’ calculation of the 25% allocation factor demonstrates (Joint CLEC Br. at 175), the “double-recovery” argument assumes that (i) *every* DLC remote terminal is capable of providing DSL services; (ii) *every* one of the lines in a remote terminal capable of providing DSL service (672 in the case of the 2016 line cabinet) is being used to provide DSL service; and (iii) SBC Illinois is recovering the full amount of the costs allegedly allocable to DSL service for each such line. Assumptions (i) and (ii) are directly contrary to the evidence, which shows that (i) currently, only [*****] of SBC Illinois RTs are DSL capable and (ii) the subscription rate for the DSL service is nowhere

³¹ In support of its cost causation theory, Staff asserts that the capability of using an RT to provide advanced services if properly equipped “is the justification for designing loops exceeding the crossover point with fiber feeder and NGDLCs.” Staff Br. at 124. This assertion is incorrect. The reason for using fiber feeders in loops which exceed a crossover point is because it is the most efficient forward-looking way to design a network for the provision of voice services. DLC systems must be installed to facilitate the use of fiber feeder facilities. Moreover, the exact crossover point of 12,000 feet proposed by SBC Illinois, which is necessary to support advanced services, is also the most efficient design for providing all services including voice and DSL service. This is demonstrated by the fact that the loop cost study used to establish rates in Docket 96-0486/96-0569, which was performed in the 1996-1997 timeframe, also used a 12kft crossover point.

close to the almost universal penetration rate for voice services. SBC Ill. Br. at 123; SBC Ill. Ex. 8.1 (White Rebuttal) at 49; SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 84. Assumption (iii) is allegedly supported by the cost study presented by SBC Illinois as support for proposed interim Broadband “UNE” rates in Docket 00-0393. As previously discussed, however, the Commission did not approve SBC Illinois’ proposed interim rates and, in any event, there is no evidence whatsoever that CLECs have purchased the Broadband “UNE” in significant quantities, if at all.

4. Premises Termination Costs

a. NID and Drop Wire Installation Costs

Staff argues that the average travel time for installing premises termination equipment used by SBC Illinois incorrectly assumes (i) that “an installer must travel roundtrip from the Company’s shop to an end user’s premises for each service connection;” and (ii) that “a technician installs a total of two drops per day.” Staff Br. at 126-27. Staff simply ignores the testimony of Mr. Smallwood, in which he carefully explained that SBC Illinois’ cost study makes neither one of these assumptions. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 86; SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 45. Specifically, Mr. Smallwood explained that the average travel time in the Company’s study assumes exactly what Staff says it should assume, i.e., that the installer “could proceed directly from one end-users premises to the next without having to return to the Company’s facilities prior to the end of the day” (Staff Br. at 127). *Id.* Mr. Smallwood further explained that the Company does *not* assume that only two installations should or would be performed each day, and that Staff witness Lazare’s assertion to the contrary was based on an apparent misunderstanding of Mr. Smallwood’s rebuttal testimony. SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 44-45. Accordingly, Staff’s critique of SBC Illinois’ estimated average travel times is unfounded. For the reasons already fully discussed in its Initial

Brief, the time for installing premises termination equipment proposed by SBC Illinois is reasonable, while Staff's proposal fails to adequately account for all of the time to perform the activities (including travel) needed to install premises termination equipment. SBC Ill. Br. at 126-27.

The Joint CLECs discuss the installation cost estimates for NIDs and drops developed by AT&T witnesses Pitkin and Turner in Section III.C.4.b ("Adjustment to remove double counting") of their brief. Those cost estimates are inaccurate and should be rejected for the reasons already fully discussed in SBC Illinois' Initial Brief. SBC Ill. Br. at 127-29.

b. Adjustment to Remove Double-counting

The Joint CLECs complain that SBC Illinois "rejected" Attorney General witness Dunkel's recommendation for how to remove the double counting of NID and drop wire costs that existed in SBC Illinois' initial loop cost study. Joint CLEC Br. at 178. The Joint CLECs blatantly ignore Mr. Dunkel's testimony that the method proposed by SBC Illinois (removal of the NID and drop costs from the calculation of the cable installation factors) "is an acceptable way to correct the double counting *and is the method used in my Rebuttal testimony.*" AG Ex. 1.3 (Dunkel Surrebuttal) at 3-4 (emphasis added).

The Joint CLECs argue that the approach endorsed by SBC Illinois and Mr. Dunkel is "inconsistent" with SBC Illinois' use of installation factors for distribution and feeder cable equipment, and that the only reason for removing NID and drop costs from those factors and including them as a separate line item is to produce "higher, inflated results." Joint CLEC Br. at 178. This argument is without merit. The installation factors developed by SBC Illinois for cable equipment are intended to be, and should be, specific to the type of equipment to which the factors are applied. Thus, SBC Illinois developed factors separately for fiber and copper cable and also developed separate factors specific to the each type (aerial, underground and buried).

SBC Ill. Ex. 4.0 (Smallwood Direct) at 29. The inclusion of unrelated NID and drop wire costs in the development of these factors was an inadvertent mistake and was properly rectified by revising the installation factors to remove those costs. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 85-86. For the reasons discussed in SBC Illinois' Initial Brief (pp. 130-31), the inclusion of NID and drop wire costs in a separate line of the study, rather than including them in the costs used to develop installation factors specific to different types of equipment, produces more accurate cost results. SBC Ill. Br. at 130-31.³²

c. Mix of Aerial and Buried Premises Termination

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 131. As discussed there, the forward-looking mix of aerial and buried premises equipment included in SBC Illinois' cost study appropriately reflects the fact that the majority of homeowners in a forward-looking network would want and would receive buried drop wire. SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 48.

d. Multiple Dwelling Units

In its brief, the Joint CLECs argue that SBC Illinois' position on this issue calls its credibility into question. In support of this argument, the Joint CLECs assert that “[i]n the end, SBC admitted that failing to properly reflect MDUs in the cost study affects costs, *but SBC continued to sponsor a cost study that knowingly produces erroneous, highly inflated results.*” Joint CLEC Br. at 182 (emphasis added). This assertion is simply false. SBC Illinois *revised* its

³² Contrary to the Joint CLECs' suggestion, the fact that SBC Illinois used a method to calculate NID and drop costs which is not identical to the method used to calculate feeder and distribution cable installation costs does not mean that either method is unreasonable. While the major cost driver for the feeder and distribution portions of the loop are materials, and the materials provide the basis for factor application, the major cost driver for NID and drop placement is the placement labor. For the NID and drop installed cost calculations, SBC merely uses the major cost driver, placement labor, as the basis for factor application. This is proper, and the results are reasonable. Moreover, Part 32.2000(c) of the FCC Uniform System of Accounts dictates that the materials used for drop and NID placement should be considered exempt (small piece-part) materials, so the same method used to develop feeder and distribution costs could not be used to develop NID and drop costs.

loop cost study on rebuttal to include the impact on premises termination costs of MDUs in response to recommendations made by witnesses for the Staff and AT&T. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 88. Staff's witness, Mr. Zolnierek, testified that SBC Illinois' cost study revision satisfied his concern.

The Joint CLECs argue that SBC Illinois' approach "knowingly overstates costs in more urban areas and understates costs in less urban areas" because it did not use U.S. Census data on a "deaveraged basis." As SBC Illinois has previously discussed, however, the Joint CLECs' argument erroneously assumes that "urban" areas, as defined by the U.S. Census Bureau, are the same as the SBC Illinois "urban" rate area, i.e., Access Area A, the Chicago downtown loop area. SBC Ill. Br. at 132. In fact, almost all of the Census Bureau's "urban" areas are located in Access Areas B and C. *Id.* Accordingly, the U.S. Census Bureau data cannot be used in the manner suggested by the Joint CLECs to produce "deaveraged" costs. The method of including MDUs proposed by SBC Illinois is reasonable and should be approved.

5. FDI Costs

The Joint CLECs' proposal to reduce the assumed number of FDI terminations per working loop from 3 to 2.0588 should be rejected for the reasons discussed in SBC Illinois' Initial Brief. SBC Ill. Br. at 135. In arguing for its proposal, the Joint CLECs erroneously assume that this issue relates solely to the amount of spare capacity incorporated into the network. Joint CLEC Br. at 186. This is not the case. As discussed in SBC Illinois' Initial Brief, FDIs are designed to terminate two distribution pairs for one feeder pair because it provides flexibility to move service from one customer to another more efficiently than if there were only one termination on the distribution side. SBC Ill. Br. at 133-34. For these and other reasons fully discussed in SBC Illinois' Initial Brief, the use of three FDI terminations per

working loop is consistent with standard network engineering guidelines and is the cost-efficient, forward-looking method of terminating loops to the FDI. *Id.*

For the reasons also discussed in SBC Illinois' Initial Brief, the assumption in its loop cost study that feeder pairs will only be terminated in a central panel on the FDI is supported by sound engineering reasons, and the Joint CLECs' proposal to modify that assumption must also be rejected. SBC Ill. Br. at 134-135.

6. Distribution Area Modeling

This issue is fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 136-37.

7. Loop Length, Cable Size and Cable Gauge Modeling

a. Distribution Lengths Over 18,000 Feet

This issue is fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 140

b. Data Used to Develop Loop Lengths

The Joint CLECs argue that because the LEIS database includes the “full universe of SBC’s loops,” it is necessarily a better source for developing loop lengths than ARES, which produced loop length data for approximately 70% of all working loops. Joint CLEC Br. at 189. The Joint CLECs ignore a key advantage of the ARES database, which is that it produces *actual* lengths of both the feeder and distribution portions of the loop. By comparison, LEIS does *not* provide the actual length of the distribution portion of the loop. Rather, LEIS provides the maximum length, which must be adjusted to develop an estimated loop length. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 97. For this reason and the reasons discussed in SBC Illinois' Initial Brief, ARES is a reasonable source of loop length data for use in the loop cost study. SBC Ill. Br. at 141.

The Joint CLECs also argue that LoopCAT should be run at the wire center level. Joint CLEC Br. at 190. The Commission, however, has previously determined the three geographic Access Areas that are to be used for ratemaking purposes, and it was appropriate for SBC Illinois to develop loop costs on that basis. SBC Ill. Ex. 4.1 (Smallwood Rebuttal) at 27-28; SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 52. Moreover, much of the data used in cost development is not available at the wire center level. Even AT&T's witnesses Pitkin and Turner used statewide average inputs for such significant cost drivers as fill factors, thereby undermining the Joint CLECs' claims regarding the degree of precision allegedly produced by Pitkin/Turner's more "granular" approach. *Id.*

c. Distribution Cable Resistance Limits

This issue is fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 141-42.

d. Allocation of Copper Cable Inventory

This issue is fully discussed in SBC Illinois' Initial Brief. SBC Ill. Br. at 142-43.

e. Copper Cable Mix

This issue is fully discussed in SBC Illinois' Initial Brief. SBC Ill. Br. at 143-44.

f. Cable Sizing

The Joint CLECs propose an adjustment to shift 10% of each cable size to the next larger size. Joint CLEC Br. at 197-98. For the reasons discussed in SBC Illinois' Initial Brief, the Joint CLECs' criticisms of the cable sizing assumptions made in LoopCAT are unjustified. SBC Ill. Br. at 147-148. Accordingly, there is no basis for making any adjustments to the cable sizes in SBC Illinois' loop cost study. Moreover, there is no evidence to support the specific adjustment proposed by the Joint CLECs, which appears to have been pulled by Pitkin/Turner out of thin air. AT&T Ex. 2.0 (Pitkin/Turner Direct) at 161.

8. Planning Period

This issue, which SBC Illinois addressed in its Initial Brief (SBC Br. at 148), was raised by CUB witness Baldwin in her direct testimony. Because neither CUB nor any other party addressed the issue in its Initial Brief, it appears that the planning period used by the Company for its UNE loop studies is no longer in dispute.

9. Previous Methodologies

This issue is fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 148-53.

10. Agreed Upon Issues

The Joint CLECs argue that sales tax remains a contested issue, and challenge SBC Illinois' revision to its cost study to include a sales tax line item for hardwired DLC investments. Joint CLEC Br. at 199-200. As SBC Illinois has explained, this revision was necessary as a result of the change in the database (from PICS/DCPR to general ledger) used to calculate DLC installation factors, since the numerator of the factor developed using PICS/DCPR data included sales tax, while the numerator of the factor developed using general ledger data did not. SBC Ill. Ex. 4.2 (Smallwood Surrebuttal) at 29-30.³³

IV. Non-Recurring Cost Studies and Rate Designs

A. General Issues

The Joint CLECs open their discussion of nonrecurring costs with a seemingly innocuous recitation of six principles that they maintain ought to guide the Commission in evaluating the parties' competing proposals. Yet, their cursory treatment of these issues belies a fundamental problem that pervades their advocacy. Time and time again, under the guise of "applying TELRIC principles," they take extreme and unsupportable positions. They assume technologies

³³ Because the denominator (but not the numerator) of the factor calculated on the basis of the general ledger data includes sales tax, it is necessary to apply the sales tax rates to the installed cost of the DLC equipment, not just the material portion of that cost.

that do not exist. They try to compare a telecommunications company to an ATM machine or an internet travel company, without having undertaken any investigation of either of these allegedly comparable businesses. They insist that an ILEC can achieve near-zero fallout rates for every aspect of UNE ordering and provisioning, with no evidence that any ILEC has ever done so. And they ignore years and years of data, dismissing it solely because, like all data, it reflects past experience. In sum, the Joint CLECs present a distorted, self-serving view of TELRIC, in hopes of gaining access to SBC Illinois' network at rates as far below costs as possible.

1. TELRIC Standards/Principles

The six TELRIC principles identified by the Joint CLECs tell only part of the story. While the Joint CLECs argue that “technology choices should reflect least-cost, most efficient technologies,” they do not note that such technology must be operationally feasible and commercially available. SBC Ill. Ex. 5.1 (Currie Rebuttal) at 12. As discussed in more detail in Section IV.A.3 below, the Joint CLECs fail to limit their view of the TELRIC world to *available* technologies.

The Joint CLECs also fail to understand what it means for a firm to operate in the long run and how technology is considered in the long run. As Dr. Currie explained:

[T]he long run reflects the circumstance in which the amounts of all resources or inputs employed by a company are modifiable to respond fully to a specific level of outputs. Sometimes, this notion is simplified to say that all inputs are variable in the long run. This understanding of the long run has a long lineage in microeconomics, which provides the core economics support to the FCC's TELRIC methodology.

Technology is the specific knowledge of how inputs are transformed into outputs. While inputs are variable in the long run, technology is fixed, *i.e.*, the notion of the long run takes the modes of transforming inputs into outputs as given and unchanged. The long run does not include the impacts of changes in technology. Instead, the long run focuses on considering the impacts of changing input levels to match output levels.

SBC Ill. Ex. 5.1 (Currie Rebuttal) at 9-10.

Likewise, as discussed in Section IV.A.2, while the Joint CLECs properly recite the TELRIC principle of cost causation, they utterly fail to apply it properly. Their treatment of the cost causation principle deliberately obscures the distinction between costs and rates, and fundamentally mischaracterizes what it means for a cost to be caused.

The Joint CLECs also spend considerable time discussing this Commission's previous nonrecurring cost dockets. For instance, the Joint CLECs list a number of Commission conclusions from its October 16, 2001, Order in Docket No. 98-0396. Joint CLEC Br. at 201-02. To the extent those conclusions are relevant to issues before this Commission, SBC Illinois addresses those conclusions in its discussion of those issues. By and large, as will be shown, SBC Illinois' cost studies comply with those Commission directives. For instance, SBC Illinois has taken into account increased flow through that has resulted from OSS enhancements and has assumed the use of primarily automated interfaces. SBC Illinois has documented its flow through experience with industry recognized performance measurements and has provided data current to the filing of surrebuttal testimony. SBC Illinois has appropriately taken into account future process improvements and system enhancements and has supported its subject matter expert ("SME") input with detailed instructions, questionnaires and testimony. All of these matters were discussed in SBC Illinois' Initial Brief and are discussed below in further detail.

On the other hand, in some instances, SBC Illinois respectfully disagrees with the conclusions made by the Commission in its earlier proceedings, and urges this Commission to take a second look at those issues and modify the decisions it made in those proceedings. Those issues are discussed more fully herein, and were raised in SBC Illinois' opening brief as well.

The rest of the Joint CLECs' discussion of "TELRIC Principles/Standards" is nine pages of rambling discussion about the procedural history of previous Commission dockets. The relevance of this discussion to general TELRIC principles is far from clear. The relevance to the issues in this case is no clearer. The rates proposed in this docket, and the costs that underlie them, should be evaluated based on the evidence in this record and the currently applicable legal standards. This docket is not about the procedural nuances of earlier Commission dockets; nor is it about the evidence that was before the Commission in those dockets. And it is not about the "backdrop" of those earlier proceedings that the Joint CLECs spend so much time discussing.

Staff's discussion of general TELRIC principles largely consists of extensive quotations from various FCC Orders and Rules. Staff Br. at 135-37. SBC Illinois does not quarrel with the excerpts that the Staff cites, nor with their observation that recurring costs should not be recovered through non-recurring charges. *Id.* at 137. As discussed below, SBC Illinois does disagree with the manner in which Staff (and the Joint CLECs) categorize a host of costs as recurring costs, when in fact they are textbook examples of nonrecurring costs.

2. Cost Causation and Characterization of Costs

The principle of cost causation provides that costs are to be attributed to the cost-causer. Despite the apparent simplicity of this concept, the Joint CLECs fail to understand it, yet alone apply it correctly. Indeed most of their discussion in Section IV.A.2 has nothing at all to do with determining the cost-causer. Instead, the Joint CLECs consistently confuse nonrecurring *costs* with nonrecurring *charges*.

For purposes of cost causation, the relevant inquiry is who or what causes the cost to be incurred. The principle of cost causation is not about evaluating who benefits from a cost that was incurred, as the Joint CLECs suggest. Joint CLEC Br. at 212. In support of their argument, the Joint CLECs cite to statements that they claim that the FCC has made. The Joint CLECs are

grossly overstating the record. The statements to which they cite come from the Wireline Competition Bureau, a division of the FCC, in its *Virginia Arbitration Order*. They are not statements by the Commission itself; the decision was not voted on by the FCC Commissioners.

Regardless of the precedential import of the *Virginia Arbitration Order*, the Joint CLECs misread the Order. The Wireline Competition Bureau was not purporting to interpret the FCC principle of cost causation or to read into that principle a benefits analysis. Indeed, the excerpt quoted by the Joint CLECs makes clear that the costs at issue represented the “costs of non-recurring activities.” Joint CLEC Br. at 212.

Moreover, even if it were proper to evaluate cost causation in terms of who benefits from the cost being incurred (rather than who caused it), many of the costs that the Joint CLECs insist should be recovered on a recurring basis would not pass the benefits test. For instance, the CLECs insist that computer processing costs should be recovered on a recurring basis. Yet many of the computer processing costs of issue are incurred to process orders by CLEC customers for service. The CLEC customer is the only person who benefits from his or her order being processed. Certainly no future CLEC or ILEC customer will benefit, as he or she will have to have his or her own order processed. Indeed, all activities associated with the service ordering process benefit only the customer who places the order. Moreover, many of the costs involved in provisioning service only benefit the customer placing the order as well.

Nor does the Joint CLEC’s citation to comments made by this Commission to the FCC support the Joint CLECs’ position. Joint CLEC Br. at 212. To the contrary, it demonstrates that the FCC has *not* concluded at this time that one should take into account who benefits from a cost being incurred when determining if a cost should be recovered on a nonrecurring or recurring basis. In the passage cited by the Joint CLECs, the Illinois Commission was seeking

advice from the FCC as to whether to consider who benefits when characterizing costs. Notably, this query was made only four months ago, in response to the FCC's *TELRIC NPRM*. As the Joint CLECs fully understand, that docket is still underway and the FCC has not issued any final decision. The Joint CLECs, however, ignore that, and presume that since this Commission has advocated this position, it has the full force and effect of the law. SBC Illinois does not believe the Commission's advocacy accurately reflects current law, and the Joint CLECs have not pointed to any authority to suggest otherwise.

Nor is cost causation about barriers to entry. Indeed, recovering certain costs through nonrecurring charges because of the existence of barriers to entry is an except to cost causation. The Joint CLECs mistakenly equate these two concepts. They are manifestly different and the potential for barriers to entry does not mean that a cost somehow becomes recurring. Moreover, the Joint CLECs fail to cite any evidence demonstrating that such barriers to entry exist. In fact, the only citation that the Joint CLECs provide is from their own witness who asserts that there may be "potential" barriers to entry. Joint CLEC Br. at 215, citing Joint CLEC Ex. 1.1 at 8. The Joint CLECs do not specifically identify such barriers, quantify their magnitude or demonstrate that they have any adverse effect on CLECs. The sum total of their evidence, thus, is "barriers might exist." The record, in fact, shows that the Joint CLECs overstate the impact of any such barriers to entry. With respect to their quintessential example of a cost that should be characterized as recurring – computer processing costs – the record demonstrates that the amount of cost at issue with computer processing costs is minor. See SBC Ill. Ex. 5.1 (Currie Rebuttal) at 25.

In fact, when one looks at the reasons why imposing nonrecurring charges for recurring costs might cause barriers to entry, one quickly sees that none of the six reasons applies here.

First Report and Order, ¶ 747. That of course is because the Joint CLECs are mischaracterizing nonrecurring costs as recurring costs. For instance, the FCC says imposing nonrecurring charges for recurring costs might inflate costs because the costs may not actually occur, or be incurred later than expected. With respect to service ordering and provisioning, however, the costs by definition occur prior to the service being turned up. Likewise, the chance that a cost will not actually be incurred is dealt with by using occurrence probabilities. Nor does one need to be concerned about costs not being incurred for as long or as frequently as expected, or at a level lower than expected. Those are issues that might pertain to costs properly classified as recurring costs, but do not apply to the activities associated with service ordering and provisioning. Finally, there is no need to be concerned with barriers to entry being caused by using a cost of capital that is too low, as the costs are being incurred by SBC Illinois up front.³⁴

Nor is the determination of the cost causer dependent on “when” or the frequency with which the cost is incurred, as the Joint CLECs try to assert. For instance, the Joint CLECs assert that a large portion of SBC’s costs are incurred on a non-recurring basis. Joint CLEC Br. at 210-211. They claim this because items like switches, transport facilities, buildings and land are typically purchased as large, one-time investments. *Id.* The Joint CLECs miss the point: a building does not become a non-recurring cost because it is purchased through a purchase agreement. Whether or not it is a recurring cost depends on who causes the cost, which is determined by the use to which a building is used. Thus, if a building is used to house switches that provide telephone service to an SBC customer, that building (or a portion thereof) is a

³⁴ The Joint CLECs complain that customer churn and ILEC winback efforts make these barrier to entry concerns worse. Joint CLEC Br. at 216-18. Putting aside that none of the six reasons why barriers to entry might develop are present here, the Joint CLECs have not set forth any evidence regarding churn rates or winback efforts. Instead, they hide their lack of analytical support with hypothetical examples and ominous sounding words like “lethal” (which they manage to use three times in just over one page). *Id.* at 216-17. Moreover, churn and winback affects ILECs and CLECs equally.

recurring cost caused by the recurring activity of a customer who day-in and day-out subscribes to telephone service from SBC. Compare that to a computer that is used to provision an order to a customer. Because that computer is used to provision an order for a customer only once, the computer is a nonrecurring cost, caused by the nonrecurring activity of a customer placing a one-time order for telephone service.

If the Joint CLECs were correct that whether a cost is recurring or nonrecurring depended on the frequency of payment, then an ILEC could turn a nonrecurring cost into a recurring cost by opting for a lease arrangement, rather than a purchase agreement (in the case of a building), or paying its employees every hour or for every order processed, rather than bi-weekly (in the case of payroll). That, of course, would turn cost causation on its head.

The Joint CLEC assertion that most costs are incurred on a nonrecurring basis is nothing more than a straw man, used to suggest that SBC Illinois is somehow deviating from its normal treatment of costs here. It most certainly is not. It has treated those costs caused by recurring activities as recurring costs, and it has treated those costs created by nonrecurring activities as nonrecurring costs. And this, approach makes perfect sense. When SBC Illinois processes an order for a customer (or a CLEC), it incurs the cost now and the cost-causer gets the benefit now (*i.e.* turned-up service.) Thus, it is eminently sensible and fair that SBC Illinois be compensated immediately and that the customer (through its CLEC) pay for what it has already received. Likewise, when SBC Illinois provides switching or transport service, it incurs the cost over time and the cost-causer gets the benefit over time. In that case, it makes sense for SBC Illinois to get paid – by the customer through its CLEC — over time.

3. Treatment of Technology

The Joint CLECs' discussion of how technology should be treated in a forward-looking nonrecurring cost study is disturbingly cursory. In fact, the Joint CLECs devote only eight lines

to this section of the brief. Notwithstanding this, technology is an issue of critical importance to the proper determination of nonrecurring costs and setting of nonrecurring rates. As was explained in SBC Illinois' Initial Brief, the Joint CLECs' criticisms of SBC Illinois' nonrecurring cost studies are replete with instances where the Joint CLECs assume a technology that is not operationally feasible or commercially available. See SBC Ill. Br. at 157-159. Moreover, the Joint CLECs frequently assert that a technology exists but come forward with no details: they cannot identify a specific technology or software, name a vendor, explain how the unnamed technology will work, or demonstrate that the benefits of such technology outweigh the costs.

Staff did not address this issue.

4. Use of Subject Matter Experts

SBC Illinois addressed the issue of subject matter experts in depth in its Initial Brief and most of what the Joint CLECs and Staff say in their briefs has already been addressed. SBC Illinois will not rehash that entire discussion. A number of observations are warranted however.

First, the Joint CLECs point to another pleading by the Illinois Commission to the FCC advocating that the FCC interpret TELRIC in a certain manner. Joint CLEC Brief at 219. Again, that proceeding is still underway and no final decision has been issued. Thus, despite the Joint CLECs' wishful thinking, the Commission's position on how the FCC should implement the cost-based requirement of Section 252(d) of the Act in the future does not rise to the level of "law."

In addition, the Joint CLECs take the Commission's advocacy out of context. For instance, the Joint CLECs quote the Commission's observation that "current practices may not be the best indication of the most efficient forward-looking practices." Joint CLEC Br. at 219. Yet the position that the CLECs advocate is that current practices are *never* an indication of the

most efficient forward-looking practice. The Joint CLECs therefore oppose consideration of any historical data merely because it is data that reflects how SBC has actually operated. The Commission does not go nearly so far in its advocacy. It merely notes that *some* practices used today *may not* be forward-looking. The Commission does not foreclose that some current practices are the most efficient, given available technology. As SBC Illinois demonstrates in its Initial Brief and herein, it is the case in many instances that current practices are forward-looking.

SBC Illinois also respectfully disagrees with the Commission's argument to the extent that it asserts that the predominant reason for any disconnect between current practices and most efficient practices relates to the "relative newness of local exchange competition." While that may have been true just after passage of the 1996 Act, the fact is that it has been over eight years since competition in the local phone market was introduced and over that time, SBC Illinois has made substantial changes to its processes to make them as efficient as possible. While the Joint CLECs insist that some unidentified technology could make some processes more efficient, they fail to provide any specifics. And they ignore the developments in order processing, provisioning and OSS over the past eight years, as described in the testimony of SBC Illinois' witnesses.

The Joint CLECs assert that the SME estimates are not supported by written documentation. Their objection is unfounded and hypocritical. It is hypocritical because one of the CLEC's own witnesses has used subject matter experts to calculate nonrecurring costs in much the same manner as SBC Illinois has done here. AT&T witness Turner, in fact, sponsored his own nonrecurring cost model in another proceeding in this state. The NRCM used SMEs who engaged in roundtable discussions to come up with average activity times. Tr. 1521-22

(Turner). They did not develop individual time estimates or come up with an arithmetic average based on several data points. Tr. 1522-23. Nor did they even document their roundtable discussions. *Id.*

The Joint CLECs' objection is unfounded because, as the Joint CLECs concede on the next page of their brief, each SME was given documentation providing detailed instructions regarding the development of time estimates and given a questionnaire used to solicit information regarding the specific development of the estimates that he or she provided.

The first piece of documentation provided to each SME was an introductory letter that explained that the Cost Studies Organization was developing cost studies to identify the forward-looking costs of provisioning services and unbundled network elements. MCI Cross Ex. 42. The letter went on to state that the SME's work organization was assisting in that process. The letter identified several other pieces of documentation that the SME was being provided. *Id.* One attachment was a "SME Data Request Letter." *See* MCI Cross Ex. 43. The SME data request letter set forth instructions for the SME to follow in order to identify the forward-looking non-recurring activities and associated activity times necessary to provide certain unbundled network elements. Specifically, the SME Data Request Letter outlined four steps that the SME was to follow in order to develop appropriate activities and activity times

Included with the SME Data Request Letter was an Estimator Profile form, which solicited information about each of the individuals who participated in responding to the cost group's request. *Id.* The SME Data Request Letter stressed the importance of the SME input and the need for a thorough assessment of the information provided. It cautioned the SMEs that their "input may be subject to regulatory scrutiny, including potential inquiries, such as data requests, depositions, or other testimonies." *Id.*

The SME Data Request Letter also explained that forward-looking meant “the most efficient method of performing the defined task during the study planning period.” SMEs were explicitly instructed that “forward-looking . . . may be different than the way the task is performed today.” The SMEs were also explicitly told to assume that the individual performing the task at issue was “FULLY TRAINED and EXPERIENCED.” *Id.* (Emphasis in the original.)

The next attachment provided to the SMEs was a comprehensive questionnaire which was used to document the SMEs’ development of the task, time and/or probability of occurrence inputs provided to the SBC Cost Studies Organization. MCI Cross Ex. 44. The questionnaire consisted of 22 separate questions, asking the SME to explain how he or she identified the “forward-looking” work activities, activity times and occurrence probabilities associated with providing unbundled network elements. *Id.* The SMEs were also asked to specifically identify any process improvements or system enhancements that were factored into the identification of work activities, activity times and occurrence probabilities. Each of the SMEs was asked to identify all other personnel consulted, documents reviewed or relied on, studies performed and any other information used to develop the SME’s activities, times and occurrence probabilities. *Id.*

The SMEs relied upon by SBC Illinois certainly were provided detailed instructions about how to determine forward-looking activities, times and occurrence probabilities. They were instructed that forward-looking meant that the SMEs should consider processes that might not exist today, but would exist during the planning period of the study. This is fully consistent with the FCC’s instructions that the ILEC take into account operationally feasible and commercially available technologies. However, it does not go as far as the CLECs would like, in

that it does not instruct the SMEs to speculate about future technologies that theoretically might be developed. Nor does TELRIC so require.

In a similar vein, Staff complains that the SMEs did not appear as witnesses in this proceeding and claims that the record lacks information about the identities of these witnesses, or what they would say regarding the tasks they were assigned by SBC. Staff Br. at 8. Staff's assertions are unfounded. First, each SME completed one of the questionnaires mentioned above, which asked a series of probing questions about what the SME did to develop the information provided to the cost group. These completed questionnaires were produced in discovery and made available to the Joint CLECs as well as Staff. In fact, Staff witness Zolnierек reviewed at least several of these completed questionnaires and attached some of them to his testimony. Staff Ex. 7.0 (Zolnierек Direct), Schedule 7.01. As can be seen from perusing even the few completed questionnaires that Dr. Zolnierек attached to his testimony, the SMEs provided information about what specific technology they considered, who they consulted (and their experience level), what documentation they relied on, and what other assumptions they made. *Id.*

In their Initial Brief, the Joint CLECs complain that the instructions given to the SMEs did not distinguish between activities that benefit only the CLEC and those that benefit the CLEC as well as SBC. Joint CLEC Br. at 220. The Joint CLEC objection is a red herring. As discussed above, cost-causation is not determined by identifying what party may benefit from a particular work activity. Moreover, to the extent that a benefit test is at all relevant, one does not need to rely on SMEs to analyze who benefits.

Nor is there any merit to the Joint CLEC claim that the SMEs were not instructed to provide estimates in a "setting that reflects significantly higher flow-through rates than those

experienced . . . in SBC's actual operations . . ." Joint CLEC Br. at 220. There are several defects with the Joint CLECs' reasoning. First, to the extent possible, SBC Illinois relied on actual data, rather than SME estimates, to determine the appropriate flow-through rates. Moreover, in those instances where SMEs were instructed to provide flow-through rates, they were specifically instructed to consider "most efficient methods." MCI Cross Ex. 43. Thus, for instance, a SME reported on his questionnaire that he considered use of a "pathfinder tool" by certain organizations, accounting for why his proposed activity time was lower than what was currently experienced. Staff Ex. 7.0 (Zolnierek Direct), Schedule 7.01 at 14. Finally, it is not altogether clear what effect higher or lower flow-through rates would have on most SME estimates. For instance, SBC Illinois witness Fred Christensen explain that the local service center, the group about which he testified, addresses service orders that fall out from the mechanized service ordering process. His group does not control the amount of fallout, and therefore did not provide SME input as to the appropriate fallout rate. Tr. 1213-14, 1261-62. However, whether the number of orders that fall out to the LSC is high or low will not have an impact on what forward-looking activities are required to correct an order that has fallen out. Nor will the quantity of orders that fall out have an impact on the amount of time it takes the LSC to remedy problems with individual orders, or on the probability that certain tasks will be required as part of addressing a single order that has fallen out. Certainly, nothing in the Joint CLEC testimony or their Initial Brief suggests otherwise.

The Joint CLECs also tried to take SBC Illinois to task for failing to do time and motion studies. This objection is wholly disingenuous. Witnesses for AT&T and the Joint CLECs each roundly criticized the use of time and motion studies as inherently unreliable. AT&T witness Turner went so far as to say that time and motion studies are "fraught with problems." Tr. 1525-

25 (Turner). He concluded that a non-recurring cost study *must* rely on some form of subject matter expertise. Tr. 1526 (Turner). Joint CLEC witness Ankum testified that “it is highly likely that you are going to inject bias into the process” when you perform a time and motion study. Tr. 1691 (Ankum/Morrison). It is incomprehensible how the Joint CLECs can disregard their own witnesses’ testimony about the problems attendant to time and motion studies, and suggest that SBC Illinois should have relied on such studies, instead of subject matter experts.

Moreover, the Joint CLECs had every opportunity since receiving SBC Illinois’ direct testimony in December of 2002 to conduct their own time and motion studies. In fact, Joint CLEC witness Sidney Morrison claims to have extensive experience performing time and motion studies. Thus, if the Joint CLECs really believed that time and motion studies were a more appropriate tool for the Commission to use, they could have performed such studies just as easily as SBC Illinois could have.

The Joint CLECs also note that SBC Illinois (when it was Ameritech Illinois) had undertaken time and motion studies for two work groups in connection with a prior Commission proceeding. However, as SBC Illinois witness Dr. Currie testified, the effort undertaken to perform these time and motion studies was a complete failure and did not yield reliable results. Tr. 1089-90. It bears repeating that this is exactly the result that Mr. Turner and Dr. Ankum each testified they would expect out of a time and motion study.

Similarly, the Joint CLECs suggest that SBC Illinois could have engaged a third-party to audit and verify the results obtained from its SMEs. As with time and motion studies, the Joint CLECs could have undertaken a similar endeavor, but apparently chose not to. Tr. 1688. Again, it begs the question why they did not do so, if they thought it would such a valuable tool for the Commission. Moreover, it is not clear how engaging a third-party to audit or verify the

results obtained from SMEs would avoid any of the biases that all of the parties, ILEC and CLEC alike, agree are likely to be introduced when one performs time and motion studies.

Staff does not object to the use of subject matter experts *per se*. Staff Br. at 139. Staff did not join in the criticisms by the Joint CLECs that SMEs are somehow inherently biased, or that time and motion studies should have been performed instead of using SMEs. Rather, Staff contends that SBC Illinois did not use its subject matter experts in an appropriate manner. Staff's criticisms are off the mark.

First, Staff is incorrect when it claims that SBC Illinois presented the testimony of only a single operational witness regarding order provisioning. In addition to Ms. Gomez-McKeon, several other witnesses testified about provisioning issues, including Tom Wiesle, Stanley Cunningham and William Deere. Staff and the Joint CLECs waived cross on all of these witnesses. Also, SBC Illinois witnesses Barch, McNiel, Currie, Silver and Christensen all provided testimony regarding nonrecurring costs and rates.

Second, Staff mischaracterizes the instructions and questionnaires given to the SMEs when it claims the SMEs were told to "ignore" technologies that SBC Illinois does not deploy or has not approved for deployment. Staff Br. at 141. In fact, as discussed above, the SMEs were explicitly instructed that forward-looking meant "the most efficient method of performing the defined task during the study planning period." And SMEs were explicitly instructed that "forward-looking" may be different than the way the task is performed today. Thus, while they were told not to speculate about potential technologies, they certainly were not told to ignore technologies they knew to exist or expected to be implemented during the study period. Nor did Dr. Currie concede Staff's point, as Staff suggests. Dr. Currie merely pointed out that the time estimates provided by the SMEs do not assume what some hypothetical firm might do. SBC Ill.

Ex. 5.1 (Currie Rebuttal) at 47. Nor does TELRIC require an ILEC to do what some hypothetical firm might do. Rather, TELRIC asks what *SBC Illinois* would do, using the most efficient technology currently available.

Staff also criticizes the work that Ms. Gomez-McKeon did. Staff Br. at 141-145. Staff's objections are unwarranted. First, Staff takes Ms. Gomez-McKeon to task for not knowing how "rates are applied." Staff Br. at 142; *see also id.* at 144. Yet, Ms. Gomez-McKeon was not the rate structure witness. Her contribution to this proceeding was to testify about the nonrecurring costs that SBC Illinois incurs when it provisions UNE orders to CLECs. How those costs are translated into rates, and how those rates are imposed, is simply not relevant to her testimony. Nor frankly is the matter of how rates are applied relevant to whether the costs that have been identified would be incurred in a forward-looking, most efficient environment. Certainly, Staff did not point to any question that Ms. Gomez-McKeon could not answer about rate structure that was somehow relevant to any of her cost testimony. Staff's comments are a red herring.

Staff also criticizes Ms. Gomez-McKeon for not witnessing 100% of the activities that are accounted for in SBC Illinois' nonrecurring provisioning costs studies. Staff Br. at 143. Yet, Staff does not point to a single activity that Ms. Gomez-McKeon did not review where she could not answer Staff's questions. Moreover, Ms. Gomez-McKeon testified that, with the exception of one group, she personally reviewed over 90% of the other group's tasks. So, while Staff is correct that the record does not demonstrate "exactly" how many of the activities Ms. Gomez-McKeon reviewed, the record is clear that she reviewed the vast majority.

Moreover, the fact that Ms. Gomez-McKeon did not personally review all the activities does not mean she is not competent to testify about those tasks or that they "were subject to no oversight at all," as the Staff intimates. Staff Br. at 144. As is demonstrated throughout Ms.

Gomez-McKeon's testimony, she worked with all the SMEs to develop their activities, times and probability occurrences. She reviewed all of their work, interviewed SMEs to discuss any follow-up questions and issues, and, as noted above, personally viewed most of the activities. *See, e.g.*, SBC Ill. Ex. 9.0 (Gomez-McKeon Direct) at 6-9. Perhaps most telling, the fact that Ms. Gomez-McKeon reviewed nearly all of the tasks at issue puts her in very stark contrast to Mr. Turner, Dr. Ankum, Mr. Morrison and Dr. Zolnierrek, who personally reviewed very few, if any, of these activities.

Staff even seems to criticize Ms. Gomez-McKeon for acknowledging during cross-examination that it was difficult for her to give a percentage on the stand of all tasks that she personally reviewed. Staff Br. at 143-44. This is unfair. Ms. Gomez-McKeon was asked on the spot to provide the specific percentage of tasks, out of hundreds in SBC Illinois' cost studies, that she personally reviewed. That is something that is hard to do without an opportunity to review her notes or even a list of activities. The Commission should appreciate her candor in saying so.

Staff concedes that it is not in a position to propose specific process improvements or system enhancements that would improve upon SBC Illinois' existing processes and systems. Staff Br. at 145. In fact, Staff's witness Zolnierrek admitted that he was not aware of any such improvements. Tr. 1954-55. Staff does observe that some of the intervenors in this proceeding (who at least claim to have actual experience in provisioning telecommunications services) should be able to offer "specific process improvements or system enhancements that would render SBC's existing processes or systems forward-looking." Staff Br. at 145. Tellingly, however, none of the intervenors came forward with any specifics. None of the witnesses could identify specific software that SBC should use that it is not currently using, or name a vendor with experience interfacing ILEC computer systems. Instead, as noted above, the CLECs merely

attempted to compare a telecommunications network to an ATM machine or an on-line travel agency, and suggested (without any real analysis of either of those systems) that SBC Illinois could achieve the same rock-bottom fall-out.

Thus, Staff, like the Joint CLECs, demands that SBC Illinois prove a negative. That, of course, cannot be done. SBC Illinois instead relied on experts who actually do the work activities at issue to inform its cost group about whether those activities will occur in the future, with what frequency and for what duration. SBC Illinois' approach is reasonable and fully compliant with TELRIC.

In the end, Staff suggests that the Commission adopt interim nonrecurring rates. Staff's proposal goes too far. The Commission has an extensive record on which to determine nonrecurring costs (and thus rates). The Joint CLECs and Staff have proposed adjustments in their briefs to activities, times, occurrence probabilities and fallout, to which SBC Illinois has responded (both herein and in its Initial Brief.) The Commission thus has a framework in which to decide the open issues and give instruction on what inputs SBC Illinois should use when it runs its compliance studies.

B. Service Order Non-Recurring Cost Studies

The Joint CLECs note in their Initial Brief that one of their witnesses, Sidney Morrison, has over 30 years of experience as an employee of an ILEC. Joint CLEC Br. at 223. In fact, Mr. Morrison has not worked as an employee of an ILEC since 1993. Joint CLEC Ex. 1.0 at 4. Thus, all of his work as an employee of an ILEC predates the 1996 Act. And most of his work since the 1996 Act was passed has been for CLECs, principally overseas. *Id.* at 4-6. Of course, Mr. Morrison is the only CLEC witness who testified about non-recurring costs that has any experience whatsoever as an employee of an ILEC. AT&T witness Steven Turner has never been employed by an ILEC, and as was explained in detail in SBC Illinois' opening brief, has

little experience relevant to the numerous issues upon which he claims to be an expert. Nor has Joint CLEC witness Dr. Ankum ever worked for an ILEC. SBC Illinois' SMEs, on the other hand, have decades of experience actually performing the tasks that are relevant to these non-recurring cost studies. Most of the SMEs have been employed by SBC Illinois or one of the sister companies within the SBC family since before the 1996 Act was passed, and therefore, understand the significant changes that have occurred since and as a result of the advent of competition in the local telephone market.

1. Identification of Tasks

As SBC Illinois anticipated in its Initial Brief, the Joint CLECs criticized SBC Illinois for including certain verification and validation tasks as part of the service order process. SBC Illinois has already completely rebutted the Joint CLECs' assertion and refers the Commission to pages 168 through 170 of its Initial Brief. However, one additional point is worth noting about verification and validation activities. In their Initial Brief, the Joint CLECs suggest that these verification and validation activities are only necessary because of SBC Illinois' "legacy" systems. The Joint CLECs do not point to any evidence to support this assertion. To the contrary, the record demonstrates that SBC Illinois' order processing system reviews each service order for over 4,800 front-end edits, for which, if the service order does not comply, it is automatically returned to the CLEC for correction. Tr. 1218 (Christensen). In comparison, there are only 14 front-end edits for which an order is rejected and falls out to the Local Service Center.

The Joint CLECs also try to compare SBC Illinois' telecommunications network to other commercial applications such as orbitz.com and ATM machines. Joint CLEC Br. at 224. The Joint CLECs' comparison to orbitz.com and ATM machines is absurd, as was explained in SBC

Illinois' Initial Brief. *See* SBC Ill. Br. at 185-86. Two additional observations are warranted. First, as they do throughout their brief, the Joint CLECs assert that the need for manual intervention is entirely SBC Illinois' responsibility. This, however, is not true. For instance, the interconnection agreements with certain CLECs require that CLECs be permitted to fax orders to SBC Illinois, rather than use the electronic interfaces that SBC Illinois has developed. For his own part, Mr. Turner objects that this is not forward-looking. However, if it is not forward-looking to transmit orders by fax, it is entirely because the CLEC has refused to employ the electronic interfaces that are made available to it. Nevertheless, the Joint CLECs seek to impose this cost on SBC Illinois. Similarly, the Joint CLECs object when a Local Service Center representative has to transfer a CLEC's telephone call to the specific service representative who worked on a particular CLEC service order. As SBC Illinois witness Fred Christensen pointed out, the CLECs could avoid the need for this work by calling the specific service representative's direct dial number, rather than the LSC general number. SBC Ill. 10.1 (Christensen Rebuttal) at 9. As with faxing orders, the failure to choose the more efficient route is entirely the CLEC's doing. Thus, when the Joint CLECs complain that too many calls from CLECs are made to the Local Service Center general telephone number, rather than the direct dial number of specific service representatives, the Joint CLECs should be complaining to their own personnel. They are the ones who are not engaging in "forward-looking" behavior, but it is SBC Illinois that the Joint CLECs maintain should bear the expense.³⁵

³⁵ Since Mr. Turner believes that routing calls from the general LSC telephone number to the telephone of a specific service representative is not forward-looking, he would probably support the Local Service Center not making available a general telephone number. However, it does not seem likely that Mr. Turner's clients would be willing to go along with that.

Staff did not propose any specific adjustments in its testimony or briefing. Staff Br. at 148.

2. Activity Times

The Joint CLECs' Initial Brief lists several specific adjustments that AT&T witness Steven Turner recommended. To the extent that these have not already been directly addressed in SBC Illinois' Initial Brief, SBC Illinois will address them here.

First, the Joint CLECs identify an error in one of SBC Illinois' formulas relating to the labor time for the Supplemental Order process performed by the LSC. CLEC Br. at 226. It is not altogether clear why the Joint CLECs mention this error. When this error was pointed out to SBC Illinois through Mr. Turner's direct testimony, SBC Illinois promptly corrected the error. *See* SBC Ill. Ex. 5.1 (Currie Rebuttal) at 23. In fact, SBC Illinois noted that the same formula error had been made with respect to several other tabs in the same cost study and corrected those as well. *Id.* SBC Illinois finds it troubling that the Joint CLECs would raise issues about which there is absolutely no dispute. Rather than focus their advocacy on issues that are in fact in dispute, the Joint CLECs appear to be taking the "kitchen sink" approach. In fact, with respect with to their discussion of non-recurring cost issues, much of their "brief" is simply a "cut and paste" of the direct testimony of their paid consultants. To that extent, their brief has not even considered the rebuttal and surrebuttal rounds of pre-filed testimony or the hearing itself. In SBC Illinois' view, this approach does not serve the interests of the Commission or the parties very well.

The next change proposed by Mr. Turner falls into the same category. Again, the Joint CLECs raise an issue about which there is no dispute. In response to Mr. Turner's direct

testimony, SBC Illinois witness Fred Christensen agreed that the proposed adjustment to the Reject Activity time in the EEL Service Order Cost Study should be the same as in the Unbundled Loops Service Order Cost Study. SBC Ill. Ex. 10.1 (Christensen Rebuttal) at page 9.³⁶

Mr. Turner also proposes to reduce the time it takes an SBC technician to select a reject reason and to make notes in the appropriate places in the service order system. Mr. Turner asserts that he has experience performing similar functions and that, on that basis, it should take only one minute to perform these activities. Joint CLEC Br. at 227. However, the record indicates that Mr. Turner has no such experience with the systems involved; nowhere in the record is there any indication that Mr. Turner has been involved in provisioning CLEC orders for UNEs on behalf of an ILEC. Moreover, as SBC Ill. witness Christensen explained, the service representative must type notes regarding the reject reason into the LASR system as well as the EXACT system. SBC Ill. Ex. 10.1 (Christensen Rebuttal) at 7. Although Mr. Turner claims that these two systems can be integrated, on cross examination, he indicated that he has no idea how that would be accomplished. He also indicated that he was not aware of any software that was available commercially to integrate these systems nor was he able to identify a vendor that had experience with these systems that SBC Illinois could retain. Tr. 1541-44. Needless to say, Mr. Turner provides no evidence whatsoever that, even if such an integration could occur, it would be cost effective to do so. Given the lack of any support for Mr. Turner's assertion that there is a

³⁶ These are not the only examples. For instance, at pages 303-04 of their Initial Brief, the Joint CLECs rail about SBC Illinois' proposed retagging charges. After criticizing the charges for an entire page, the Joint CLECs concede that SBC has removed its proposed retagging costs. Joint CLEC Br. at 304. Once again, the Joint CLECs are wasting time discussing issues over which there is no dispute. Staff properly recognized that this issue was no longer in dispute. Staff Br. at 13.

more efficient process that could be used, the Commission should reject his proposed adjustment.

The next adjustment addressed by the Joint CLECs is Mr. Turner's proposed adjustment to the time to check the EXACT SUPP page for a change request. Joint CLEC Br. at 227. This is another instance where the Joint CLECs seek to burden SBC Illinois with costs caused by CLECs not doing what they are supposed to do. As Mr. Christensen explained, when the LSC receives a supplemental order from the CLEC, the CLEC is supposed to provide information in the remarks section of the order identifying what the supplemental activity is. SBC Ill. Ex. 10.1 (Christensen Rebuttal) at 8. However, CLECs do not always do so. *Id.* In that case, the service representative must perform a "stare and compare" to discern from the CLEC order what the supplemental activity is. *Id.* SBC Illinois proposed a time associated with this task based on input from its SMEs who have actually performed this task. In response, the Joint CLECs, whose witnesses have no experience performing those activities, resort to misrepresenting the record. Specifically, at page 227 of their brief, the Joint CLECs write that "the service representative must do a mere 'stare and compare' exercise, often a single page," and cite to the cross examination of Mr. Christensen. The trouble is, that is not what Mr. Christensen said. First, he did not refer to this as a "mere" stare and compare exercise. Tr. 1226. The Joint CLECs simply add the term "mere," completely changing the tenor of his testimony. Second, Mr. Christensen never said that the exercise "often" involves only one page. In fact, he indicated that there may be multiple screens, depending on the number of items that are being supplemented and the type of supplemental order. Tr. 1226-27. The CLEC's proposed adjustment should be rejected.

The next adjustment proposed by the CLECs is equally unfounded. Here, the Joint CLECs call into question the amount of time spent receiving incoming calls from CLECs to LSC service representatives. Once again the CLECs misrepresent the record. The CLECs are under the false impression that this task involves nothing more than picking up a telephone handset. Joint CLEC Br. at 228. As Mr. Christensen explained, the time proposed by SBC Illinois accounts for SBC Illinois' individualized service to CLECs. Specifically, when a CLEC calls into the call center, the representative who answers the phone attempts to "warm transfer" the CLEC to the service representative who actually processed the CLEC's original order. SBC Ill. Ex. 10.1 (Christensen Rebuttal) at 8. Mr. Christensen did not testify that the time estimate includes the CLEC dialing the number and maneuvering through a menu of options, as the Joint CLECs state in their brief. Joint CLEC Br. at 228. Moreover, while Mr. Christensen agreed that it is not efficient for the CLEC to call the LSC general number, it is an option that is made available to CLECs as part of the customer service that SBC Illinois offers. It is important to keep in mind that it is the CLEC who opts to call the general number, rather than the number of the specific service representative who worked on the CLEC's order (whose number is provided to the CLEC on the service order.) SBC Ill Ex. 10.1 (Christensen Rebuttal) at 9. It is patently unreasonable to impose the cost of this CLEC decision on SBC Illinois.

For their next proposed adjustment, the Joint CLECs object to the [*****] activity time identified for "receipt of service order request assigned by MOR/TEL." Joint CLEC Br. at 228-29. Although this activity hardly involves any time at all, it is not true that it takes no time, as the Joint CLECs assert. Again, with most activities at issue in this case, none of the Joint CLEC witnesses have any experience performing the task. Mr. Christensen, however, does. He explained that receipt of a service order requires the service representative to

first log into the order delivery system and requests a PON. The order delivery system sends the Operating Company Number (“OCN”) and the PON to the service representative terminal. The representative then must paste this information into a second screen in order for the PON to be pulled from the appropriate database and delivered to the service representative’s screen. SBC Ill. Ex. 10.1 (Christensen Rebuttal) at 9-10. The Joint CLEC’s proposed adjustment should be rejected as unfounded.

Finally, the Joint CLECs propose to adjust the activity time to handle the fallout of simple loop orders. Joint CLEC Br. at 229. The Joint CLECs do not provide any support for this adjustment other to claim that it is “[c]onsistent with SBC’s typical practice elsewhere.” *Id.* However, other than citing to Mr. Turner’s testimony, which contains the same language, the Joint CLECs do not identify any other SBC cost study that includes an activity time of only ten minutes to handle fallout for simple orders. Without any justification for their proposal, the Joint CLECs’ final activity time adjustment should be rejected.

Staff did not propose any specific adjustments to SBC Illinois’ activity times in its testimony or briefing. Staff Br. at 148.

3. Occurrence Probabilities

The Joint CLECs propose a single adjustment to the occurrence probabilities used in SBC Illinois’ service order nonrecurring cost studies. *See* Joint CLEC Br. at 229-30. Specifically, the Joint CLECs claim that SBC Illinois has double counted activities in its Combination ULS Ports and New Combinations UNE-P Service Order studies. *Id.* While the Joint CLECs list the activities they claim are duplicative, their Initial Brief does not provide a reference to a tab or

page number in the studies. Nor does the testimony of the witness to whom they cite (Steven Turner). And none of the other CLEC witnesses addressed this proposed adjustment.

The Combination ULS Port study, attached as Schedule DJB-08R to the Rebuttal Testimony of David Barch, refers to activities about which the CLEC's complain at two places: Tab 6.4, lines 13-17 and Tab 8.6, lines 10-14. *Id.* In each instance, the activities are listed under the task entitled "Disconnect Basic Line Port, Ground Start Port, Centrex Basic Line Port, Centrex EKL Line Port, Centrex Attendant Console Line Port, Basic COPTS Line Port, COPTS-Coin Line Port." On the other hand, the New Combinations UNE-P Service Order, Schedule KAC-R3 Revised to Dr. Currie's Rebuttal Testimony, are identified as part of translation work for connection and disconnection of AIN triggers. *See* Tab 6.7, lines 1-11 and Tab 8.24, lines 2-12. Thus, these similar activities relate to two separate and distinct processes; SBC Illinois has not duplicated any activities or costs.³⁷ The Joint CLECs' proposed adjustment should be rejected.

The Staff does not propose any adjustments to the occurrence probabilities in SBC Illinois' service order nonrecurring cost studies. Staff Br. at 148.

4. Service Order Computer Processing Costs

The Joint CLECs' discussion of service order computer processing costs shows the degree to which they toss cost causation and the dichotomy between recurring and nonrecurring costs on their heads. Consider the very first paragraph of their discussion. There, they say that computer processing costs are not caused by single service orders, but rather they are caused by

³⁷ In fact, in the Existing UNE-P Service Order Cost Study (Schedule KAC-R2 Revised to Dr. Currie's Rebuttal Testimony), each of these activities are listed for both AIN trigger connection and disconnection (Tab 8.28) and port translation disconnection (8.29).

service orders “collectively.” Joint CLEC Br. at 230-231. That ignores the fundamental notion of cost causation. When a UNE order is placed, computer processing costs are incurred to process that order. The costs incurred to process that order are not incurred to process any other order, or orders collectively. The only thing causing the cost is the placement of that single order.³⁸ Moreover, for each UNE ordered, the order is processed only once. That is the textbook definition of a nonrecurring cost. Still, the Joint CLECs insist these costs should be recovered on a recurring basis.

The Joint CLECs also continue to confuse the manner in which SBC Illinois pays for its computer processing costs with cost causation. Whether SBC Illinois buys its computers up front, or leases them, does not affect the cost causation analysis. Indeed, to do so would be completely arbitrary, as the decision to buy, or lease (on an annual, monthly or daily basis) would end up being the determining factor in who caused the cost to be incurred, when, in each of those instances, the cost causer is, and always will be, the customer who has requested that a UNE be provisioned.³⁹ The Joint CLEC approach would essentially mean that all costs are recurring costs because SBC Illinois does not pay for any of the activities involved in processing service orders each and every time an individual service order is processed. For example, when a service representative spends time dealing with fallout of a UNE order, the representative does not receive a separate paycheck for each and every fallout condition addressed.

³⁸ “Computer processing costs that vary in the long run with the volume of service orders are direct costs of service orders, and the cost causation principle requires their inclusion in any service order TELRIC study.” SBC III. Ex. 5.0 (Currie Direct) at 28.

³⁹ As Dr. Currie explained, “the way costs are incurred does not determine how costs are caused. Individual investments are incurred one time, but if the investment has or would occur because of capacity limits, then the investment is caused by volumes that exhaust that capacity. Under these circumstances, the investment is volume sensitive, and its cost should be directly assigned to those volumes. Consequently, it is reasonable and appropriate to include volume-sensitive computer processing costs in service order costs, since such costs are caused by service orders.” SBC III Ex. 5.0 (Currie Direct) at 28-29.

Not surprisingly, the Joint CLECs point to this Commission's previous decision agreeing with the CLEC position on computer processing costs. *See* Joint CLEC Br. at 231-32. SBC Illinois respectfully disagrees with the previous Commission decision on this issue, for the same reasons that it disagrees with the Joint CLECs' position.

The Joint CLECs also claim that the OSS costs that SBC Illinois is attempting to recover are already recovered through support assets and overhead loading factors applied generally to all UNE charges. Joint CLEC Br. at 232. In support, the Joint CLECs cite the testimony of AT&T witness Turner. The Joint CLECs have significantly mischaracterized Mr. Turner's testimony. Mr. Turner merely posits that OSS costs *should* be recovered in recurring charges. AT&T Ex. 3.0 (Turner Direct) at 87, lines 4-5; *id.* at 87, lines 20-22.

For instance, in his testimony, Mr. Turner stated:

In short, a proper restatement of SBC-Ameritech's OSS costs should assume that the costs of the underlying OSS (hardware, system software, processor costs, updates, and upkeep), are recovered in SBC-Ameritech's recurring wholesale and retail rates.

Id. at 87, lines 4-5.

Yet, when this passage appeared in the Joint CLEC brief, it had been modified in a dramatic fashion, as is shown by inserting as stricken-through text the words from the Turner version that were omitted from the Joint CLEC version:

In short, ~~a proper restatement of SBC's OSS costs should assume that the costs of the underlying OSS~~ (hardware, system software, processor costs, updates, and upkeep), are recovered in SBC's recurring wholesale and retail rates.

Joint CLEC Br. at 232.

Those are fundamentally different statements. The Joint CLECs have done nothing less than misrepresent the record.

Moreover, the record is crystal clear that there is no double recovery of computer processing costs. Dr. Currie testified that some computer processing costs are caused by nonrecurring activities, while some are not. SBC Ill Ex. 5.1 (Currie Rebuttal) at 23. Those that are not caused by nonrecurring activities were discussed in Mr. Barch's direct testimony. *Id.* A detailed study was undertaken by SBC Illinois (and was provided to the CLECs with the work papers submitted in this proceeding) to identify the computer-related costs that are caused by having nonrecurring activities. *Id.* SBC Illinois has only proposed to include those service order computer processing costs in its nonrecurring costs. Notably, the CLECs do not take issue with any aspect of that study.

Furthermore, as discussed above in SBC Illinois' discussion of general TELRIC principles, the FCC in Paragraph 747 of the *First Report and Order* made clear that its real concern was that imposing nonrecurring charges that are excessive could impose barriers to entry. The FCC listed six circumstances that it believed raised a concern. However, the service order computer processing costs included in the cost of a service order are relatively small. SBC Ill. Ex. 5.1 (Currie) at 25. And the only item of the six that might potentially be a concern with respect to the inclusion of service order computer processing costs in nonrecurring charges is the sixth item in which the cost may "be discounted to the present using a cost of capital that is too low." *Id.* However, the Commission is evaluating SBC Illinois' cost of capital in this very proceeding, and therefore this should not be a concern either.

Staff did not address this issue in its testimony or briefing. Staff Br. at 148.

5. **Fallout Rates**

In large part, SBC Illinois' opening brief has addressed the arguments that are presented by the Joint CLECs and the Staff in their briefs. Thus, SBC Illinois will not repeat those arguments here, but instead refer the Commission to the relevant portions of its Initial Brief. To the extent that the Joint CLECs or Staff raise arguments not already addressed, SBC Illinois responds below.

SBC Illinois does not quarrel with Joint CLEC contention that fallout rates are a significant cost driver. In fact, some of the fallout adjustments that the Joint CLEC propose would reduce SBC Illinois' cost by as much as 80 or 90%. See SBC Ill. Ex. 5.1 (Currie Rebuttal), Schedule KAC-R15 Revised. Thus, it is vitally important that the Commission order fallout rates that are reasonable and compliant with TELRIC. The Commission should reject the Joint CLECs' proposal, which is based on a mythical, super-efficient telecommunications that has no basis in reality.

The Joint CLECs' first line of defense of their fallout proposal, surprisingly, has nothing to do with telecommunications at all. Instead, the Joint CLECs advocate that this Commission look to orbitz.com and its experience with fallout. SBC Illinois has addressed the irrelevance of orbitz.com – as well as the CLECs' other non-telcom example, ATMs – in its Initial Brief. See SBC Illinois Initial Brief at 185-86. As SBC Illinois explained, orbitz.com bears no relationship to what SBC Illinois must do to process and provision UNE service orders. The CLEC's reliance on Orbitz is all the more baseless in light of the fact that the sum total of the experience with orbitz.com relied on by the CLECs is the fact that Dr. Ankum and Mr. Morrison have booked tickets using the orbitz.com flight reservation program. The Joint CLECs have not studied orbitz.com, conducted any analyses of how it works or what fallout it experiences, or

investigated the costs or revenues associated with the system. And the same can be said for ATMs. For these reasons, the Commission should give no weight to the Joint CLEC testimony regarding orbitz.com (or ATMs).

Nor should the Commission give weight to the fallout data relating to EASE, as was discussed in SBC Illinois' Initial Brief at page 184 to 185, as the Joint CLECs suggest. Joint CLEC Br. at 234-35. EASE is not used to process UNE orders; thus it is an irrelevant benchmark. For the same reasons, the experience of SBC Ohio with respect to resale orders should not be given weight by this Commission.

The Joint CLECs next assert that the decision-making process used by SBC Illinois' Information Technology department is flawed because it allegedly does not take into account the costs and benefits to CLECs when it analyzes OSS upgrades. Joint CLEC Br. at 235. This assertion is demonstrably false. Not surprisingly, the Joint CLECs do not point to any evidence in the record to support this assertion.⁴⁰ Nor do the Joint CLECs discuss the evidence that disproves their assertion. For instance, the Joint CLECs do not reference the cross-examination of SBC Illinois witness Lance McNiel who testified that SBC does take benefits to the CLECs into account when considering OSS improvements. Tr. 1319. Nor do the Joint CLECs acknowledge (at least in their brief) that SBC Illinois has a collaborative process in place for considering OSS improvements which involve CLECs. SBC Ill. Ex. 11.0 (Mitchell Direct⁴¹) at 4-59; SBC Ill. Ex. 11.1 (McNiel Rebuttal) at 9, 11-12.

⁴⁰ The Joint CLECs cite to page 73 and 74 of the Direct Testimony of Ankum/Morrison, but those pages do not provide any support for the Joint CLECs' assertion.

⁴¹ The Direct Testimony of John Mitchell was adopted by Lance McNiel.

AT&T witness Turner certainly acknowledged this collaborative process in his testimony:

A. The process that I understand takes places is that there's a collaborative effort between CLECs and the ILEC to determine prioritizations of what should flow through and what should not.

...

Q. And you understand that there's a collaborative process by which CLECs give input as to what automated processes they'd like to see put in place?

A. That is my understanding.

Tr. 1532-33, 34.

Joint CLEC Dr. Ankum likewise testified about these collaboratives and the purpose underlying them:

Q. Are you familiar with the OSS collaboratives that SBC participates in with some of the CLEC community?

DR. AUGUST ANKUM: Somewhat, but I have not participated in it myself.

Q. Are you aware of what the purpose of those collaboratives is?

DR. AUGUST ANKUM: I believe that the genesis of those collaboratives goes back in large part to the anticipation of 271 applications and the setting up of standards and making sure that the CLECs and ILECs interface in a way that these can be met.

Q. And is it your understanding that these collaboratives solicit input from both ILECs and CLECs in the development of performance measures and development of OSS enhancement?

DR. AUGUST ANKUM: Yes.

Tr. 1699-1700.

As testified to by the CLECs' own witnesses, as part of this collaborative process, the CLECs prioritize the improvements that they most want to see. Presumably, the CLECs do that based on their own cost-benefit analysis. (What other type of analysis would they rationally engage in?) SBC, of course, cannot conduct a rigorous financial analysis of the extent to which the CLECs will benefit since the CLECs do not give SBC Illinois access to their information. Instead, SBC Illinois must rely on the CLECs to provide input as to their priorities.

The Joint CLECs also misrepresent the record when they assert that AT&T witness Turner recommended a 2% fallout. Joint CLEC Br. at 236. In fact, unlike Joint CLEC witnesses Ankum and Morrison, Mr. Turner does not recommend a fallout of 2% for all service orders; instead he recommends 2% for simple orders and 10% for complex orders. AT&T Ex. 3.0 (Turner Direct) at 104. While the Joint CLECs may find it beneficial to gloss over the disagreements between its witnesses in briefing, it is important to consider that not even Mr. Turner thinks the Ankum/Morrison position is TELRIC-compliant. Perhaps more importantly, Mr. Turner necessarily does not believe that a Commission decision setting fallout for complex orders at 10% would be TELRIC-compliant.

In support of their fallout proposals (whether it be the Ankum/Morrison proposal or the Turner proposal), the Joint CLECs continue to assert that SBC Illinois should be using different, more efficient technology that, according to the Joint CLECs, would lower fallout. As was explained at length in SBC Illinois' Initial Brief at pages 157-59 and 183-186, the Joint CLECs' claims are unfounded. The Joint CLECs assert over and over that SBC Illinois should be using the "best available OSS that exist today" (Joint CLEC Br. at 237), but when pressed to provide details, they cannot. The Joint CLECs cannot identify any software that SBC Illinois could use that it isn't currently using; and they cannot explain with any specificity how such software

works or even who makes it. Their testimony is simply not credible when it comes from experts who say they have all sorts of relevant expertise, but are unable to come up with any specifics. Instead, it seems to be the expectation of the Joint CLECs that SBC Illinois will disprove the existence of better technology. Of course, one cannot prove a negative. Instead, the Commission should credit the SBC Illinois testimony that states that SBC Illinois is not aware of any technology that is operationally feasible and commercially available that would permit it to achieve during the planning period of these NRC studies the fallout rates that the Joint CLECs propose.

Moreover, as discussed above and in SBC Illinois' initial brief, the Joint CLECs make illegitimate comparisons between retail and UNE service ordering and provisioning. The Joint CLECs continue this pattern with respect to software interfaces that they assert occur with retail provisioning and that therefore must exist for UNE provisioning. *See* Joint CLEC Br. at 238. However, as Mr. McNiel explained, UNE provisioning and retail provisioning are fundamentally different in many important respects. SBC Ill. Ex. 11.1 (McNiel Direct) at 4-5. For instance, there are a host of UNE products that have no analog on the retail side. Moreover, with UNE ordering one is dealing with multiple CLECs, with different equipment, interconnection agreements, etc. The Joint CLECs' attempt to equate retail fallout with UNE fallout is a classic example of mixing apples and oranges.

Staff's criticisms of SBC Illinois' fallout rates are also flawed. The principal argument that Staff makes is that SBC Illinois' fallout should be decreasing over time, as its systems mature. Staff Br. at 149-50. Staff misunderstands the relationship between system maturity and improvements (reductions) in fallout. Contrary to what Staff postulates, the most marked

improvement in fallout occurs when systems are new; as they mature, fallout only marginally improves.

SBC Illinois witness McNiel explained this phenomenon in his rebuttal testimony:

When systems are first brought on line, management of defects can have noticeable positive effects on flow through. However, over time, defect management begins to produce only minimal increases in flow through percentages. This is because the larger, more significant problems are identified and handled soon after system releases, leaving only the smaller, incidental glitches to be fixed as they occur.

SBC Illinois engages in comprehensive efforts to increase flow through as much as possible. For instance, SBC performs daily monitoring of production orders for Stored in Error messages and system-related error messages to identify error conditions affecting flow through performance and to analyze root cause. Defects and, where applicable, Change Requests to address the error conditions are opened and prioritized. Error volume is also assessed to determine need for escalation of defects to higher priority status. Error messages that indicate unidentified error conditions between systems are monitored daily to determine root cause for various conditions behind the messages. Diagnostic tools are in place to assist with analysis of the messages and the errors are reviewed on daily calls for root cause and resolution. In addition, where the messages are the result of delayed response times between systems, a mechanized reflow process is in place to identify these errors and issue up to three attempts to flow the order to increase opportunities for flowing through. The flow through rates that SBC Illinois actually experiences represent the outcome of all these efforts. Based on these efforts and SBC Illinois's actual flow through data, SBC has applied flow through rates in its cost studies that represent the flow through that it will experience on a forward-looking basis, during the study period.

SBC Ill. Ex. 11.1 (McNiel Rebuttal) at 7-8.

Staff witness McClerren pointed to improvements in flow through for resale orders to buttress his argument. Staff Ex. 30.0 (McClerren Rebuttal) at 10. In fact, his testimony supports SBC Illinois' position. Mr. McClerren's analysis points out that the improvements to flow

though have taken considerable time to achieve – over six years. SBC Ill. Ex. 11.2 (McNiel Surrebuttal) at 4. And even over that extended period of time, resale flow through has only reached 96 percent, not the 98 percent he advocates for UNE ordering. *Id.*

Staff also criticizes SBC Illinois' reliance on fallout data from July through September of 2002, asserting that such data does not reflect the efforts that SBC Illinois undertook subsequent to September 2002. Staff Br. at 151-53. Staff's objection has no merit. SBC witness McNiel explained that many of these efforts were not expected to increase flow through. For instance, Mr. McNiel disagreed with Mr. McClerren that the release of LSOG 6 would increase flow through. Mr. McNiel explained that every LSOG release adds new and better functionalities, but they do not all necessarily add flow through capabilities. Moreover, even if there were enhancements to flow through in every release, it would only affect certain products. All products are not enhanced in the same manner in each release. *See* SBC Ex. 11.1 (McNeil Rebuttal) at 10; *see also* SBC Ex. 5.1 (Currie Rebuttal) at 28-30.

Moreover, SBC Illinois has provided the more recent data sought by Staff and it shows that the fallout data from the July/September 2002 time frame is consistent with SBC Illinois' more recent flow through data. *See* SBC Ex. 11.2 (McNeil Surrebuttal) at 5 and Schedules LM-S1 and LM-S2; SBC Ex. 5.1 (Currie Rebuttal) at 28-30. This data corroborates SBC Illinois' position that its systems have reached a forward-looking fallout level, and undermines Staff's position that these mature systems can obtain fallout rates that approach 0%.⁴²

⁴² Staff also contends that SBC Illinois should calculate its fallout using PM 13 rather than PM 13.1. SBC Illinois addressed this argument in its Initial Brief. SBC Ill. Br. at 186-87.

The Joint CLECs, as well as Staff, point to this Commission's previous decision in support of their fallout proposals. It should come as no surprise to anyone that SBC Illinois respectfully disagrees with that Commission decision. SBC Illinois believes that its experiences with fallout since that Commission decision help underscore the error in setting a fallout rate as low as 2%. As the data since the Commission's earlier decision demonstrates, SBC Illinois has still not obtained the very low fallout rate that the CLECs insisted over five years ago that SBC should have been achieving then. Of course, the Joint CLECs want this Commission to ignore those five years of experience (and the 3 years before then) and all of the data that shows that SBC has not reached the levels of fallout that the Commission ordered in the previous proceeding. Instead, the Joint CLECs hope this Commission will just rubberstamp its earlier conclusion.

The Joint CLECs point to two other state commissions that have ordered 2% fallout rates. Joint CLEC Br. at 238-39. Significantly, both states limited their 2% to simple orders only. *Id.* at 239. Staff points to a decision from Michigan, but that decision predates even this Commission's first decision on fallout. Staff Br. at 150-51. Both the Joint CLECs and Staff omit any discussion of a much more recent decision from Indiana, where the Indiana commission rejected the Joint CLECs' proposal for an across-the-board 2% fallout rate. Instead, the Indiana Commission set upper limits for traditional fallout ranging from 5 to 23%. *Indiana UNE Order* at 114-15. The Indiana proceeding was similar to this proceeding, in that the Indiana commission was revisiting fallout after an earlier decision in which it set a 2% fallout rate (for simple orders). As is the case here, the Indiana commission was presented with historical fallout data that demonstrated, despite the very low fallout set by the Indiana commission in its earlier docket, that SBC Indiana had not been able to actually achieve such a fallout rate. The Indiana

commission agreed with SBC Indiana that “SBC Indiana’s actual rates are a key ingredient when determining fallout rates,” and set new fallout rates substantially above the rates it had set in the earlier proceeding. *Indiana UNE Order* at 114.

Staff also objects to the fallout rate proposed for EELs, which was based on SME estimates. Staff’s objection should be dismissed. First, SBC Illinois properly relied on a SME since EELs are relatively new products and SBC Illinois lacks sufficient data to determine a forward-looking fallout rate. *See* SBC Ex. 5.1 (Currie Rebuttal) at 30-31. In addition, EELs are complex services requiring multiple service orders and more interdepartmental coordination. *See* SBC Ex. 11.1 (McNeil Rebuttal) at 8. EEL orders currently are not designed to flow through at all. *Id.* Thus, as explained by SBC witness Dr. Kent Currie, SBC Illinois’ proposed flow through rate of [*****] is a forward looking rate.

Finally, the Joint CLECs devote a significant portion of their discussion of fallout to support activities that the LSC performs. The fact that the Joint CLECs discuss support activities in this section demonstrates that they do not understand the nature of these support activities and how they differ from activities undertaken as a result of fallout. Support activities are properly discussed in the section pertaining to occurrence probabilities, not the section pertaining to fallout.

Indeed, the only connection between support activities and fallout activities is that they are performed by the same work group – the LSC. Fallout represents the percentage of UNE orders that are submitted electronically and fall out to the LSC as a result of some error in the electronically submitted order that is detected as part of the front-end edit process. As SBC Illinois witness Christensen explained, SBC Illinois’ OSS detects over 4800 front-end edits that

result in the order being automatically sent back to the CLEC who placed the order. Tr. 1218. There are also some errors that, rather than being sent back to the CLEC, are sent to the LSC for manual intervention. Mr. Christensen testified that there were 14 reasons why an order would be sent to the LSC, rather than flowing through the ordering process. Tr. 1287; *see also* SBC Ill. Ex. 11.1 (Christensen Surrebuttal) at 1-2. These orders are said to “fall out.”

Support activities, on the other hand, are activities that the LSC may undertake with respect to a CLEC order once it has successfully passed through this front-end edit process. These are situations where the order is flowing through the electronic process but, as a result of some development subsequent to the order being electronically submitted, the LSC must undertake some activity. For instance, ACD coverage activity occurs when a CLEC calls to inquire about an order. SBC Ill. Ex. 10.0 (Brown Direct⁴³) at 15. Obviously, when the order is electronically submitted, SBC Illinois’ OSS has no way of knowing whether the CLEC will make a phone call with respect to that order. Therefore, the order does not fall out; instead, subsequent to that time, the LSC becomes involved when it receives the call from the CLEC. Similarly, with respect to Supplemental Order activity – which occurs when a *CLEC* makes changes to due dates, features, addresses, or listings prior to completion of the order – SBC Illinois’ OSS has no way of knowing whether a supplement order will occur at the time the order is submitted. SBC Ill. Ex. 10.1 (Christensen Rebuttal) at 4-5. Therefore, the order does not fallout. Likewise, as the Joint CLECs themselves note in their brief (at page 241), the ESOI activity “only occurs when the order initially passes the edit process.” Thus, it has not fallen out, but returns to the LSC due to a subsequent development.

⁴³ Fred Christensen adopted the direct testimony of Mr. Brown.

As a result of their misunderstanding of support activities, the Joint CLECs argue that SBC Illinois is trying to add the occurrence probabilities for these support activities to its proposed fallout rate. The Joint CLECs are wrong. The fallout rate for service orders is based on PM 13.1, which does not include manual intervention resulting from support activities. The probability of occurrence percentages provided by the LSC for support activities were determined based on actual data reports that the LSC maintains. SBC Ill. Ex. 10.1 (Christensen Rebuttal) at 3-4. Moreover, each of the support activity occurrence probabilities is only being applied to the specific tasks associated with that support activity, and the PM 13.1 fallout rate is not applied to any of these tasks. Thus, the PM 13.1 fallout rate and the support activity occurrence probabilities are not additive in any manner whatsoever.

For the same reasons, it is entirely irrelevant that the LSC SMEs were not told that the Cost Group was using both support activity occurrence probabilities and a fallout rate. That is by no means “alarming,” as the Joint CLECs suggest. Joint CLEC Br. at 240.

The approach taken by SBC Illinois to parse out specific activities and the probability of occurrence associated with those activities leads to a result that is more compliant with TELRIC. It reduces that possibility that unrelated tasks are lumped together, when the likelihood of those tasks happening are completely independent of each other. Recently, the Indiana Commission agreed with SBC Indiana’s approach of breaking down activities into more discrete categories. *Indiana UNE Order* at 114.

The Joint CLECs ultimately propose to greatly reduce or set at zero the probability occurrence factors related to these six support activities. As SBC Illinois explained in its Initial Brief, such a proposal flies in the face of the record evidence. *See* SBC Ill. Br. at 176-79 for a

refutation of the proposed adjustments to the occurrence probabilities for Reject Activity, Supplemental Order Activity, PPD Activity and ACD Coverage Activity; *see* SBC Ill. Br. at 166-68 for a refutation of the proposed adjustments to the occurrence probabilities for 3E Error and ESOI activity.

The Joint CLECs generally object to the occurrence probabilities for support activities because the historical data upon which they are based dates from late 2001 and 2002. Joint CLEC Br. at 245. The CLECs' argument is patently inconsistent with the position they took with respect to updated labor rates, when they successfully moved to strike SBC Illinois' revised costs studies on the ground that the revised studies relied on more current data. The Joint CLECs cannot have it both ways. In addition, the Joint CLECs take Dr. Currie's testimony about trends out of context. When Dr. Currie testified on cross-examination that a data set of a few months was insufficient for predicting a trend (indeed he said a whole year would be insufficient), he was discussing whether a trend would be statistically valid for predicting future data. The context of his conversation with AT&T's counsel is absolutely clear. Tr. 1174-76, 1189. Finally, the CLECs misrepresent the recent decision by the Indiana commission regarding the appropriate occurrence probabilities for these support activities. Joint CLEC Br. at 243. Contrary to the Joint CLECs statement, the Indiana commission did not set all of these support activities at 1%. *Indiana UNE Order* at 114. Instead, based on the type of order, it set them anywhere from 1% to 4%. *Id.* And the Indiana Commission did not set any of them at 0%, as the Joint CLECs advocate here. *Id.*

A few additional points are worth emphasizing about Reject Activity. First, the Joint CLECs again misrepresent the record when they claim that SBC Illinois proposes an "an astronomical [*** ***** ***] percent" Reject Activity rate. Joint CLEC Br. at 242. As SBC

Illinois explained in its initial brief, that figures is the Reject Activity for EELs, which are complex, relatively new types of UNEs that are currently not designed to flow-through electronically. The occurrence probability for UNE-P is only [***** ***], which is significantly less than the service order fallout rate for UNE-P. SBC Ill. Br. at 176; *see also* AT&T Ex. 3.1 (Turner Rebuttal) at 20.

Second, the activity times involved with Reject Activity are small, and account for tasks above and beyond what SBC Illinois must do to complete orders that fall out of the electronic service ordering processing. Specifically, Reject Activity includes a total of [*** *****] minutes to halt the request that contains invalid data or lacks crucial data, and an additional [*** ***** ***] minutes to determine the reject reason, to reject the request, and to make notes regarding the reason. *See* SBC Ill Ex. 5.1 (Currie Rebuttal), Schedule KAC-R7 at 51; SBC Ill Ex. 10.1 (Christensen Rebuttal) at 6-7.

With respect to supplemental order activity, the Joint CLECs claim SBC Illinois' process is not efficient, yet do not suggest any manner in which it can be made more efficient. Joint CLEC Br. at 243. It is not surprising, then, that the Joint CLECs proposed adjustment actually assumes the same process that SBC Illinois uses. *Id.* Instead, the CLEC insist that the occurrence probability for this task should be the same as the general fallout rate. *Id.* This defies logic. Supplemental Order activity occurs when a CLEC decides to change part of its order, for instance, when a CLEC makes changes to due dates, features, addresses, or listings prior to completion of the order. That decision to make a change rests solely with the CLECs; it has nothing to do with whether SBC Illinois' processes are efficient or not; and there is absolutely no reason why the likelihood of CLEC order changes would be affected by (let alone the same as) the general fallout rate.

Finally, with respect to ACD Coverage activity, the Joint CLECs' proposal to reduce the occurrence probability to 2% is patently unreasonable. Joint CLEC Br. at 244-45. The likelihood that a CLEC will place a call to the LSC to inquire about an order is entirely within the control of the CLEC and there is no logical reason to presume that it will bear any relationship to the general fallout rate, let alone be 2%. In addition, the fact that SBC Illinois included calls that pertain to orders that are faxed does not mean its occurrence probability is not forward-looking. The interconnection agreements between SBC Illinois and some CLECs permit the CLEC to fax orders to SBC, rather than use the electronic interfaces that SBC has developed. On a forward-looking basis, those agreements will remain in effect and it is unreasonable to assume away the costs associated with taking calls about faxed orders by utilizing an arbitrarily low occurrence probability.

6. Other Issues

The CLECs assert that SBC Illinois should be required to separate connection and disconnection nonrecurring charges. Joint CLEC Br. at 247-50. Staff makes a similar assertion, which it addressed in Section IV.C.6 of its brief. SBC Illinois responds to these assertions below in Section IV.C.6.

With respect to the service order cost study for EELs, the CLECs also complain that SBC Illinois developed separate service order charges for loops that are ordered as stand-alone UNEs and loops that are ordered for an EEL. Joint CLEC Br. at 250-51. The CLECs assert that this makes "cost development" and "practical implementation of EEL service order charges far more difficult than it needs to be." *Id.* But if that is true, then so is having separate connection and disconnection charges, separate charges for UNE-P migrations and "new" UNE-Ps, separate line connection charges for unbundled loop and new UNE-P, etc. – all things that the CLECs have

insisted upon. The CLECs' call for less "complexity" is merely a red herring. The CLECs' real goal is to simply, and blindly, substitute the EEL nonrecurring charges for the stand-alone UNE loop nonrecurring charges, *regardless* of whether SBC Illinois performs different tasks and incurs different costs in the two different situations. *See* SBC Ill. Ex. 3.1 (Silver Rebuttal) at 9. The CLECs' proposal violates TELRIC, and should be rejected.

The CLECs also assert that SBC Illinois should remove from its existing UNE-P service order nonrecurring cost study the very small probability that an existing UNE-P combination has no dial tone. *See* Joint CLEC Br. at 251-52. This proposal should be rejected. The CLECs do not deny that existing UNE-P combinations sometimes, in the small number of cases identified by SBC Illinois, lack dial-tone. Nor do the CLECs deny that in this small number of cases SBC Illinois must perform slightly more work. *See* SBC Ill. Ex. 5.0 (Currie Direct) at 13. Rather, the CLECs suggest that SBC Illinois should be denied cost recovery in these cases because, the CLECs allege, "SBC lacks the ability to distinguish between a *new UNE-P service order* where everything is already wired but where there is no dial tone from a *new UNE-P service order* in which the combination is not already wired." Joint CLEC Br. at 252 (emphases added). But that makes no sense. First, "new UNE-P service order[s]" are not at issue; at issue are orders for *existing* UNE-P. Second, SBC Illinois assuredly can tell whether a combination without dial-tone is wired through or not; its SWITCH database, which inventories central office switching and related equipment, identifies whether or not a facility is "DIP'd." *See* SBC Ill. Ex. 6.0 (Cass Direct) at 19.

C. Provisioning (Loops and EELs) Non-recurring Cost Studies

1. Identification of Tasks

Staff takes issue with some of SBC Illinois' proposed activities and activity times, noting that the activities and times may differ between the UNE loop cost study and EEL cost study, and that different work groups may be involved. In particular, Staff notes that the work groups responsible for provisioning stand-alone UNE loops have some lower travel times and testing times than the work groups responsible for provisioning loops that are part of an EEL, and that SBC Illinois included testing activities for the loop component of an EEL that it did not include in the stand-alone UNE loop cost study.

Staff focuses particularly on the testing activities conducted by the SSC and CPC with respect to EELs, noting in its initial testimony that SBC Illinois did not include these same activities in its stand-alone UNE loop cost study. Staff Ex. 7.0 (Zolnierek Direct) at 39-40. As Staff notes, SBC Illinois subsequently explained what Staff refers to as the "CPC discrepancy." Staff Br. at 158. While Staff calls SBC Illinois' explanation "unconvincing[]," Staff does not attempt to rebut SBC Illinois' explanation (and thus SBC Illinois' proposed CPC activities and activity time should be approved). Instead, Staff focuses on the alleged "SSC discrepancy." *Id.*

Staff asserts that the costs for SSC activities in the EEL cost study and LOC activities in the stand-alone UNE loop cost study should be the same, because "SBC's only explanation for the differing cost estimates is the fact that different groups perform the provisioning activities." Staff Br. at 160. Staff is wrong. Stand-alone UNE loops and EELs are undeniably different products, and require different provisioning activities. In particular, SBC Illinois explained that different testing is required for the provisioning of a stand-alone loop and for the provisioning of the loop component of an EEL. SBC Ill. Ex. 9.2 (Gomez-McKeon Surrebuttal) at 11. Staff's proposal to ignore these differences should be rejected.

The CLECs take issue with SBC Illinois' use of the designed loop process for stand-alone UNE loops and loops that are part of an EEL combination. Joint CLEC Br. at 253-56. SBC Illinois' opening brief fully addressed this issue (at 192-93), and SBC Illinois will not repeat that discussion here. In short, the CLECs' assertions are without merit. While the CLECs assert that SBC did not treat unbundled loops as designed circuits in Indiana, and find it "hard to understand why unbundled loops in Illinois would be different" (Joint CLEC Br. at 254), in fact SBC did treat unbundled loops as designed circuits in Indiana. And the Indiana commission *agreed* with SBC Indiana that that was the proper treatment, concluding that "designed loops are necessary to identify issues related to the circuit layout and will prevent any potential errors that may arise." *Indiana UNE Order* at 116.

The CLECs also misrepresent the design process reflected in SBC Illinois' nonrecurring cost studies. First, while the CLECs' testimony and brief focuses on working POTS loops, not all loops (whether stand-alone or as part of an EEL) are POTS loops, and far from all loops are already "working" (as evidenced by SBC Illinois' DIP and DOP rates). Second, the CLECs ignore the actual "design" activities at issue. SBC Illinois does not propose to charge CLECs for "special testing" or placing "additional test points" (Joint CLEC Br. at 256), but performs several minutes of ordinary testing and must process the orders as design circuits so that, for instance, SBC Illinois can verify the connecting facility assignment information and establish the circuits in the TIRKS database. SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 3. The CLECs also note that there is a design process "for the transport portion of the EEL" (Joint CLEC Br. at 256), but, obviously, loops are not the same as transport, and different provisioning activities are required for each.

2. Activity Times

Distinction between unbundled loop and EEL provisioning times. As Staff notes (at 160-61), the work times associated with provisioning activities on the “customers’ side of loops” (*i.e.*, performing cross-connect activities at the SAI/FDI) are different for stand-alone 2-wire analog loops and for the same loops when part of an EEL. As Staff also notes, there are two causes of this difference: (1) the work group responsible for the relevant activities in the case of EELs (the “DOG”) has longer travel times than the work group that performs similar activities in the case of stand-alone loops (the “CP&M”), and (2) the DOG has longer testing times than the CP&M. *See* Staff Br. at 160-61. Contrary to Staff’s assertion, these differences are entirely reasonable.

First, the travel times associated with these two work groups differ for the simple reason that the groups cover geographic areas of different size, as SBC Illinois explained in its Initial Brief. *See* SBC Ill. Br. at 194. It is common sense that if one technician has to cover a geographic area covered by more central offices than another technician, on average, the first technician will spend more time traveling. And Staff’s speculation that this necessarily means that one group is “inefficient” (*see* Staff Br. at 161-62) is nonsense; Staff has provided no evidence to suggest that it would be more efficient for SBC Illinois to hire more technicians and staff them at more garage locations simply to shave off a few minutes of travel time.

Second, with respect to the testing time discrepancy, Staff’s assertion that SBC Illinois “did not address” the issue is simply wrong. Staff Br. at 161. In particular, SBC Illinois *agreed* to reduce the DOG’s “conduct circuit test” activity time to make it the *same* as the CP&M testing time in the unbundled loop cost study. SBC Ill. Ex. 5.2 (Currie Surrebuttal) at 4; SBC Ill. Ex. 9.2 (Gomez-McKeon Surrebuttal) at 12.

EEL cross-connects and multiplexing. Staff also asserts that certain activities in the EEL cost study are duplicated with respect to the dedicated transport and multiplexing portions of EEL provisioning, and asserts that “the Commission should order SBC to refrain from assessing multiplexing charges in combination with orders for dedicated transport” in order to ensure that “SBC does not assess charges twice for work activities that it performs once.” Staff Br. at 162-164. The CLECs make a similar assertion, alleging that SBC Illinois has included “inappropriate multiplexing costs” that are completed in connection with the transport portion of an EEL, and alleging that SBC Illinois has double-counted certain cross connects. Joint CLEC Br. at 281-83. These proposals, however, would inappropriately deny SBC Illinois cost recovery for activities that it must in fact perform. For instance, CLECs may order the transport and multiplexing component of the EEL on different orders, in which case SBC Illinois must process each order with two different due dates. SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 13. *See id.* at 19.

Travel Times. The Joint CLECs make many of the arguments about travel times that SBC Illinois anticipated in its Initial Brief. Despite the fact that travel (at least by motor vehicle) is an easily understood task and does not require any special expertise, the Joint CLECs endeavor to make it seem like one of the most complicated activities in all of SBC Illinois’ cost studies. *See, e.g.,* Joint CLEC Br. at 257 (advocating a “complex and detailed analysis”). SBC Illinois has addressed the specific adjustments proposed by the Joint CLECs and demonstrated that the Joint CLECs’ approach defies common sense. To the extent that SBC Illinois has addressed these issues already, it refers the Commission to its initial brief at pages 158 and 193-198.

Only two additional observations are warranted. At page 257 of their brief, the Joint CLECs assert that the experience of SBC Illinois’ SMEs is skewed toward longer and older copper loops, and assert that since it takes more time to get to a longer loop, SBC Illinois has

overstated travel times. Joint CLEC Br. at 257. The Joint CLECs' logic is faulty. Without any explanation, the Joint CLECs equate longer with older. Yet they do not present any evidence to demonstrate a correlation, or explain why there would be one. Even if their assertion were true, it would prove nothing. If travel to older loop facilities were over-represented in any historical travel data, it would likely describe travel to repair facilities rather than to engage in installation activities. SBC Ill. Ex. 5.1 (Currie Rebuttal) at 34-35.

Second, the Joint CLECs claim that SBC Illinois has double counted travel time associated with multiplexing. CLEC Br. at 269. However, a CLEC may order transport and multiplexing on different ASRs; in such a case, the LSC would process each ASR with two different due dates and travel will be required in both instances. SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 14.

Cross-Connect Times. The CLECs propose to reduce a number of cross-connect activity times. *See* Joint CLEC Br. at 258-259, 261-263. SBC Illinois refers the Commission to its opening brief (at 198-199), where it fully addressed, and refuted, the CLECs' cross-connect assertions. As SBC Illinois explained, Ankum/Morrison's proposed adjustments, based solely on vague assertions of "their experiences" and a reference to "one-sided cosmic frames" (*see* Joint CLEC Br. at 258) are unsupported and based on the use of expensive, operationally limited technology that does not constitute the most efficient technology currently available.⁴⁴

⁴⁴ Ankum/Morrison also asserts that some cross-connection costs, as well as some testing costs, should be classified as recurring costs on the theory that "other CLECs and SBC itself will also benefit from these activities." Joint CLEC Br. at 260; *id.* at 259. As explained in SBC Illinois' opening brief (at 180 n.61), this novel theory of UNE costing, allocating costs based on speculation about who might benefit down the road, violates the FCC's TELRIC pricing rules, which require that costs be assigned according to cost-causation principles. *See First Report and Order*, ¶ 691.

AT&T's proposed modifications fare no better. With respect to four-wire cross-connects (*see* Joint CLEC Br. at 263), the record demonstrates that AT&T's proposal ignores reality. In particular, the technician must first place as much as 100 feet of cable, perform eight wire wraps on the frame, may be required to work on multiple floors in the building, and must move up and down ladders to access overhead cable racks or trays. *See* SBC Ill. Br. at 198-199. With respect to DS1 and DS3 cross-connects, AT&T's proposal is based on the assumption that pre-connectorized jumpers are used (*see* Joint CLEC Br. at 263), but the record demonstrates that that is the exception rather than the rule. *See* SBC Ill. Br. at 199. Similarly, SBC Illinois demonstrated that its proposed cross-connect times for two-wire loops are reasonable and should be approved. *See* SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 32-33.⁴⁵ Thus, the CLECs' proposed cross connect adjustments should be rejected.

Testing Times. The CLECs' proposed reductions to SBC Illinois' testing times were also fully addressed in SBC Illinois' opening brief (at 199-200), and the CLECs offer nothing new in their brief. SBC Illinois' testing times are fully supported by the experts that actually perform those tasks, and, contrary, the CLECs' assertions (*see* Joint CLEC Br. at 260), those testing times do not assume that technicians are "sitting around" waiting for tests to complete. *See* SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 18-19; SBC Ill. Ex. 9.2 (Gomez-McKeon Surrebuttal) at 7-8.

AT&T's proposed testing time adjustments must be rejected as well. AT&T first asserts that pre-serve testing is "nothing more than a continuity test," and thus should be reduced to two

⁴⁵ The CLECs' assertion that IDFs do not constitute forward-looking technology is addressed in SBC Illinois' opening brief (at 190). SBC Illinois' network expert testified that IDFs indeed constitute forward-looking technology, and remain an integral part of SBC Illinois' *current* engineering methods and procedures for the efficient placement of central office frames. *See* SBC Ill. Ex. 16.0 (Deere Rebuttal) at 4-6.

minutes. Joint CLEC Br. at 267. But the record demonstrates otherwise. In particular, SBC Illinois explained precisely the *series* of tests involved, which, for 4-wire analog and DS1 loops include not just a continuity test, but also an office to office test, a test involving converting the dial tone from analog to digital (for 4-wire loops), and several other tests as well, as defined in SBC's Methods and Procedures. *See* SBC Ill. Br. at 199-200. Moreover, these tests may involve multiple cross-connects on different floors. *Id.*

AT&T also asserts that DS1 and DS3 loop testing times for the CP&M/DOG and the SSC should be the same, because “[t]he CP&M-DOG technician works with the SSC to perform the service testing on DS1 and DS3 Loops.” Joint CLEC Br. at 268. AT&T again is wrong. While the CP&M/DOG and SSC do work together in part, the CP&M/DOG requires *additional* time to complete the required testing, including the stress test, 1&7's test, 3&24 test, and QRSS. *See* SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 28-29.

Finally, AT&T's proposal to significantly reduce the time for DS1 CKL testing on the theory that the technician can “perform other activities” while the test is running (Joint CLEC Br. at 273) should be rejected. As SBC Illinois explained, the activity time for this test includes not just the time for actually running the test, but preparation and set-up time as well. Moreover, the work group involved cannot perform other activities at the same time, but must closely coordinate with other work groups and with the CLEC. SBC Ill. Br. at 200.

Order Analysis Functions. The CLECs propose numerous adjustments to the activity times associated with order analysis functions. *See* Joint CLEC Br. at 264-66, 272. None, however, are supported by anything more than speculation, and all are refuted in SBC Illinois' opening brief (at 191-92, 200-02, 214-25). The CLECs' only support for these adjustments is

naked speculation about what might be possible with some unidentified “forward-looking OSS” and “Mr. Turner’s experience with similar functions in other SBC states” (Joint CLEC Br. at 265) – apparently referring to Mr. Turner’s “experience” as a paid CLEC consultant reviewing and proposing similar random activity time reductions for cost studies in other states. *See id.* at 266 (“based on his extensive experience reviewing these costs in other states”). That kind of experience is not relevant at all, and the CLECs’ proposed modifications should be rejected.

For instance, AT&T proposes to significantly reduce a number of “additional” order analysis and close-out tasks (*i.e.*, the additional time for performing these tasks for additional circuits on the same order) on the theory that the focus of these activities is on “the *order* – not on the individual loops themselves.” Joint CLEC Br. at 264-66. But that is not how orders for multiple circuits are worked. Rather, SBC Illinois’ technicians receive an order-wide work request *and* a separate workstep ticket for each circuit within the order. Thus, the technicians must separately review, and separately close-out, each workstep ticket, for each circuit within the order. *See* SBC Ill. Br. at 201-02.

Alleged Double Recovery of Recurring Costs. AT&T vaguely alleges that some costs associated with “establishing cross-connections at the remote terminal or the SAI/FAI are already being recovered in the loop recurring rate,” and proposes some equally vague “revision” of SBC Illinois’ cost studies. Joint CLEC Br. at 266-67. This proposed adjustment, whatever it might be, should be rejected. AT&T fails to even coherently explain what costs or activities it is referring to, or how those costs could already be included in the recurring loop rates (thus denying SBC Illinois the opportunity to respond more specifically to AT&T’s proposed adjustment).

TIRKS. AT&T proposes to significantly reduce the EEL-related activity times associated with assigning circuits in the TIRKS database. *See* Joint CLEC Br. at 272-73. As SBC Illinois explained in its opening brief (at 202-03), AT&T's proposal rests on a gross simplification of the necessary tasks, and would deny SBC Illinois the opportunity to recover the TELRIC costs it incurs to provision EELs to CLECs.

3. Occurrence Probabilities

DOP and DIP. As explained in SBC Illinois' opening brief (at 203-06), the work group occurrence factor ("WGOF") for certain outside plant provisioning activities (*e.g.*, performing a cross-connect at the FDI/SAI) is inversely related to the Dedicated Outside Plant ("DOP") ratio. The DOP ratio measures the percentage of loops that are already "connected through" in the outside plant environment.

Staff asserts that the occurrence factor for cross-connecting unbundled loops should be significantly reduced, but Staff's proposal is unsupported, unreasonable, and non-TELRIC-compliant. Staff first asserts that "even when there is a fully established and available loop facility from the end-user premises to the central office, SBC assumes that it must dispatch CP&M to perform line connection activities [*** ***** ***] of the time." Staff Br. at 167. That is inaccurate. Rather, as Staff itself notes (at 166-167), SBC Illinois' nonrecurring cost study for stand-alone loops does not differentiate between stand-alone loop orders that are for "migrations" of existing service and orders for "new" loops, unlike its UNE-P nonrecurring cost studies, which distinguish between orders for UNE-P migrations and new UNE-P. Thus, the WGOF at issue is an overall average, reflecting the frequency with which outside plant technicians must be dispatched over all types of stand-alone UNE loop orders.

Moreover, SBC Illinois provided actual data demonstrating the reasonableness of its proposed WGOF for the outside plant provisioning group, showing that only approximately 50% of 2-wire analog UNE loop orders were “DOP’d,” meaning the remaining UNE loop orders required an outside plant technician dispatch for provisioning. SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 23. In respond to this evidence, Staff attempts to throw an impenetrable cloud of confusion over the whole issue (*see* Staff Br. at 168-170), positioning SBC Illinois’ supporting evidence as some kind of “new DOP figure” that “is applied differently,” and expressing confusion over whether SBC Illinois “has changed its methodology.” Staff Br. at 168. It has not.

SBC Illinois is not proposing a new DOP figure or methodology, or asserting that “the new DOP SBC has presented should be applied differently than the DOP SBC is filing in its cost studies.” Staff Br. at 168. Rather, the additional evidence SBC Illinois presented is merely supporting evidence that proves the reasonableness of SBC Illinois’ original WGOF proposal, because an even *higher* WGOF would have been fully justified.

In particular, SBC Illinois presented data taken from the actual 2-wire analog UNE loop orders it provisioned from January 2003 through November 2003, which revealed that, of all these orders, the loop plant was connected through in the outside plant environment only 50% of the time “with or without a migration.” SBC Ill. Ex. 9.2 (Gomez-McKeon Surrebuttal) at 4. The remaining 50% of the time, SBC Illinois had to dispatch a technician to complete the provisioning. This actual loop provisioning performance data demonstrates that the WGOF SBC Illinois estimated in its cost study using its overall DOP – only [***** ***] – is clearly reasonable.

Finally, Staff's proposed WGOF is entirely unsupported. Staff proposes to cut the relevant WGOF nearly ten-fold, to reflect the frequency with which Staff asserts outside plant technicians must be dispatched to provision *UNE-P* orders. *See* Staff Br. at 171. But the record demonstrates that Staff's proposal cannot be correct. In particular, the actual data show that technicians must be dispatched to physically perform provisioning activities *far more often* for UNE loop orders than for UNE-P orders. SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 23.

The CLECs' DIP and DOP proposals should also be rejected. For the most part, the CLECs merely summarize their testimony on the issue; SBC Illinois addressed (and refuted) the CLECs' arguments at length in its opening brief (at 203-206). A few points, however, require further discussion.

Ankum/Morrison initially proposed DIP and DOP ratios of 75% (*see* Joint CLEC Ex. 1.0 (Ankum/Morrison Direct) at 94-103), which, as SBC Illinois explained, is not based on an efficient, forward-looking network at all, but instead on one that is grossly inefficient because it does not include spare capacity deployed to satisfy future demand (*see* SBC Ill. Br. at 205-06).⁴⁶ However, the CLECs now propose DIP and DOP ratios of 100%, quoting a paragraph of the FCC Wireline Competition Bureau's *Virginia Arbitration Order*. Joint CLEC Br. at 275. That proposal must be rejected, because the Bureau's Virginia decision is inapposite. First, as the quoted portion indicates, in that arbitration AT&T/WorldCom specifically fashioned and proposed an annual cost factor to provide for the recovery of installation costs when DIP and DOP were not present. Here the CLECs propose no such thing, but instead propose to simply

⁴⁶ SBC Illinois also explained the flaws in AT&T witness Turner's proposal. *See id.* at 204-05. Among other things, AT&T ignores the fact that SBC Illinois has developed *separate* nonrecurring charges for UNE-P migrations and new UNE-P. Thus, AT&T's assertion that at least 90% of new UNE-P orders are for "migrations" of "already working" service (*see* Joint CLEC Br. at 276-77) is complete nonsense. And with respect to both UNE-P and stand-alone UNE loops, SBC Illinois provided actual data conclusively demonstrating that AT&T's assumption (based on nothing more than "Mr. Turner's experience," whatever that might be) that 90% of such orders are "migrations" (*see id.*) is simply wrong. *See* SBC Ill. Br. at 204-05; SBC Ill. Ex. 9.2 (Gomez-McKeon Surrebuttal) at 4.

deny SBC Illinois *any and all* cost recovery for the provisioning work that is required when facilities are not already connected through in the inside or outside plant.

Second, the issue in Virginia arose in a very different context. Verizon Virginia had previously developed a cost model under which many nonrecurring installation costs were included in annual cost factors, and thus recovered through recurring charges. In the arbitration, Verizon proposed to “back out” those costs from its ACFs by subtracting nonrecurring charge revenues from its ACFs, and instead apply them as nonrecurring charges *when actual provisioning was required*. *Virginia Arbitration Order*, ¶¶ 585-588. In other words, the CLEC would not know at the time of its UNE order whether any nonrecurring installation charge (about \$100) would apply, but would only find out later, when it was determined that actual technician dispatch was required. The Bureau, not unreasonably, rejected Verizon’s proposal, because of the “significant likelihood” of double-recovery associated with Verizon’s unique revenue “back-out” proposal, and because the Bureau was uncomfortable with the idea of CLECs not knowing at the time of a UNE order whether there would be a nonrecurring installation charge of zero or \$100, an uncertainty the Bureau felt might constitute a “barrier to entry.” Thus, the Bureau accepted the CLECs’ proposal, which was based on Verizon’s historical method of installation cost recovery, while recognizing that no network could actually be built or operated at 100% DIP and DOP. *Id.*

None of those considerations apply here. SBC Illinois’ cost studies and methodologies are very different than those used by Verizon Virginia. Unlike Verizon, SBC Illinois has not historically included nonrecurring installation costs in its ACFs, and the CLECs have not offered any proposal as to how such a factor could be fashioned and applied to SBC Illinois’ cost studies. Moreover, SBC Illinois does not propose to assess nonrecurring installation charges as an after-

the-fact “surprise,” as Verizon did – the practice the Bureau suggested might constitute a “barrier to entry.” Rather, SBC Illinois’ cost studies apply occurrence probabilities to account for the fact that certain installation activities are not always required, and spread the average costs of installation over all UNE loop and EEL orders. In short, the Virginia decision is simply inapplicable here, and the CLECs’ proposed 100% DIP and DOP, intended to completely deny SBC Illinois recovery of any of its TELRIC-compliant installation costs, should be rejected.

4. Fallout Rates

The Joint CLECs do not make any additional arguments regarding fallout in this section of their briefs. *See* Section IV.B.5 above. Staff did not address this issue in its testimony or briefing. Staff Br. at 173.

5. Disaggregation of Connect and Disconnect Charges

Staff suggests that SBC Illinois should be required to disaggregate connection and disconnection nonrecurring charges because Staff is dissatisfied with SBC Illinois’ assumption of a 2-year average location life for UNEs, which SBC Illinois used to compute the present-day cost of disconnection activities. Staff Br. at 178. That is nonsense. First, even if some longer life should be used (Staff itself suggested 4 years, but does not even attempt to defend that assumption in its brief), then the proper course would be to order the use of a longer life.

Second, SBC Illinois’ 2-year location life is well-supported. In particular, SBC Illinois provided actual data going back to January 2000 showing that the average churn for stand-alone UNE loops and UNE-P was far shorter than 2 years – only 14 to 15 months. *See* SBC Ill. Ex. 3.2 (Silver Surrebuttal) at 2. Staff’s attempts to cast doubt on that data are not well-founded. SBC Illinois tracks data by “outward activity,” and while Staff might purport to not understand “what[] that might be” (Staff Br. at 176), SBC Illinois explained that data. In particular, SBC

Illinois explained that in general “outward activity” includes both “disconnections and changes of address-out,” but in the case of UNE loops and UNE-P, SBC Illinois does not treat change of address activity as a “change of address-out,” meaning “the outward activity that is tracked is synonymous with disconnections.” SBC Ill. Ex. 3.2 (Silver Surrebuttal) at 2. Staff’s suggestion that this disconnection data must be ignored because SBC Illinois did not type the word “disconnections” at the top of the report is frivolous.

Staff’s other gambit is to point to the fact that the SBC Illinois witness supporting the 2-year assumption and SBC Illinois’ disconnection data is not an expert on the work activities underlying SBC Illinois’ cost studies. Staff Br. at 174, 176-77. Then again, neither is Staff’s witness. In any event, estimating the average location life of a UNE (and providing detailed data in support thereof) has nothing to do with being an expert on the actual tasks and activity times required to perform disconnects.

The CLECs also assert that SBC Illinois should be required to separate connection and disconnection charges because, the CLECs assert, “SBC’s proposal inappropriately requires CLECs to pay for work in advance despite the very real possibility that the work will never be performed and, therefore, costs may never be incurred.” Joint CLEC Br. at 248. *See also id.* at 283-85. However, as noted in SBC Illinois’ opening brief (at 207-08), SBC Illinois proposes to continue combining these charges because separating the charges may prevent SBC Illinois from recovering its TELRIC-compliant costs. In particular, a CLEC that disconnects service may no longer have a relationship with SBC Illinois. *See* SBC Ill. Br. at 207-08.

Finally, it should be noted that, if the Commission does require SBC Illinois to separate its connection and disconnection charges, neither Staff nor the Joint CLECs raised any objection in their briefs to SBC Illinois’ proposed implementation of such a requirement, which is

necessary in order to afford SBC Illinois sufficient time to undertake the complex tasks necessary to implement that requirement. *See id.* at 209; SBC Ill. Ex. 3.1 (Silver Rebuttal) at 12-13 & Sch. MDS-R3, -R4, and -R5.

6. Other Issues

AT&T raises three rate design issues with respect to SBC Illinois' provisioning nonrecurring cost studies. None have merit.

First, AT&T proposes that the Commission establish new nonrecurring charges for stand-alone dedicated transport, based on the nonrecurring charges it establishes for the dedicated transport component of EELs. Joint CLEC Br. at 285-87. SBC Illinois fully addressed this issue in its opening brief (at 210-11). In short, SBC Illinois developed separate nonrecurring charges for EELs precisely because the costs of provisioning an EEL are not the same as the sum-of-the-parts of provisioning the various components of an EEL on a stand-alone basis. AT&T would like to pretend, without *any* analysis of the underlying activities or costs, that the same efficiencies are available when provisioning the stand-alone elements. But AT&T's proposal has no basis in fact, and indeed violates the FCC's TELRIC pricing rules.

Second, AT&T asserts that a number of EEL rate elements should be adjusted or replaced with different rate elements already found in SBC Illinois' tariff. AT&T alleges that the EEL combinations that SBC Illinois has priced are too "restrictive," and proposes to replace the EEL rate elements with rate elements from the stand-alone dedicated transport tariff. *See* Joint CLEC Br. at 288-90. But this appears to be another ploy by AT&T to equate EEL nonrecurring charges with the nonrecurring charges for stand-alone elements, notwithstanding the fact that SBC Illinois incurs different costs when providing UNEs on a stand-alone basis and as part of a

combination. Moreover, the combinations that SBC Illinois priced include the combinations identified in the Draft I2A and incorporated by reference in Section 13-801 of the Illinois PUA. In Docket No. 01-0614, the Commission concluded that these are the combinations appropriately included in the EEL tariff, and found that if a CLEC wishes to order some other combination, it could do so via the BFR process or BFR-OC process. *See* SBC Ill. Br. at 190 n.65; SBC Ill. Ex. 3.1 (Silver Rebuttal) at 14-15.

Third, AT&T asserts that SBC Illinois should be required to develop separate rate elements for initial and additional loops, instead of applying a single rate element that uses a weighting of the costs of initial and additional loops. Joint CLEC Br. at 292. However, AT&T fails to provide any compelling reason for such a requirement, especially in light of the difficulties SBC Illinois would encounter to implement such a requirement. *See* SBC Ill. Br. at 210. AT&T notes that the weighted rate element assumes an average of [*** **] loops per order, and asserts that if a CLEC orders more than that number of loops, it will “significantly overpay loop connection costs.” Joint CLEC Br. at 292. What AT&T fails to note, however, is that the converse is true – under SBC Illinois’ weighting, every time a CLEC orders a *single* loop, it will very significantly *underpay* loop connection costs. Moreover, pursuant to industry standards, multiple loops can be placed on a single service order only when the loops all terminate to a single customer premise. *See* SBC Ill. Ex. 3.1 (Silver Rebuttal) at 9-10. Thus, it is reasonable to expect that a large number of CLEC orders will be for single loops.

D. Switch Port and Features Non-recurring Cost Studies

1. Identification of Tasks

The Joint CLECs do not make any additional arguments regarding identification of tasks in this section of their briefs. See Section IV.B.1 above. Staff did not address this issue at all, in its brief or testimony.

2. Activity Times

The Joint CLECs repeat their allegation that SBC Illinois has not taken into account forward-looking, most efficient technologies when determining activity times. Yet again, however, the Joint CLECs do not provide any specifics to support their position. The Commission should not credit the Joint CLECs' unfounded allusions to these phantom technologies. The rest of the CLECs' discussion pertains to specific adjustments proposed by AT&T witness Turner (there is no discussion of any adjustments proposed by Joint CLEC witnesses Ankum and Morrison).

Mr. Turner's primary gripe seems to be that SBC Illinois did not assume that the task times for translations work are identical for all switches, regardless of the manufacturer. Joint CLEC Br. 293-94. AT&T's speculation that in the long run a switch vendor must design its switches to have the same provisioning times as other switches is unfounded, as SBC Illinois explained in its initial brief (at 212-13). Competitive products routinely have varying "provisioning"-like characteristics, and will continue to do so in the future. In short, AT&T's speculation about what switches will look like in the future is simply that, speculation. AT&T's proposed changes should be rejected.

Mr. Turner next proposes an adjustment to the DID Trunk Port UNE to reflect that customers typically order multiple ports in a trunk group. Joint CLEC Br. at 295-96. This is another example where the Joint CLECs have ignored the record. As Mr. Barch testified, SBC

Illinois generally agrees with Mr. Turner's observation and has adjusted its study already. SBC Ill. Ex. 7.1 (Barch Rebuttal) at 72-73.

The Joint CLECs also endorse AT&T witness Turner's proposed adjustment to the time for translation work for DID Trunk Ports. The basis for Turner's adjustment is his contention that SBC Illinois might not have assumed the use of fully trained technicians Joint CLEC Br. at 297-98. The record is clear, however, that SBC Illinois' SMEs were explicitly instructed to assume fully trained technicians. MCI Cross Ex. 43. (It appears that the Joint CLECs are abandoning their position that TELRIC requires one to assume the use of the most efficient technicians, a contention that SBC Illinois rebutted in its Initial Brief. SBC Ill. Br. at 213-214. In so doing, the Joint CLECs seems to be crediting the testimony of their witnesses Ankum and Morrison, who agreed that average technicians should be assumed, and discrediting the testimony of Mr. Turner, who insisted that only the most efficient and experienced technicians should be assumed.)

Mr. Turner also objects to the activity time proposed by SBC Illinois for the Centrex Attendant Console Port. Joint CLEC Br. at 298. As SBC Illinois witness Cunningham explained, Mr. Turner does not understand the difference between a Centrex extension (line) and a Centrex console. SBC Ill. Ex. 18.0 (Cunningham Rebuttal) at 3. While Centrex line provisioning is a core function performed regularly at SBC, consoles are a unique item and require vastly different provisioning methods which take a significant amount of time. *Id.* SBC Illinois witness Barch added that three basic analog port terminations are required for a Centrex Attendant Console Port. SBC Ill. Ex. 7.1 (Barch Rebuttal) at 72. Mr. Turner's proposed adjustment should be rejected.

Finally, Staff did not address this topic.

3. Occurrence Probabilities

The Joint CLECs do not propose any specific adjustments. Joint CLEC Br. at 298-99. Staff did not address this issue in its brief or testimony.

4. Fallout Rates

The Joint CLECs do not make any additional arguments regarding identification of tasks in this section of their briefs. See Section IV.B.5 above. Staff did not address this issue at all, in its brief or testimony.

5. Other (including rate design issues)

Centrex feature activation charges. AT&T asserts that SBC Illinois' Centrex nonrecurring cost studies should be modified because some Centrex port features "can be provisioned electronically," just as they can for basic line ports. Joint CLEC Br. at 300-01. AT&T is wrong. See SBC Ill. Br. at 216. SBC Illinois' network expert, who has many years of switch provisioning experience and who has support responsibilities for all six types of switches currently found in SBC Midwest's network, testified that "Centrex common block features . . . must be provisioned by network translations personnel." SBC Ill. Ex. 18.1 (Cunningham Surrebuttal) at 3. That is because "Centrex common block features . . . are not an inherent part of the line provisioning process in that the datafill changes needed to add the feature *must be performed manually* in the core centrex translations in the switch." SBC Ill. Ex. 18.0 (Cunningham Rebuttal) at 2 (emphasis added).

E. Miscellaneous

1. Special Access to UNE Conversion Non-recurring Cost Study

Staff takes issue with SBC Illinois' "design and coordination" charge for special access to UNE conversions. But Staff's entire argument is a hollow word-game.

As Staff notes, a special access to UNE conversion does not involve any physical provisioning, in the sense that there are no physical disconnection or connection activities involved. Staff Br. at 184. Staff then notes that SBC Illinois "propose[s] to assess a Design & Coordination charge for special access to UNE conversions that are supported by activities performed by its physical provisioning units." Staff Br. at 185. Thus, Staff asserts, SBC Illinois must be "assessing charges for not doing work." *Id.* Staff is wrong.

SBC Illinois explained – *in testimony that Staff does not attempt to dispute* – that in order to "provision" a special access to UNE conversion, SBC Illinois' provisioning work groups must analyze "two separate service orders, one for the disconnect of the existing SA circuit ID and one for the addition of the UNE circuit ID," and "ensure that the information within the system across the two orders is identical," which "allow[s] for error free completion," "allows for a clean cut from one billing system to another and ensures that the inventories in the databases are accurate." SBC Ill. Ex. 9.2 (Gomez-McKeon Surrebuttal) at 2. This work admittedly does not involve physical provisioning work, but Staff does not contest that SBC Illinois must actually undertake these activities. Rather, Staff's objection is that these activities are performed by employees who work in what are otherwise labeled "provisioning" units. That is ludicrous. If it were more efficient for SBC Illinois to hire and train a separate, non-"provisioning" work group to perform these necessary tasks, then presumably SBC Illinois would have done so. The fact that SBC Illinois' provisioning groups can multi-task, and perform tasks that are not strictly physical "provisioning" activities, is no reason to deny SBC Illinois cost recovery.

The CLECs lead off their discussion of the special access to UNE conversion nonrecurring cost study by asserting that “SBC has inappropriately inflated these charges to well over a thousand dollars” because of “the expensive practice of re-tagging.” Joint CLEC Br. at 303. Of course, that is not true. SBC Illinois determined that it would not re-tag converted circuits and has removed all associated costs from the nonrecurring cost study. *See* SBC Ill. Ex. 501 (Currie Rebuttal) at 20-21; SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 35-36. Thus, there is no reason for the Commission to issue what would amount to an advisory opinion to “explicitly reject all costs associated with re-tagging” on the basis of a one-sided record filled with inflammatory accusations about SBC Illinois technicians engaging in “incidental mischief” (Joint CLEC Br. at 304), because there are no such costs in SBC Illinois’ cost study.

AT&T also proposes to adjust a number of the activities and work times for the HPC’s functions in completing special access to UNE conversions. As explained in SBC Illinois’ opening brief (at 218-19), AT&T’s proposal is irrational, and violates TELRIC pricing rules. AT&T first lists all the HPC functions from a *completely unrelated cost study* – that for new DS3 unbundled loops. Joint CLEC Br. at 304-05. Then, AT&T eliminates all the HPC functions that sound like actual provisioning functions, leaving only one – “Corrective Action SOAC/SORD.” *Id.* This single function, AT&T asserts, should be the only one included in the conversion cost study, because the circuits are already working in a conversion (and thus no actual provisioning is required). *Id.* AT&T is wrong. The conversion cost study was developed to identify those tasks and costs specific to conversions, just as the DS3 unbundled loop study was developed to identify those tasks and costs specific to providing unbundled DS3 loops. While the HPC may not undertake some of the provisioning activities listed in the *DS3 loop cost study* when performing conversions, it does undertake the activities listed in the *conversion cost study*.

Finally, AT&T proposes that the “fall-out” for the SSC’s functions in performing special access to UNE conversions be reduced from 100% (a completely manual process) to [***** **]. Joint CLEC Br. at 306. But AT&T has provided *no* evidence to explain how these functions could be performed electronically at all, much less the vast majority of the time. SBC Illinois explained that the conversion process requires SBC Illinois to “remove the SA information from all billing systems and modify the inventory system.” SBC Ill. Ex. 9.1 (Gomez-McKeon Rebuttal) at 36. Moreover, “[t]he changes are not completed electronically,” and SBC Illinois’ expert was “not aware of any system available today that would cost-effectively handle this function [electronically].” *Id.* And the CLECs have not identified any such system either. Finally, even if it were possible to design and implement electronic systems to handle these functions automatically, it is highly doubtful that doing so would be efficient or cost-effective, given that of all DS1 and DS3 UNE service orders in 2003, SBC Illinois processed a mere [*****] special access to UNE conversion orders. *Id.* at 36-37.

2. ULS Billing Establishment

Neither Staff nor the CLECs take issue with SBC Illinois’ ULS Billing Establishment cost study (except to flow-through proposed labor and inflation rate adjustments, which should be rejected for the reasons discussed below). *See* Joint CLEC Br. at 306-07. Thus, the Commission should approve that cost study as filed.

F. Labor Rates

SBC Illinois demonstrated in its Initial Brief that there was no basis for the Joint CLECs’ labor rate adjustment. SBC Ill. Br. at 219-24. Nowhere did the Joint CLECs demonstrate that the Bureau of Labor Statistics data on which they based their analysis was an appropriate

benchmark for large, unionized companies like SBC Illinois. Although SBC Illinois addressed this issue primarily in the context of the proposed adjustment to benefits loadings, these deficiencies are equally applicable to the other labor rate components where Mr. Flappan made adjustments, such as paid absences, clerical support, and supervisory support. Joint CLEC Br. at 314, 316-18, 325-27.

The Joint CLECs argue that the Hewitt analysis of benefits costs presented in Mr. Flappan's surrebuttal testimony supports his benefits adjustment. Joint CLEC Br. at 330-31. They are incorrect. Mr. Flappan contends that benefits costs should be capped at what SBC Illinois pays managers hired after August of 1997, when there was a change in the Company's benefits policy relative to post-retirement health care. What he ignores, however, is that SBC Illinois' employee base will continue to be a mix of managers hired before and after August of 1997 for the foreseeable future. Thus, this is the relevant cost basis for developing labor rates used in TELRIC studies. Even more damning, the Hewitt study presented by Mr. Flappan demonstrated that the 20 comparator companies – all but one of which operate in fully competitive markets – offer post-retirement health care benefits and do so at a *higher level* than SBC Illinois for its pre-August 1997 hires. AT&T Ex. 4.2 (Flappan Surrebuttal), Attachment RPF-20; Tr. 1897-98 (Flappan). Thus, there is no basis for the Joint CLECs' argument that offering post-retirement health care benefits is somehow out of sync with the practices of competitive companies and the competitive marketplace or that the costs SBC Illinois will incur relative to its entire base of employees should be ignored.

The Joint CLECs claim that the benefits costs *in* SBC Illinois' TELRIC cost studies are somehow higher than what SBC Illinois actually incurs in the real world. Joint CLEC Br. at 330-31. This is incorrect. SBC Illinois develops the benefits components in its labor rates by

starting with a wage or salary rate per productive hours and applies a benefits loading factor developed through a separate analysis. SBC Ill. Ex. 7.0 (Barch Direct) at 56-57, Sch. DJB-3 at 1. Rather than basing his analysis on the data used to develop the benefits factor in the first place, Mr. Flappan used an indirect, Rube Goldberg methodology of his own to convert data in SBC Illinois' labor rate development sheets into an annual, per employee dollar amount. AT&T Ex. 4.2 (Flappan Surrebuttal) at 3, n. 4. Unfortunately for Mr. Flappan, the results of his calculations bear no resemblance to the benefits costs actually in SBC Illinois' cost studies. Data in the worksheets used to develop SBC Illinois' benefits loading factor can be readily converted into annual, per employee benefits costs. SBC Ill. Flappan Cross Exs. 55P, 56P. These are the costs that are *in* SBC Illinois' labor rates. When *these* costs are compared to the results of the Hewitt study presented by Mr. Flappan, his argument falls apart. In fact, the total benefits costs *in* SBC Illinois' TELRIC studies are *substantially* lower than those calculated by Mr. Flappan, are comparable to or lower than SBC's costs as reported in the Hewitt study and are comparable to or lower than the costs for the 20 comparator companies. SBC Ill. Ex. Flappan Cross Ex. 57P. In other words, the Joint CLECs' recommendations rest on faulty data and should be disregarded.

V. Shared and Common Factors

A. Issues Common to Shared and Common Factors Development

1. Use of New Methodology Generally

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 225-26.

2. Use of Regulated and Unregulated Data

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 226-27.

3. Consistency of Numerators and Denominators

The Joint CLECs continue to recommend a shared and common factor that demonstrably will not allow SBC Illinois to recover a reasonable level of shared and common costs from purchasers of UNEs. Joint CLEC Br. at 350-58. Although they attempt to cloak their proposal in terms of maintaining “consistency” between the numerator and denominator, in fact, it is a transparent attempt to understate shared and common costs attributable to UNEs and it should be rejected.

The Joint CLECs claim that SBC Illinois’ common cost (i.e., the costs in the numerator) should be based on forward-looking, efficient technologies and practices. *Id.* at 352. However, these are *common overhead functions*, not network operations. SBC Illinois is at a loss to understand what “technologies and practices” are going to dramatically change the costs associated with its senior executives or shareholder relations activities or human resources department, for example. The Joint CLECs never provided even a single example of such “forward-looking” technologies. As explained in SBC Illinois’ Initial Brief, historical expense levels do provide the best available benchmark for determining SBC Illinois’ shared and common costs on a going-forward basis. SBC Ill. Br. at 227-28.

Contrary to their claim, the Joint CLECs’ approach of using embedded costs in the denominator is *not* equally valid as compared to using forward-looking costs. Joint CLEC Br. at 355. The issue is whether the ratio, when applied to UNE costs that have been developed on a TELRIC basis, will produce the right amount of shared and common cost recovery. Proper cost recovery is a mathematical impossibility if the ratio is developed based on embedded costs and is then applied to a TELRIC cost. In other words, the net effect of the Joint CLECs’ approach is to reduce SBC Illinois’ common and shared cost recovery by the difference between SBC Illinois’

embedded costs and its forward-looking TELRIC costs. This is demonstrated by the following example:

Suppose that the shared and common costs of a firm are \$40. Additionally, assume that the booked direct costs (based on direct investment) are \$200. The shared and common factor in this very rough instance would be 20 percent (i.e., $\$40 / \$200 = 0.20$). Now, suppose the firm identified the forward-looking TELRIC investment and, subsequently, direct costs, to be \$100. If the 20 percent factor based on \$200 of booked costs were applied to the TELRIC cost of \$100, it would result in a shared and common cost recovery of only \$20, instead of \$40. This is clearly too low. SBC Ill. Ex. 7.0 (Barch Direct) at 16.

This is precisely the sleight-of-hand that the Joint CLECs are attempting to pull off in this proceeding and it should not be countenanced.

The Joint CLECs bootstrap their proposal by referring to the decision of the Indiana Commission and a report by the Staff of the Michigan Commission. Joint CLEC Br. at 356-57. The Indiana Commission obviously erred on this issue, and its error should not be imported to Illinois. The Michigan Staff's comments are of no consequence whatsoever. The Michigan UNE proceeding is still in progress and the Michigan Public Service Commission has yet to rule on any of these issues.

4. Productivity and Efficiency

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 228.

B. Common Cost Factor

1. Development of the Denominators

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 228-29.

2. The 67XX Accounts (Including Retail Cost Adjustment)

SBC Illinois addressed at length in its Initial Brief why the 67XX Accounts are properly treated as common costs. SBC Ill. Br. at 229-32. The Joint CLECs' discussion of this issue is misleading in several respects. *First*, their view of common costs is unduly narrow. For a function to be considered common in nature, it is not necessary that it relate "solely" to the total output of the firm as they claim. Joint CLEC Br. at 364. It may also be that the personnel involved in performing this function one day touch on wholesale issues and the next touch on retail issues, and, thus, their associated costs are also attributable to the business as a whole. SBC Ill. Ex. 7.1 (Barch Rebuttal) at 19. *Second*, to the extent that these personnel do touch both retail and wholesale activities, the retail portion is *not* being recovered through UNEs. Joint CLEC Br. at 364. Common costs are *allocated* between retail and wholesale services based on the total direct costs of the business in the denominator of the factor. Since retail-related direct costs account for a very substantial portion of that denominator, retail services receive an appropriate allocation of every 67XX account that the CLECs complain about. SBC Ill. Ex. 7.1 (Barch Rebuttal) at 22. *Third*, the Joint CLECs' persistence in claiming that SBC Illinois is somehow trying to "foist" the costs of its efforts to enact Senate Bill 885 onto wholesale customers exceeds the bounds of reasonable advocacy. Joint CLEC Br. at 365. As SBC Illinois explained, and as the Joint CLECs acknowledge, SBC Illinois' legislative efforts in 2003 *are not included in the common cost factor in this proceeding*. SBC Ill. Ex. 7.2 (Barch Surrebuttal) at 6-7; Joint CLEC Br. at 365. The legislative activity which occurred during the period covered by SBC Illinois' common cost study involved enactment of Section 13-801, which the CLECs *supported*.⁴⁷ SBC Ill. Ex. 7.2 (Barch Surrebuttal) at 6.

⁴⁷ SBC Illinois fundamentally disagrees with the Joint CLECs' view that legislative activities that they do not support are not legitimate costs. However, that is an issue for another day and another TELRIC proceeding.

Accordingly, the adjustment proposed by the Joint CLECs should be rejected by the Commission.

3. Transition Benefit Obligation

Staff and the Joint CLECs argue that the annual amortization of the Transition Benefit Obligation (“TBO”) is an expense that was “incurred” in the past and, therefore, should not be included in UNE rates. In support of this argument, Staff and the Joint CLECs assert that the TBO represents an obligation to pay for post-retirement benefits that arose in connection with service rendered by employees prior to 1992, when SBC Illinois changed its method of accounting for non-pension post-retirements from cash (or “pay-as-you-go”) to accrual accounting in accordance with SFAS 106 .

Staff and the Joint CLECs miss the point. The accounting rules dictate when post-retirement benefits should be considered to have been “incurred.” For example, prior to 1992, post-retirement benefits were incurred and recognized as an expense when benefits were actually paid to retirees. If that accounting convention were still in effect, there would be no debate about the need to recognize the post-retirement benefits currently being paid out to retirees as common costs properly reflected in the development of UNE rates, even though the services to which the benefits related had been rendered by the retirees in the past, when they were employees.

Contrary to the Staff and Joint CLEC assertions, the TBO expense that SBC Illinois has included in its calculation of common costs is not an expense incurred in the past; it is an expense that SBC Illinois currently incurs and will continue to incur in the future. The TBO represents the amounts of post-retirement obligations that the Company would have accrued on its books prior to the effective date of SFAS 106 if the accrual method had been in effect. Because those amounts had not yet been paid out as benefits when SFAS became effective, they

were not, contrary to the Staff and Joint CLECs' arguments, "incurred" as expenses prior to 1992, when the pay-as-you-go accounting rule was in effect. Rather, accounting rules authorized by SFAS 106, and mandated by the FCC in RAO 20, required that TBO be amortized and recognized (i.e., "incurred") as an expense over an 18 year amortization period for regulatory accounting purposes. SBC Ill. Br. at 232-33.

In accordance with SFAS 106 and the FCC's requirements, each year SBC Illinois records a liability and corresponding expense equal to one-eighteenth of the previously unrecognized TBO obligation. SBC Ill. 17.0 (Dominak Rebuttal) at 8. SBC Illinois will continue to do so for the remainder of the 18-year amortization period, which expires in 2008. *Id.* at 9. Because the TBO expense will continue to be incurred each year through 2008, the expense is forward-looking and should be recognized in setting UNE rates. SBC Ill. Br. at 233-34.

The Joint CLECs also argue that the TBO expense is a "non-economic cost with no cash-flow implications." Joint CLEC Br. at 373. This argument is unsupported. TBO represents a continuing obligation that is owed to employees today. The employee benefit amounts represented by the TBO will have to be paid out as cash to relieve the post-retirement liability in the future. Accordingly, TBO is a forward-looking expense with "cash-flow implications" and should be recognized as such in setting UNE rates. Failure to do so will cause benefit costs incurred by SBC Illinois to go unrecognized (i.e., unrecovered), in violation of the FCC's required adoption of SFAS 106. SBC Ill Ex. 17.1 (Dominak Surrebuttal) at 7.

4. Pension Settlement Gains

In support of their position that pension settlement gains are a normally recurring event for which an adjustment should be made to the common cost numerator, the Joint CLECs assert that pension settlement gains are "accrued" whenever SBC Illinois' "actual pension costs are less than anticipated due to actual expenses that are lower than actuarial estimates and/or the result of

better than anticipated returns on its pension investments.” Joint CLECs Br. at 373. This assertion is incorrect and reflects a misunderstanding of pension accounting rules. In fact, differences between anticipated costs and what actually occurs are maintained as a side record in an Unrecognized Gain or Loss account for pension accounting and ordinarily are *not* recorded on an accelerated basis as pension settlement gains or losses. Rather, they are amortized, typically over the average service life of the covered employees. This allows a company to minimize fluctuations in pension expense that can be caused by such events as sudden and large changes in the market value of plan assets or changes in actuarial assumptions SBC Ill. Ex. 17.0 (Dominak Rebuttal) at 12.

A company is required to accelerate recognition of deferred pension losses or gains and immediately recognize those losses or gains as “pension settlement” gains or losses, *only* when certain triggering events occur. For example, a pension settlement can occur when the employer settles a pension obligation through lump-sum cash payments in exchange for the liability (the right to receive specified pension benefits in the future). When the amount of these lump-sum cash pension payments made by a pension plan in a given year exceeds a given threshold (established by the FASB), that triggers a requirement that the company accelerate the unamortized balance of any transition assets and immediately recognize its net gain or loss in its earnings. Such an occurrence is not directly related to the operation of the pension plan and is not in the ordinary course of business. SBC Ill. Ex. 17.0 (Dominak Rebuttal) at 12-13.

The large pension settlement gains experienced in the years 1999 through 2001, which the Joint CLECs point to as support for their adjustment, occurred because a large enough number of SBC Illinois employees left and elected to receive lump-sum pension payouts so that the FASB’s triggering threshold was met. The gains experienced in those years were caused by

an abnormal set of events that is unlikely to recur in the future. *First*, during 1998 and 1999, many people left the business as a result of a number of factors, such as: the uncertainties of their job, the potential elimination of duplicate job functions, an aged work force of retirement eligible personnel, a robust economy and job market, and the potential negative impact of federal law changes on interest rate/mortality assumptions attributable to lump sum pension calculations. The lump-sum pension payments attributable to these events caused the recognition of the 1999 settlement gains. *Second*, in September of 2000, the Company introduced an Enhanced Pension and Retirement program (EPR). This was a one-time, voluntary offer that provided pension and benefit enhancements to eligible management employees in order to further streamline the organization. This event caused the accelerated recognition of the 2000 and 2001 settlement gains as a large amount of lump sum cash pensions were paid. SBC Ill. Ex. 17.0 (Dominak Rebuttal) at 13-14.

As discussed in SBC Illinois' Initial Brief, and as recognized by Staff, it is highly unlikely that SBC Illinois will experience anything like the set of conditions described above in the foreseeable future. SBC Ill. Br. at 237; Staff Br. at 205. Additionally, reduced market returns have negated much of the favorable returns of the 1990s, thereby further reducing the likelihood of realizing settlement gains. In fact, SBC Illinois experienced no pension settlement gains in 2002 and 2003. Based upon the lower market returns of recent years, if events similar to those which triggered the pension settlement gains in 2001 had occurred in 2003, SBC Illinois would have recognized significant pension settlement losses. SBC Ill. 17.0 (Dominak Rebuttal) at 16-17. Accordingly, the Joint CLECs' proposed adjustment, which is heavily weighted by the extraordinary level of pension settlement gains experienced during the 1999-2001 period, is not

representative of forward-looking costs.⁴⁸ For these and other reasons discussed in SBC Illinois Initial Brief, the Joint CLECs' proposed adjustment should be rejected. SBC Ill. Br. at 236-38.

5. Merger Savings

SBC Illinois demonstrated in its Initial Brief that the Joint CLECs will receive more than their fair share of merger savings under the approach used to develop SBC Illinois' common cost factor. SBC Ill. Br. at 238-41. The contrary arguments made by the Joint CLECs in their brief are not supported by the record evidence they themselves supplied. For example, the Joint CLECs claim that use of 2001 data to establish the common cost factor does not reflect enough merger savings because over “. . .80% of all merger-related savings would not be captured until the 2002-2004 time frame. . .” Joint CLEC Br. at 376-77. The table that the Joint CLECs supplied in Starkey/Fischer's direct testimony says otherwise: that is, based on the data in their *own* testimony, the level of merger savings experienced in 2001 (the time period of the common cost study) is over 60% of the total level of merger savings expected over the long run (the “run rate” for merger savings is expected to plateau in 2004 and remain constant thereafter).

AT&T/Joint CLEC Ex. 1.0 (Starkey/Fischer Direct) at 62.⁴⁹ Therefore, the Joint CLECs' statement that SBC Illinois' merger savings run rate in 2001 “. . .fails to capture more than 80% of its total merger savings. . .” is flat-out wrong. Joint CLEC Br. at 377. In view of the fact that

⁴⁸ The adjustment proposed by the Joint CLECs is [*** *****] based on the average annual amount of pension settlement gains for the period from 1987 through 2002. The average annual pension settlement gain reflected in the calculation of that amount for all of the years excluding 1991-2001 was only [*** *****]. AT&T/Joint CLEC Ex. 1.0 (Starkey/Fischer Direct), Attachment MS/WF-4. Accordingly, the Joint CLEC's proposed adjustment clearly is distorted by inclusion of the extraordinarily high amount of gains triggered in the 1999-2001 time period. Moreover, no pension settlement gains were recorded in six of those years, including 2002. *Id.* at 56. As discussed above, no gains were recorded in 2003.

⁴⁹ The Joint CLECs may be misinterpreting their own chart. The amount of merger savings shown for each year is not incremental to the previous year. Rather, each year includes the savings incurred the previous year and adds the new savings achieved in that year. For example, the [*****] merger savings level shown for 2002 consists of the [*****] in savings achieved in 2001 and [*****] in new savings achieved in 2002. Starkey/Fischer understood this because their adjustment addresses only the *incremental difference* between the 2001 level of savings and the average expected savings over 2002-2004. AT&T/Joint CLEC Ex. 1.0 (Starkey/Fischer Direct) at 63.

the CLECs are only entitled to 50% of the merger savings achieved by SBC Illinois under this Commission's *Merger Order*, SBC Illinois' common cost factor – which flows 60% of ultimate savings through to them – is already overly generous and should not be adjusted further.

6. Employee Levels

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 241-42

7. Agreed Upon Issues

These issues were fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 242.

C. Shared Cost Factor

1. Definition of Wholesale Shared Costs

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 242.

2. Uncollectible Expense

SBC Illinois demonstrated in its Initial Brief that its approach to recovering uncollectible expense is reasonable and that the alternative proposals of the CLECs and Staff should be rejected. SBC Ill. Br. at 244-46.

The Joint CLECs suggest that SBC Illinois' identification of its wholesale uncollectible expense is somehow suspect, because the Company did not explain how it had made that determination. Joint CLEC Br. at 381-82. Apparently, they did not read SBC Illinois' rebuttal testimony. Mr. Dominak explained that wholesale revenues are billed through a different billing system than retail revenues and, therefore, that outstanding wholesale receivables are separately identifiable and the uncollectible reserve can be maintained on a wholesale-specific basis. SBC Ill. Ex. 17.0 (Dominak Rebuttal) at 21. This system, however, does not permit a further breakdown by wholesale product categories (e.g., UNEs vs. all other wholesale products).

The Joint CLECs contend that UNEs should not be assigned a proportional share of wholesale uncollectible expenses because they bear “little similarity” to other wholesale services like switched and special access. Joint CLEC Br. at 382. This assertion is supported by no evidence. If anything, the CLECs should be assigned more than a proportional share of uncollectible expense because it was the CLECs – not the long distance companies purchasing switched and special access – that were involved in the bulk of the bankruptcies in 2001 and, thus, caused the wholesale uncollectible expenses. SBC Ill. Ex. 17.0 (Dominak Rebuttal) at 22.

The Joint CLECs also recommend a significant adjustment to SBC Illinois’ uncollectible expenses on the assumption that a significant portion of this amount will eventually be recovered. Joint CLEC Br. at 384-85. This is incorrect as an accounting matter. The uncollectible expenses shown in Account 5301 are already *net* values: i.e., they represent gross bad debt expense *less* expected recovery and further reducing these balances would double count any expected recoveries. SBC Ill. Ex. 17.0 (Dominak Rebuttal) at 23. There is also no reason to believe that SBC Illinois will recover any significant portion of these expenses, because these companies have failed or are approaching failure. The analysis that Starkey/Fischer performed of Accounts 5301 and 1181 (write-offs) is not meaningful because write-offs always lag the recognition of uncollectible expense as bankruptcies wend their way through the judicial system; as a result, the difference between uncollectible expense and write-offs in any given year simply represent bad debt expense that will be written off in future years – not amounts that will be collected, as the CLECs contend. *Id.* at 24-26.

3. Wholesale Marketing Expense

SBC Illinois demonstrated in its Initial Brief that wholesale marketing expense should be included in the shared cost factor. SBC Ill. Br. at 246-48. Even the Joint CLECs – who, like

Mikey in the old Life cereal commercial, generally oppose everything – agree that most wholesale marketing costs should appropriately be included in a shared cost factor. Joint CLEC Br. at 387-88.

Staff's position on this issue is the outlier and SBC Illinois is at a loss to understand it. Staff Br. at 210-12. Staff initially took the position that no wholesale marketing expense should be included because it was all promotional in nature. However, Mr. Smith testified in his rebuttal testimony that marketing costs incurred to provide CLECs with information and assistance and to enter into interconnection agreements were appropriately included. Staff Ex. 29.0 (Smith Rebuttal) at 13. In response to his request that SBC Illinois provide more information about costs in these accounts that can be considered "promotional" in nature, Mr. Dominak examined them and concluded that "nearly all" of the costs booked to accounts that are rolled up to Account 6610 are associated with non-promotional activities and that the costs associated with promotional activities (i.e., trade shows, logo usage and media relations) were *de minimis*. SBC Ill. Ex. 17.1 (Dominak Surrebuttal) at 18-19. In Staff's Initial Brief, Staff complains that SBC Illinois did not quantify "nearly all," and, therefore, recommends that *no* wholesale marketing costs be included in the factor. Staff Br. at 211-12.

Staff is not being reasonable. "Nearly all" is "nearly all." "*De minimis*" is "*de minimis*." It is arbitrary to throw out *all* wholesale marketing expense – including expenses that Staff agrees should be included – because SBC Illinois was not able to precisely quantify the very small amount of costs associated with "promoting" UNEs. And it is not clear that even trade shows or logo usage or media relations are truly "promotional." For example, personnel at an SBC Illinois booth at a CLEC trade show may well spend most, or all, of their time responding to questions from CLECs that have not yet entered Illinois, which would be more accurately

classified as “informational.” Based on the record evidence, the Commission should approve a shared cost factor that includes wholesale marketing expense. At a minimum, SBC Illinois and the Joint CLECs agree that Accounts 6611 (Product Management) and 6612 (Product Sales) are properly included. Staff’s contrary position should be rejected.⁵⁰

SBC Illinois, however, does not agree with the Joint CLECs’ proposal to apportion these marketing costs between UNEs and other wholesale products based on revenues. Joint CLEC Br. at 387-88. As demonstrated in SBC Illinois’ Initial Brief, the Joint CLECs are in denial if they believe that UNE customers receive a lower level of sales and service support than the long distance carriers per dollar of direct cost. The interrelationships between SBC Illinois and the CLECs are extremely resource-intensive and the product management function is complex, given the constantly changing legal and regulatory landscape.⁵¹ If SBC Illinois had the ability to track marketing costs to specific wholesale customer groups, the bulk of wholesale marketing expense would likely be assigned to the *CLECs*. SBC Ill. Br. at 243-44. As a result, the CLECs will arguably pay too little under SBC Illinois’ cost-based denominator as it is, and there is absolutely no policy reason to further skew the allocation away from the CLECs by using a revenue-based allocator.

4. Calculation of Wholesale Shared Cost Denominator

SBC Illinois demonstrated in its Initial Brief that the shared cost denominator should be based on forward-looking costs. SBC Ill. Br. at 248-49. Although Staff objects to the *methodology* used by SBC Illinois to develop its denominator, Staff agrees that forward-looking

⁵⁰ The Joint CLECs oppose inclusion of Account 6613 (Advertising), which is by far the smallest of the three marketing accounts. Joint CLEC Br. at 388; SBC Ill. Ex. 7.1 (Barch Rebuttal) at 38.

⁵¹ The Joint CLECs also make the bizarre comment that UNE customers do not receive the same sales and service support as *retail* customers. This is highly unlikely on a per-customer, per dollar of direct cost basis. Moreover, it is beside the point, since the marketing expense at issue is *wholesale only*.

costs is the right approach from a *conceptual* point of view. Staff Br. at 216. Staff’s position was the subject of considerable cross-examination, where Staff witness Chang clarified her recommendation. If the Commission concludes that there are costs that should be recovered through a shared cost factor – e.g., wholesale marketing expense or uncollectible expense – Staff recommended use of an “extended TELRIC” approach, similar to what the Commission ordered in the 1998 TELRIC proceeding, to develop the denominator. Tr. 1968 (Chang). This was a departure from Staff’s pre-filed testimony. Based on Staff’s statements in cross-examination, SBC Illinois indicated in its Initial Brief that, if the Commission agrees, SBC Illinois will work with Staff on implementation processes. SBC Ill. Br. at 249.

Given this history, Staff’s statements on the subject of the shared cost denominator in its Initial Brief are somewhat puzzling. For example, Staff reiterates the position Ms. Chang took in pre-filed testimony that, if wholesale marketing costs are to be allocated to UNEs, “. . .it is more appropriate to add those to common costs given the lack of evidence of cost causation relationship [sic].” Staff Br. at 216. This is precisely the recommendation that Ms. Chang *disavowed* in cross-examination:

Ms. Sunderland: So your alternative proposal, because you don’t like how SBC calculated the shared cost denominator is to instead put – if we have a numerator for shared costs, to put that into the common cost factor; is that your position?

Ms. Chang: *No.* My position is that if part of shared cost is evident and supported that they are shared costs for UNEs, then true, we should have a wholesale direct cost in the numerator for the shared cost factor.

Ms. Sunderland: In the numerator or the denominator?

Ms. Chang: Denominator.

Tr. 1967 (Chang) (emphasis added). She subsequently elaborated on what she meant by a “wholesale direct cost” (i.e., that it would be “extended TELRICs”). Tr. 1968 (Chang).

Therefore, the statement in Staff’s brief that wholesale marketing costs should be assigned to the common cost factor does not represent Staff’s final recommendation and should be disregarded.

The Joint CLECs contend that wholesale shared costs should be recovered using a denominator based on 2001 UNE revenue. Joint CLEC Br. at 389. Use of a revenue-based denominator will overallocate wholesale shared costs to non-UNE products and services for all of the reasons stated previously and should not be adopted.

VI. Annual Cost and Other Factors

A. Annual Cost Factors

1. Adjustments to Maintenance and Other Expense Factors

SBC Illinois demonstrated that its maintenance factor is appropriate in its Initial Brief. SBC Ill. Br. at 249-51. Contrary to the Joint CLECs’ contention in their Initial Brief, maintenance expense does *not* increase as fill factors increase; as SBC Illinois explained at length in its rebuttal testimony, the maintenance factor simply holds maintenance expense constant. Joint CLEC Br. at 391-95.⁵² Staff appears to have been confused by this issue as well, since Staff challenges SBC Illinois’ contention that maintenance expense increases as fill factors increase. Staff Br. at 218-19. Although SBC Illinois believes that to be true as an engineering matter, it is not relevant to the maintenance expense factor and Staff’s objection is unfounded.

The Joint CLECs continue to complain about SBC Illinois’ adjustment that removed non-recurring expenses associated with customer-generated service order activity. Joint CLEC Br. at

⁵² SBC Illinois is surprised to see the Joint CLECs beating this dead horse again. Starkey/Fischer acknowledged in their rebuttal testimony that they had misunderstood the nature of the adjustment. AT&T/Joint CLEC Ex. 1.1 (Starkey/Fischer Rebuttal) at 54-55.

395-96. They contend that the data SBC Illinois relied on to make this adjustment is too old (*i.e.*, it is 1998 instead of 2001 vintage data) and is not Illinois-specific (*i.e.*, it is from a SWBT state analysis). *Id.* They propose use of their own adjustment, based on changes in service order-related activity in Illinois between 1999 and 2001.

The Joint CLECs are ignoring SBC Illinois' rebuttal testimony. As SBC Illinois explained, the SWBT analysis was used because, at the time SBC Illinois' UNE studies were prepared, data specific to the SBC Midwest states was not available. SBC Ill. Ex. 7.1 (Barch Rebuttal) at 47-48. However, subsequent to the original filing, such an analysis was performed and it was provided to the Joint CLECs in discovery. Based on the new study, an adjustment based on Illinois-specific data would be virtually *identical* the adjustment based on the older vintage SWBT data. *Id.* Therefore, there is absolutely no basis for the Joint CLECs' continued insistence that their adjustment be made.

2. Ad Valorem Factor

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 251.

3. Capital Cost Factor

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 251.

B. Investment Factors

SBC Illinois fully addressed the issue of collocated space in its Initial Brief. SBC Ill. Br. at 251-52.

The Joint CLECs contend that SBC Illinois double-counted MDF investment by including it in both the loop studies as a direct investment input and also in the development of the Power and Common cost factor. Joint CLEC Br. at 40-02. Once again, they are ignoring

SBC Illinois' rebuttal testimony. SBC Illinois removed the MDF investment from the Power and Common cost factor at that time and flowed the effect through to revised factors. SBC Ill. Ex. 7.1 (Barch Rebuttal) at 76.

The Joint CLECs again object to the fact that both regulated and non-regulated investment was included in the development of SBC Illinois' investment factor. Joint CLEC Br. at 402. The use of total company data in developing factors was addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 226-27.

C. Support Asset Factors

SBC Illinois fully addressed the appropriate treatment of support asset costs in its Initial Brief. SBC Ill. Br. at 252-54.

The Joint CLECs point out that certain data entry errors were made in developing the factors and should be corrected. Joint CLEC Br. at 405. This is also no longer an issue. SBC Illinois made all of the data corrections in the rebuttal round of testimony and flowed the effects through to the revised factors. SBC Ill. Ex. 7.1 (Barch Rebuttal) at 76.

The Joint CLECs contend that their cost of capital and depreciation recommendations should be used to develop the capital cost factors in the support asset studies. Joint CLEC Br. at 405. SBC Illinois disagrees. The cost of capital and depreciation recommendations of SBC Illinois' witnesses should be used in developing these factors, for the reasons stated previously in connection with those input factors generally.

Finally, the CLECs contend that regulated data, rather than total company data, should be used to develop the support asset factors. Joint CLEC Br. at 406. This is the same issue that has been addressed previously.

D. Inflation/Deflation Factors

The use of CPIW and PPI as measures of inflation was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 254-55. The Joint CLECs include the issue of whether applying an inflation factor to investment double-counts the impact of inflation in this section of their brief. SBC Illinois addressed the same issue under "Capital Cost Factor" in its Initial Brief. SBC Ill. Br. at 251.

E. Productivity Offset

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 255-57.

F. Depreciation and Net Salvage

This issue was fully addressed in SBC Illinois' Initial Brief. SBC Ill. Br. at 258.

VII. Imputation and Price Squeeze

Staff, the Joint CLECs, the Attorney General and CUB predict dire consequences for SBC Illinois' retail rates if the Commission approves increases in SBC Illinois' UNE loop rates because of imputation requirements imposed by Section 13-505.1 of the Act. Staff Br. at 220-28; Joint CLECs Br. at 411-23; AG Br. at 28; CUB Br. at 26-30. This "crisis" has been largely manufactured by the parties and it is by no means a necessary result of the rate changes proposed in this proceeding. As SBC Illinois demonstrated in its Initial Brief, the Commission has flexibility in determining how to apply Section 13-505.1 and adoption of a reasonable imputation policy would not require any retail rate changes. SBC Ill. Br. at 259-66. Nevertheless, the parties continue to *insist* on a form of imputation that would require broad scale restructuring of SBC Illinois' business rates. Their positions make no policy sense. To the extent that they constitute a veiled attempt to scuttle the UNE loop rate changes proposed by SBC Illinois by way of back door threats of retail rate changes, they are improper. As SBC Illinois has stated previously, UNE loop rates *must* be set at levels that are in compliance with federal law and

attempts to reverse engineer those rates based on state law concerns are patently unlawful.

Wisconsin Bell, Inc. v. Bie, 340 F.3d 441 (7th Cir. 2003).⁵³

As SBC Illinois explained in its Initial Brief, Section 13-505.1 of the Act does not require the imputation of UNE loop rates to business retail services at all and most certainly does not require the imputation of UNE loop rates to business network access lines on a stand-alone basis. SBC Ill. Br. at 259-62. Nothing in Staff's legal analysis changes this conclusion. SBC Illinois is not contesting the fact that it provides competitive and noncompetitive services (thus making it subject to Section 13-505.1) or that its retail business services are classified as "competitive" under Section 13-502 of the Act. Staff Br. at 220; Joint CLEC Br. at 416. Rather, the two issues in dispute are: (1) whether UNEs are "services" or "service elements" which must be imputed to a competitive service at all and (2) whether the "competitive service" should be viewed as business network access lines on a stand-alone basis or whether the "service" should include the other products that necessarily accompany a business network line (e.g., vertical services and usage).

Staff and the Joint CLECs contend that UNE loops "... are properly classified as service elements." Staff Br. at 222; Joint CLEC Br. at 416. They ignore the fact, however, that UNEs are not "services" to begin with. Staff relies on the definition of a "telecommunications service" in Section 13-203 of the Act, which includes "access and interconnection arrangements and services," to support its position. Staff Br. at 223. However, nothing in Section 13-203 indicates that this language was directed at UNEs.⁵⁴ The language "access and interconnection arrangements" was added in 1997 (P.A. 185, eff. July 23, 1997). Since then, the Illinois General

⁵³ Since the Attorney General's and CUB's position are essentially identical to Staff's and the Joint CLECs', they will not be discussed separately.

⁵⁴ For example, the terms "access and interconnection arrangements" would clearly include the switched and special access services which SBC Illinois offers to long distance companies.

Assembly enacted Section 13-216 of the Act which separately defines “network elements” as “facilities,” *not* “services.” Moreover, the Illinois Appellate Court has since ruled definitively that UNEs are *not* services. *Globalcom, Inc. v. Ill. Comm. Comm.*, Nos. 1-02-3605, 1-03-0068 Consol., Slip. Op. at 20-21 (1st Dist. 2004). Therefore, UNEs do not and cannot fall within the ambit of Section 13-203.

If UNEs are not “services,” they logically cannot be “service elements” either.

The term “service element” is not defined in the Act. However, Section 13-505.1 was enacted in 1992, a time when even the *concept* of UNEs had not been developed yet. Staff cites to the principle of statutory construction that words should be accorded their “ordinary and properly understood meanings.” SBC Illinois is at a loss to imagine what the ordinary and properly understood meaning of “service element” is. It is a term of art that is unique to the telecommunications industry generally and to Section 13-505.1 in particular, since it appears nowhere else in the Public Utilities Act. Moreover, it is an equally fundamental principle of statutory construction that the words of a statute should be taken in the sense they were understood when the statute was enacted. Here, the Illinois General Assembly could not possibly have intended to include UNEs in the term “service element” because they did not exist. To the contrary, the only reasonable interpretation of the term “service element” is that it is equivalent to a *rate element* within a service – since rate elements *did* exist in 1992. Their separate identification would allow the subject carrier to selectively impute only certain rate elements when not all rate elements must be used by a competitor. Therefore, Staff’s statutory arguments are unpersuasive and should be rejected.

Even if the Commission concludes that UNEs should be viewed as “service elements” – which it should not – that does not answer the question of what *form* of imputation is required.

Staff proceeds directly from its conclusion that UNE loops are a “service element” to the assertion that the imputation test must compare the costs of those UNEs “absolutely required to enable CLECs to provide functionality equivalent to that of a network access line” to the price of a retail network access line and no more. Staff Br. at 227. Staff then claims that “dial tone” (i.e., a bare access line) is that basic functionality. Notably, Staff provides no legal or statutory citation to support its position. Nothing in Section 13-505.1 requires this narrow definition of the form of an imputation test. Therefore, although Staff presents its position as a legal conclusion, in fact it is a *policy* recommendation and must be viewed as such. SBC Illinois notes that Staff’s policy witness on this issue agreed that the Commission had the latitude to adopt the broader imputation test recommended by SBC Illinois. Staff Ex. 24.0 (Koch Rebuttal) at 19-20.

From a policy standpoint, Staff’s and the Joint CLECs’ position makes no sense. Staff suggests that SBC Illinois did not include vertical service revenues “for any good reason,” but just to enable its business service rates to “pass imputation.” Staff Br. at 227. This assertion ignores the extensive analysis provided by SBC Illinois witnesses Panfil and Dr. Aron of the economic and policy considerations that should underlie any imputation or price squeeze analysis.⁵⁵ SBC Ill. Ex. 1.1 (Panfil Rebuttal) at 8-25; SBC Ill. Ex. 2.0 (Aron Direct) at 24-33; SBC Ill. 2.1 (Aron Rebuttal) at 37, 63-65, 81. Staff is also ignoring the extensive work done by the FCC in evaluating price squeeze claims in Section 271 proceedings, on which SBC Illinois’ analyses were based. In other words, the analyses provided by SBC Illinois were not made up on the spur of the moment just to avoid a problem under Section 13-505.1, but rather reflect widely held views of how price squeeze issues should be addressed. And these analyses demonstrate

⁵⁵ As Staff states, the purpose of an imputation test is to ensure that ILECs cannot engage in “anticompetitive pricing.” Staff Br. at 224. Price squeeze tests are designed to accomplish the same purpose. Therefore, Staff’s distinctions between Dr. Aron’s analyses and imputation constitute form over substance.

that, contrary to Staff's and the Joint CLECs' assertions, CLECs "...can enter the market and serve customers. . ." and "... can remain in the market and continue to serve customers," at the higher UNE loop rates. Staff Br. at 228 (emphasis added); Joint CLEC Br. at 427, 430, 432.

SBC Illinois notes, moreover, that Staff is quick to defend its own judgment on how to perform an imputation test when it finds itself on the other side of the fence. As Staff points out, the Joint CLECs' approach to imputation would cause SBC Illinois' retail business network access lines to fail even if UNE loops are priced at *Staff's proposed rates*. Staff is appalled at the prospect and objects vehemently on the grounds that the effect on SBC Illinois' retail revenues would be "staggering." *Id.* at 229.⁵⁶ The intensity of Staff's reaction raises the question whether the form of imputation Staff is recommending is influenced, at least in part, by the fact that SBC Illinois' retail business rates would pass at *Staff's* rates under Staff's approach to imputation and that Staff does not want the Commission to approve UNE loop rates that are any higher.

The Joint CLECs claim that Section 13-408 of the legislation enacted in 2003 belies SBC Illinois' position on imputation. Joint CLEC Br. at 416-18. Section 13-408 provided that any UNE rate increases approved by the Commission in the 30-day proceeding would not require retail rate increases pursuant to Section 13-505.1. In fact, this legislation *hurts* Staff's and the Joint CLECs' positions, not *helps* them. *First*, Section 13-408 is in no way inconsistent with SBC Illinois' position in this proceeding. It was intended to avoid precisely the debate which is currently going on. Regardless what SBC Illinois believes to be the proper form of an imputation test, it is apparent that other parties – e.g., the Commission Staff and the Joint CLECs – believe otherwise. This statutory provision served to eliminate any dispute over the issue. *Second*, and more significantly, Section 13-408 demonstrates that the Illinois General Assembly

⁵⁶ Staff's focus on the impact on SBC Illinois' retail *revenues* is perplexing. SBC Illinois has made it clear that it would implement any required restructure on a revenue-neutral basis. SBC Ill. Ex. 1.1 (Panfil Rebuttal) at 16, 21.

did not intend for Section 13-505.1 to require retail rate increases if UNE loop rates are increased. Thus, to the extent that Staff argues that the Commission must adopt its recommended form of imputation to satisfy the goals of the *legislature*, Staff has clearly misperceived these goals. Staff Br. at 228.

The Joint CLECs raise another “parade” of retail rate “horribles” on the consumer side. They argue that increased UNE rates will ultimately cause SBC Illinois’ residential retail rates to increase and will squeeze CLECs out of the residential market. Joint CLEC Br. at 413-14, 425-27. This is gamesmanship. SBC Illinois’ residential service rates are not classified as “competitive” today and, therefore, are not subject to imputation.⁵⁷ Moreover, the *only* reason that competitive residential rates would not pass an imputation test is because Staff, the Joint CLECs and the other parties are insisting on such a narrow form of imputation. Dr. Aron conducted similar price squeeze analyses for both business and residential services in Illinois and residential services passed with flying colors. SBC Ill. Ex. 2.1 (Aron Rebuttal) at 64-65. The solution to the *terrible dilemma* that the Joint CLECs posit is simply to adopt a reasonable form of imputation in this proceeding – and the dilemma will evaporate.⁵⁸

The Joint CLECs also point out the conflict between their form of imputation and the requirements of Section 13-502.5(b) of the PUA which caps retail rates provided to 1-4 line business customers until July 1, 2005. Joint CLEC Br. at 424-25. This is not a new issue: SBC

⁵⁷ The Joint CLECs ascribe nefarious motives to the fact that SBC Illinois has not yet declared its residential services competitive. Joint CLEC Br. at 430-31, n. 303. This is nothing but mudslinging. As anyone who was involved in the business reclassification docket (Docket No. 98-0860) knows, such proceedings are highly contentious. In that proceeding, *everyone* – the Commission Staff, consumer groups and the CLECs opposed the reclassification. The legislature ultimately resolved the contested issues as a matter of law. 220 ILCS 515-502.5(b). At the same time, the Illinois legislature made changes to the standards that must be met to make other reclassifications. 220 ILCS 313-502(c). SBC Illinois will reclassify its residential services as competitive when it deems it appropriate.

⁵⁸ The Staff report that the Joint CLECs use to bootstrap their argument proves nothing new. Joint CLEC Br. at 426-27. Staff’s analysis was based on the same narrow form of imputation that Staff has urged in this proceeding, and, for all the reasons stated previously, it is inappropriate and unnecessary.

Illinois pointed it out in Mr. Panfil's rebuttal testimony. SBC Ill. Ex. 1.1 (Panfil Rebuttal) at 17. There is no issue, however, if the Commission adopts a reasonable form of imputation, because SBC Illinois' retail business rates will pass. On the other hand, the Joint CLECs' proposed solution is clearly unlawful. They recommend that the Commission hold SBC Illinois' UNE rates hostage to the 1-4 line business cap:

Because business NAL rates for SBC's business customers with four or fewer lines are capped until July 1, 2005, those rates cannot be raised in order to satisfy the imputation requirements of Illinois law. Consequently, until July 1, 2005, any proposed increases in wholesale UNE rates are constrained by SBC's existing business NAL rates. In other words, *regardless of the merits of any proposed increase in SBC's unbundled loop rates*, those rates can only be raised to the extent that its existing business NAL rates pass an imputation test. Joint CLEC Br. at 425 (emphasis added).

This is shockingly lawless and should be rejected out-of-hand.

Finally, the Joint CLECs continue to raise technical issues associated with the test performed by SBC Illinois. For example, they contend that because SBC Illinois' promotional offers waive service order and line connection charges in certain circumstances, these revenues are overstated. Joint CLEC Br. at 419. However, nowhere do the Joint CLECs quantify the impact of these offers on overall nonrecurring revenues obtained from end users, much less demonstrate that the impact would be material. The Joint CLECs claim that SBC Illinois' access line location life of four years for imputation is inconsistent with the two-year location life used for wholesale service orders. Joint CLEC Br. at 420. The Joint CLECs are comparing apples and oranges. The location life used in SBC Illinois' imputation test reflects the length of time a customer stays with *SBC Illinois* at a given location. The location life used in Mr. Currie's service cost study reflects the length of time a customer stays with *any particular CLEC* at a given location. SBC Ill. Ex. 3.1 (Silver Rebuttal) at 4-5. Both were based on actual data and

both are valid.⁵⁹ It is a common sense proposition that customers who have already switched to a CLEC are more likely to switch again and switch sooner than customers who still take service from SBC Illinois. The Joint CLECs complain that SBC Illinois adjusted certain computer and other costs out of its service ordering costs. Joint CLEC Br. at 421. This was necessary to avoid double-counting the same costs, because they are already included in other cost elements. Tr. 205 (Panfil). Thus, SBC Illinois' analysis is not "demonstrably conservative" – it is simply accurate.

In short, contrary to the impressions that Staff, the Joint CLECs, the Attorney General and CUB would leave with the Commission, the issue of how to perform an imputation test in this case is not cut-and-dried. The Commission has ample authority to adopt a reasonable approach that recognizes that no carrier competes for business network access line rates on a stand-alone basis. Under SBC Illinois' approach, increases in SBC Illinois' UNE loop rates will have no impact on business retail rates or (over the longer term) residential retail rates. Alternatively, the Commission can adopt the rigid approach recommended by the other parties. However, the retail rate consequences that flow from such a decision will be of the Commission's own making – not the result of increasing UNE loop rates.

VIII. Other Legal Issues

A. Preemption, Tariffing and Related Issues

The Joint CLECs spend seven pages rearguing whether this case is properly classified as a Section 9-201 tariff proceeding under the Illinois PUA or a generic UNE rate docket under Section 252 of the 1996 Act. Joint CLEC Br. at 433-39. The CLECs contend that the

⁵⁹ The CLECs also contend that a four-year location life for SBC Illinois' customers is contradicted by the fact that it offers 12, 24, and 36 month term plans for network access lines. Joint CLEC Br. at 420, n. 279. This is nonsensical. These are standard term plan lengths in the marketplace. Nothing says that customers will leave SBC Illinois at their conclusion. The tariff itself gives customers the option of re-upping for another term.

Commission needs to clarify the “procedural foundation . . . for this investigation” or risk reversal on appeal. *Id.* at 438. It is unclear why the CLECs continue to pursue this issue, which has already been decided. As they note, “there was [and is] no disagreement among the parties that this case could move forward as a generic TELRIC proceeding pursuant to federal law.” *Id.* And, in fact, that is exactly how this case is being treated as a substantive matter. *See* ALJ’s Feb. 4, 2004 Memorandum to the Commission at 7 (“this matter is substantively a generic ratemaking pursuant to Section 252 of TA96.”).

The CLECs’ complaints about the procedural basis for the proceeding had some relevance when the case was reopened, as the CLECs argued at that time that a generic Section 252 proceeding did not have to be finished in six months (as a tariff investigation would have to be) and that the schedule should therefore be extended. The Commission, however, stated all along that it was “not under any specific deadline for the entry of a final order in this case, either by statute or under the terms of the injunction.” Reopening Order at 6. Furthermore, now that the case is being completed and the CLECs have received complete due process, the CLECs’ scheduling arguments are moot. In any event, the alleged tariffing issues that the CLECs raise now are either irrelevant (as SBC Illinois and most CLECs will likely implement the new prices through interconnection agreements) or moot (as SBC Illinois has already indicated that it could make sense for it to incorporate the new prices into its tariffs as part of an orderly transition from the past tariffing regime to the interconnection agreement regime required by Congress and the Seventh Circuit.) *See* SBC Illinois’ Opening Brief on the Effect of the *AT&T/Voices* and *Bie* Decisions on this Proceeding, at 7 (filed Jan. 13, 2004).

B. Procedural and Evidentiary Issues

The Commission should deny the CLECs’ request for reconsideration of the ALJs’ determination to deny most portions of the CLECs’ motion to strike. All of the testimony

submitted by SBC Illinois was proper rebuttal testimony. “Rebuttal evidence is that which answers, explains, repels, contradicts, or disproves evidence introduced” by an opposing party. *Gabrenas v. R.D. Werner Co.*, 451 N.E. 2d 1307, 1312, 116 Ill.App.3d 276, 283 (Ill. App. Ct. 1st Dis. 1983); *see also Brown v Sexner*, 405 N.E.2d 85, 1090, Ill.App.3d 139, 149 (Ill. App. Ct. 1st Dis. 1980) (“The fact that testimony might also be admissible in chief does not render it improper for rebuttal.”) “[W]here a defendant introduces evidence of an affirmative matter in defense or justification, the plaintiff, as a matter of right, is entitled to introduce evidence in rebuttal as to such affirmative matter.” *Gabrenas*, 451 N.E. 2d at 1312, 116 Ill.App.3d at 283 (citation omitted).

SBC Illinois orally responded to the Joint CLECs’ motion to strike during the first day of hearing. Rather than detail those extensive arguments herein, SBC Illinois incorporates by reference its arguments at pages 73-113 of the transcript in this proceeding.

With respect to the rebuttal testimony of SBC Illinois witnesses Gomez-McKeon and Currie addressing the design loop process for stand-alone UNE loops. The ALJs’ determination was correct. Contrary to the CLECs’ characterization, SBC Illinois did not introduce a “new” proposal in its rebuttal testimony (*see* Joint CLEC Br. at 440), but corrected an inadvertent error.

In its original filing, SBC Illinois inadvertently omitted costs associated with the design process from its stand-alone unbundled loop nonrecurring cost study, including them only in its EEL nonrecurring cost study. In their direct testimony, the CLECs took issue with the design loop process, asserting that it should not be used for any loops. Among other arguments, the CLECs asserted that if the design process was not used for stand-alone POTS loops, it should not be used for loops that are part of an EEL. In its rebuttal testimony, SBC Illinois noted that it in fact does use the design process for all POTS loops, whether part of an EEL or ordered on a

stand-alone basis. SBC Illinois also noted that it had inadvertently omitted costs associated with the designed loop process from its stand-alone loop nonrecurring cost studies.

While the CLECs suggest that SBC Illinois' correction somehow deprived them of an "equal opportunity to participate and prepare their cases" (Joint CLEC Br. at 442), the CLECs were in no way prejudiced by this correction. First, SBC had previously discovered – and corrected – the same error in Indiana, in a cost proceeding in which the same CLEC witnesses and attorneys that are involved in this proceeding participated. Second, the CLECs had two subsequent rounds of testimony to address SBC Illinois' correction, and they in fact took advantage of that opportunity, presenting several pages of testimony on the issue. Third, the issue of whether the designed loop process should be used for stand-alone unbundled loops is identical to the issue of whether the same process should be used for the loop component of EELs (the issue the CLECs first raised in their direct testimony). AT&T Ex. 3.1 (Turner Rebuttal) at 62. In short, the CLECs were not prejudiced in any way or surprised by SBC Illinois' correction, and the Commission should deny their request for reconsideration of the ALJs' ruling.

The Joint CLECs' assertions that the ALJs erred in denying their request to strike portions of the testimony and exhibits of SBC Illinois witnesses Vanston, Smallwood and White are similarly without merit. As SBC Illinois discussed in detail at the hearing on March 15, 2004, each portion of the testimony and exhibits at issue was directly responsive to comments made in the testimony of witnesses for other parties and, therefore, was proper rebuttal. Tr. 73-113.

IX. CONCLUSION

For the reasons stated above and in SBC Illinois' Initial Brief, the Commission should approve the charges proposed by SBC Illinois for its UNE loop rates and non-recurring charges.

April 12, 2004

Respectfully submitted,

ILLINOIS BELL TELEPHONE
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