STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company	:	
	:	
Filing to increase Unbundled Loop and Nonrecurring Rates	:	**ICC Docket No. 02-0864**
	:	

BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

PUBLIC VERSION
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*****BEGIN CONF _____ END CONF*****

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Table of Contents

Page

I. INTRODUCTION 1

II. EXCEPTIONS 2

1. [III.B.1] The Proposed Order Incorrectly Decided To Use SBC Illinois' 1998 Actual Distribution Fill Rates Instead Of 2002 Actual Distribution Fill Rates As The Starting Point For Developing Forward Looking Actual Fills 2
2. [III.B.3(a-b)] Cost of short term and long term debt 10
3. [III.C.4.(a)] NID and Drop Wire Installation Costs 15
4. [VI.C.2] Uncollectible Expense 22
5. [VI.C.3] Wholesale Marketing Expense 24
6. [IX.A] Preemption, Tariffing and Related Issues 25

III. STAFF'S CALCULATION OF RATES RECOMMENDED BY THE PROPOSED ORDER 29

A. UNE Loop Recurring Cost Studies 29
   1. Major Inputs to Cost Studies 29
      a) Fills 29
      b) Depreciation 30
      c) Cost of Capital 31
B. Other Loop Recurring Cost Modeling Input Issues 32
   1. Cable and DLC Installation Factors 32
   2. DLC Investment cost Issues - Allocation of Shared DLC Components 32
   3. DLC Investment cost Issues - Remote Terminal investment Cost Allocation 32
   4. FDI Costs 33
   5. Loop length, Cable size and gauge modeling - Copper Cable Mix 33
C. Labor Rates 34
D. Shared and Common Factors 34
E. Annual Charge Factors 36
   1. Investment Factors 37
   2. Inflation Factors 37
   3. Support Asset Factors 38
   4. Shared and Common Costs 38

F. Rates for Non-Recurring Costs..... 39
IV. CONCLUSION..... 45

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REPLY BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

Now comes the Staff of the Illinois Commerce Commission ("Staff"), by its undersigned attorneys, and pursuant to Section 200.830 of the Commission's Rules of Practice (83 Ill. Adm. Code 200.830) respectfully submits this Brief on Exceptions to the Administrative Law Judges' Proposed Order issued by the Administrative Law Judges ("ALJs") on May 6, 2004 ("Proposed Order").

I. INTRODUCTION

The Staff concurs in the *Proposed Order* with respect to most – indeed the great majority – of the findings of fact and conclusions it recommends. The Staff is of the opinion that the ALJs have prepared a *Proposed Order* that will, if adopted by the Commission, establish rates squarely consistent with TELRIC principles in almost all respects. The Staff is acutely aware of the magnitude of this undertaking and the industry necessarily involved in seeing it through to a conclusion, and accordingly takes the view that the ALJs are to be commended for diligently and fairly applying the law to the facts developed in the record.

In particular, the *Proposed Order's* recommended adjustments to the three major cost components of the SBC LoopCat model – fill factors, depreciation, and cost of capital/capital structure – are particularly well-thought out and well-taken. The Staff recommends that the Commission adopt these findings, with the amendments proposed by Staff herein.

While the Staff concurs generally in the *Proposed Order*, it nonetheless takes certain exceptions to the *Proposed Order*, as more fully set forth herein. The Staff further notes that in taking only limited exception to the *Proposed Order*, it does not thereby intend to waive the right to respond to the *Briefs on Exceptions* and *Exceptions* filed by other parties in all relevant particulars, and specifically reserves such right.

II. EXCEPTIONS

1. [III.B.1] The Proposed Order Incorrectly Decided To Use SBC Illinois' 1998 Actual Distribution Fill Rates Instead Of 2002 Actual Distribution Fill Rates As The Starting Point For Developing Forward Looking Actual Fills

The Proposed Order errs in ordering the use of 1998 distribution fill rates to "correct" for "short-term fluctuations" in SBC Illinois' actual fill rates associated with its DSL initiative called Project Pronto. Proposed Order at 61. Project Pronto refers to SBC's recent broadband initiative, which overlays copper *feeder* facilities with fiber *feeder* facilities and DLCs. *See* AT&T/Joint CLEC Exhibit 1.2P (Starkey/Fischer Surrebuttal) at 129; Staff Initial Brief at 110-111; Staff Reply Brief at 6. The Proposed Order finds that Project Pronto is a reasonable and necessary long-term objective, but that it has "reduced utilization rates in the short term." Proposed Order at 61. To correct for the short-term fluctuation associated with Project Pronto, the Proposed Order

directs the use of "1998 fill factor data for distribution fill factors" instead of the January 2002 fill factor data used by SBC and Staff. *Id*. at 61, *see also Id*. at 29, 41 and 46. The Proposed Order errs both factually and conceptually in ordering this adjustment.

Although Staff agrees that overlaying copper feeder facilities with fiber facilities creates additional feeder capacity that could temporarily reduce fill rates if end users are migrated from copper to fiber feeder facilities, Staff is unaware of any evidence in this proceeding that such a reduction occurred or was reflected in the January 2002 data. In fact, the evidence in this proceeding indicates that Project Pronto was not implemented in Illinois until April of 2002 (three months after the January 2002 fill data used by SBC Illinois and Staff). Proposed Order at 29; SBC Illinois Ex. 8.2P (White Surrebuttal) at 10. Even if the January 2002 data did reflect short-term fluctuations in fill rates resulting from Project Pronto, it was incorrect to order the use of 1998 ***distribution*** fill data as a remedy.[1] As noted above, Project Pronto involves an overlay of feeder facilities rather than distribution facilities. In short, Project Pronto does not involve the *distribution* network. Accordingly, distribution fill rates are not impacted by Project Pronto. It is thus inappropriate to "correct" for short-term fluctuations that might be associated with Project Pronto by making adjustment to distribution fill rates in general and by using 1998 (in place of 2002) distribution fill rates in particular.

Although the Joint CLECs also attributed short-term fluctuations in capacity to the business cycle (i.e., economic recession) (*see* Proposed Order at 47), the Proposed

[1] As noted in the Proposed Order, 1998 fill data was not available for the non-distribution components of SBC Illinois outside plant. Proposed Order at 61.

Order limits its determination to adjust SBC Illinois' actual fill data to the effects of Project Pronto:

> We agree with the CLECs and DoD/FEA that short-term fluctuations should be removed from SBC's actual fill factor data. Specifically, SBC's DSL initiative called Project Pronto temporarily lowered SBC's actual fill rates below levels that would have been observed otherwise.

Proposed Order at 61. Staff wants to make clear that the Proposed Order properly declined to adopt AT&T/Joint CLECs recession bias proposal.

In their supplemental surrebuttal testimony, AT&T/Joint CLECs made the assertion that SBC Illinois' actual fill rates need to be adjusted to "correct" for short-term recession bias (or business cycle bias). AT&T/Joint CLECs Ex. 1.3P at 13-14, 24. AT&T/Joint CLECs contended that the economic recession would have an adverse impact on demand and lead to a *reduction in demand* ("recession bias"). AT&T/Joint CLECs Ex. 1.3P at 13. AT&T/Joint CLECs made adjustments to SBC Illinois' distribution fill rates to "remove" this short-term recession bias based on SBC Illinois' distribution fill rates at *year-end 1998* instead of *January 2002*. *Id*. at 24-25. AT&T/Joint CLECs asserted that they could confirm their short-term recession bias hypothesis by comparing SBC Illinois' distribution fill rates at year-end 1998 and January 2002 – i.e., confirming that the economic recession has had an adverse impact on demand and has led to a reduction in demand. *Id.* This contention is not borne out by the facts. Rather, a comparison of SBC Illinois distribution fill rates at year-end 1998 and January 2002 rebuts AT&T/Joint CLECs' recession bias hypothesis.

Staff agrees with AT&T/Joint CLECs that local *business* access line demand would be more sensitive to the state of the economy than the *residential* market. AT&T/Joint CLECs Ex. 1.3 at 25. Staff also agrees that recession, if having any impact

at all, would have a more pronounced negative impact on demand (*i.e.*, higher percentage decline in demand) in Access Area A, the urban density zone, than in other Access Areas because Access Area A has a higher proportion of business customers. *See* AT&T/Joint Ex. 1.3P at 25. While possessing all the necessary demand information,[2] AT&T/Joint CLECs have not presented any analysis regarding changes in demand between year-end 1998 and January 2002. Specifically, they have not presented any evidence that demand in Access Area A experienced the greatest decline between year-end 1998 and January 2002. Instead, AT&T/Joint CLECs' assertion of a recession bias is based on their observation that statewide fill rates declined by approximately *****BEGIN CONF xxx END CONF***** and that the change in fill rate is the greatest in Access Area A, the urban density zone. AT&T/Joint CLECs Ex. 1.3P at 25. AT&T/Joint CLECs mistakenly equate changes in demand with changes in fill rates, rendering their recession bias assertion erroneous. A change in fill rate may not reflect a change in the underlying demand. Rather it may simply reflect a change in the underlying available capacity.

First, AT&T/Joint CLECs have mistakenly identified the *****BEGIN CONF** xxx% **END CONF*****drop in SBC's statewide distribution fill rate as a short-term recession bias — *i.e.*, a reduction in demand caused by the economic recession. *Id.* From the year-end 1998 to January 2002, the statewide demand for local access lines *increased* (not decreased) by *****BEGIN CONF xxxx END CONF*****. SBC Ex. 8.0

[2] Demand information for year-end 1998 is contained in SBC Response to AT&T Data Request No. MS-55 as well as in Schedule RSW –11 attached to SBC Ex. 8.0. Demand information for January 2002 is contained in ILCurrentFillData2002 (Jan02).xls (one of the work papers filed by SBC), and it is also contained in Attachment MS/WF-23 of AT&T/Joint CLECs Ex. 1.3.

(White), Schedule RSW-11 Revised, and AT&T/Joint CLECs Ex. 1.3, Attachment MS/WF-23. Moreover, statewide usable distribution capacity increased from year-end 1998 to January 2002, by *****BEGIN CONF xxx END CONF*****. SBC Ex. 8.0 (White), Schedule RSW-11 Revised, and AT&T/Joint CLECs Ex. 1.3, Attachment MS/WF-23. The *****BEGIN CONF xxx END CONF***** drop in statewide distribution fill rates during this time period is thus attributed to the increase in the statewide usable capacity rather than a decrease in demand, and cannot properly be attributed to an alleged recessional effect (*i.e.*, a reduction in demand caused by the economic recession). That is, the *****BEGIN CONF xxx END CONF***** drop in distribution fill rate is due to the fact that the percentage increase in usable capacity is greater than the percentage increase in the total demand. Therefore, AT&T/Joint CLECs have mistakenly identified the *****BEGIN CONF xxx END CONF***** drop in the statewide distribution fill rate as short-term recession bias.

Second, analysis of Access Area data produces a similar conclusion. Although the demand for local access lines in Access Area A, the urban zone, declined between year-end 1998 and January 2002, that decline was insignificant - decreasing by *****BEGIN CONF** xxx **END CONF***** copper pairs (from *****BEGIN CONF xxx END CONF*****. SBC Ex. 8.0 (White), Schedule RSW-11 Revised, and AT&T/Joint CLECs Ex. 1.3, Attachment MS/WF-23. Thus, the *****BEGIN CONF** xxx **END CONF***** drop in distribution fill rate in *Access Area A* from 1998 to 2002 is mostly attributable to the increase in total usable capacity. Approximately *****BEGIN CONF** xxxx **END CONF***** drop in the Access Area A distribution fill rate (i.e., roughly 10% of the drop) is attributed to the reduction in

demand for local access lines, and approximately ***BEGIN CONF xxx xxx END CONF*** drop (i.e., roughly 90% of the drop) is attributed to the increase in usable capacity. Therefore, the ***BEGIN CONF xxx END CONF*** drop in distribution fill rate in Access Area A cannot be attributed to a reduction in demand (or recessional effect).

Between year-end 1998 and January 2002 the total demand for local access lines in Access Area B declined by ***BEGIN CONF xxx xxx END CONF***. There was a ***BEGIN CONF xxx END CONF*** drop in the distribution fill rate in Access Area B between year end 1998 and January 2002, ***BEGIN CONF xxx END CONF*** of which is attributed to the increase in the total usable capacity and ***BEGIN CONF xxx xxx END CONF*** of which is attributed to the reduction in demand ***BEGIN CONF xxx END CONF***. Thus, approximately 78% of the drop in distribution fill rate is due to the increase in usable capacity and 22% of the drop is due to the reduction in demand. Therefore, the ***BEGIN CONF xxx END CONF*** decline in fill rate between year-end 1998 and January 2002 in Access Area B cannot be translated into a ***BEGIN CONF xxx END CONF*** decline in demand in Access Area B during the same time period.

In summary, contrary to AT&T/Joint CLECs' belief, a comparison of data at year-end 1998 and January 2002 is not consistent with AT&T/Joint CLECs' recession bias hypothesis. The reduction in demand between year-end 1998 and January 2002 in Access Area A, the "urban density zone", is not only *in*significant ***BEGIN CONF xxx END CONF*** but it is also much less pronounced than the reduction in demand

in Access Area B *****BEGIN CONF xxx END CONF*****. As explained above, if the changes in demand at the Access Area level were attributable to a recession we should observe a more significant reduction in demand in Access Area A, the "urban density zone", than in Access Area B. Because the data does not reveal such a pattern, the Access Area data does not support AT&T/Joint CLECs' recession bias hypothesis and the Proposed Order properly declined to find such an effect.

AT&T/Joint CLECs erred in their recession bias theory in the same way that they erred in their "best observed" practice theory. In the latter, they erroneously equated "efficiency" with fill rates and best-observed practice with lowest-observed defective percentage. In the former, AT&T/Joint CLECs erroneously equated reduction in distribution fill rates with reduction in demand. During the three year period (year end 1998 and January 2002) while distribution fill rates experienced a more significant decline in the urban density zone (Access Area A) than in other access areas, demand in the urban density zone experienced *insignificant* and *less pronounced decline* than Access Area B – which serves to rebut AT&T/Joint CLECs' recession or business cycle (short-term) bias hypothesis. Therefore, similar to the "best-observed" practice adjustments, AT&T/Joint CLECs' <u>recession</u> (or business cycle) bias adjustments to <u>distribution</u> fill rates also lacks legitimate foundation and should be rejected.

As noted above, AT&T/Joint CLECs' recession bias adjustment lacks a legitimate foundation and erroneously equates changes in fill rates with changes in demand, and thus was properly rejected. Specifically, AT&T/Joint CLECs' proposal of using 1998 distribution fill rates to "correct" the so-called recession bias should be rejected.

The Proposed Order should be amended to reflect a revised finding on the alleged Project Pronto bias argument. Similarly, Staff recommends additional language to explicitly reject AT&T/Joint CLECs' recession bias argument. Staff's proposed exceptions language follows:

Use of 1998 Distribution Data

Although ~~We~~ agree with the CLECs and DoD/FEA that short-term fluctuations, if established by the facts, should generally be removed from ~~SBC's~~ actual fill factor data used as a proxy for forward looking actual fills, no such fluctuations have been established in the record before us. ~~Specifically, SBC's DSL initiative called Project Pronto temporarily lowered SBC's actual fill rates below levels that would have been observed otherwise. The implementation of Project Pronto began in 1999, when SBC added significant amounts of fiber and DLC equipment to its network. Although installing this infrastructure was reasonable and necessary, its deployment is a long-term objective that has reduced utilization rates in the short term. Therefore, we find it appropriate to use 1998 fill factor data for distribution fill factors. Because similar data was not available for the other network elements, the use of 1998 data is not mandated for the other network elements.~~ Although AT&T/Joint CLECs asserted that Project Pronto could have a short-term impact on feeder fill rates, the evidence indicates that SBC's January 2002 fill factor data was not impacted by Project Pronto because Project Pronto was not implemented in Illinois until April of 2002. Further, neither AT&T/Joint CLECs nor Dod/FEA have offered an adjustment to feeder fill rates for Project Pronto.

We similarly find that AT&T/Joint CLECs have not provided convincing evidence to support their recession bias hypothesis. On a statewide basis, demand actually increased between year end 1998 and January of 2002 and the statewide reduction in distribution fill over this time period is attributable to increased capacity. Further, the decreases in demand in Access Areas A and B also fails to support AT&T/Joint CLECs' argument. We agree that local *business* access line demand would be more sensitive to the state of the economy than the *residential* market and that recession, if having any impact at all, would have a more pronounced negative impact in Access Area A, the urban density zone, than in other Access Areas. AT&T/Joint CLECs, however, did not provide any assessment or analysis on the existence of recession (or business cycle) effects or bias. Specifically, they did not provide any assessment of whether demand actually experienced more significant changes in Access Area A, the urban density zone, than in other Access Areas between year end 1998 and January 2002. As Staff has noted in its Brief On Exception, contrary to AT&T/Joint CLECs' recession bias hypothesis, demand

> experienced an insignificant and less pronounced decline in the urban density zone (Access Area A) than in other Access Areas. Therefore, we conclude that AT&T/Joint CLECs' recession bias theory has no legitimate basis and thus their recession bias based adjustments are rejected. That is, we decline AT&T/Joint CLEC's request to adjust SBC's distribution fill rates based on its 1998 distribution fill rates to "correct" the alleged recession bias.

2. [III.B.3(a-b)] Cost of short term and long term debt

Staff takes exception to the *Proposed Order's* adoption of AT&T/MCI's proposed costs of long-term and short-term debt. Proposed Order at 74-5.

First, AT&T/MCI's ten-year interest rate estimates are based on speculative forecasts. No one can forecast when, or even if, interest rates will rise and remain consistently above the rates Staff recommended. Moreover, the record does not show that AT&T/MCI's hybrid interest rate estimates are more representative of future interest rates than are the most recent spot rates. The Commission should not base rates on speculation.

Second, as indicated in Staff's Initial Brief, Staff IB at 73, interest rates were, as of February 2004, very near the same levels they were at the time of Staff's initial analysis; if anything, interest rates had fallen slightly overall. Indeed, the annual yield for thirty-day, A2/P2 non-financial commercial paper, which Staff used as the basis for its short-term debt cost recommendation, has fallen from 1.47% at the time of Staff's analysis (April 3, 2003) to 1.21% as of May 11, 2004.[3] Accordingly, it would be improper to assume any upward trend from the record in this proceeding.

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[3] *See* www.federalreserve.gov\releases\cp\

Third, such an approach is inconsistent with a past Commission ruling. In its *Order*, Illinois-American Water Company: Proposed general increase in water and sewer rates, ICC Docket No. 02-0690, 2003 Ill. PUC LEXIS 685; 227 P.U.R.4th 217 (August 12, 2003), the Commission accepted Staff's current spot rate for the cost of variable rate debt rather than use a forecasted interest rate, as proposed by the Company. The Commission stated that it "agrees with Staff that the spot interest rate provides a more accurate means of forecasting the cost of variable rate debt during the estimated life of the rates than does the five-year forecast period used by the Company." Order at 195 (Lexis pagination). The Commission also noted that it had approved the use of a spot rate to estimate the cost of short-term debt in other dockets, such as ICC Docket Nos. 01-0465/0530/0637 (consolidated). Id.

Finally, the *Proposed Order* adopts a rate in excess of SBC's *current* marginal cost on the speculation that its cost will *eventually* rise. This is inappropriate because, in addition to the speculation as to the future level of interest rates, it allows the UNE provider to earn more than its required return until such time as interest rates rise to the adopted rates, if they ever do.

For the reasons stated above, Staff recommends the second paragraph under section III. B. 3. a) (2) be stricken and replaced with the following language:

> ~~ST debt is currently at historic low prices. History and common sense suggest that its cost is unlikely to stay as low as it is now. Due to the unusual circumstances present in capital markets, we reject Staff's recommended cost of ST debt, 1.47%, because it is too low. Therefore, we agree with ATT/MCI that it is appropriate to incorporate an estimate of the forward-looking cost of ST debt for an extended period. Because neither Staff nor SBC proposed a prospective cost of ST debt in their proposal, we adopt the ATT/MCI 2.84% estimate of the cost of ST debt.~~ As Staff points out, no one can forecast when, or even if, interest rates will

rise and remain consistently above the rates Staff recommended. Indeed, as of February 2004, interest rates were very near the same levels they were at the time of Staff's initial analysis; if anything, interest rates had fallen slightly. Thus, any forecast of interest rates is speculative; it is inappropriate for the Commission to set rates based on speculation. In contrast, current interest rates are known. Moreover, the record does not show that AT&T/MCI's hybrid interest rate estimates are more representative of future interest rates than are the most recent interest rates. In addition, the adoption of projected interest rates that are higher than current interest rates allows the UNE provider to earn more than its required return until such time as interest rates rise to the adopted rates, if they ever do. Finally, the Commission notes that it has approved the use of a spot rate to estimate the cost of short-term debt in other dockets, such as ICC Docket Nos. 01-0465/0530/0637 (consolidated) and 02-0690. Therefore, we adopt Staff's 1.47% estimate of the cost of ST debt.

Likewise, Staff recommends the second paragraph under section III. B. 3. b) (2) be stricken and replaced with the following language:

> ~~Once again, in view of the present historically low rate, it is prudent to incorporate an estimate of future rates in any calculation of the cost of long-term debt. Although we find both Staff's and the ATT/MCI's analysis of the present cost of LT debt reasonable, we adopt ATT/MCI number because it includes an estimate of future costs.~~For the same reasons summarized for the cost of short-term debt, we adopt Staff's 4.99% estimate of the cost of long-term debt, which was based on the current interest rates available at the time of Staff's analysis.

Staff also notes the following factual and typographical errors that should be corrected:

1) The above exceptions notwithstanding, based on the capital component costs and the capital structure adopted in the *Proposed Order*, Staff calculates the overall cost of capital to be 8.96%, rather than the 8.94% shown in the table at the end of the cost of capital section and the immediately preceding paragraph. Proposed Order at 83. It appears that the *Proposed Order* truncated the weighted cost of each capital component after two decimal places before summing them to derive the overall cost of

capital. Staff believes that the weighted cost of each capital component should be rounded to two decimal places rather than simply truncated at two decimal places. Thus, should the Commission decide to adopt the capital structure and component costs recommended in the *Proposed Order*, the *Final Order's* cost of capital summary should read:

This leaves 44.22–% to be financed through long-term debt. Inputting these values we find an overall cost of capital of 8.~~94~~96% to be reasonable and supported by the evidence.

Component	**Cost Rate**	**Percent of Total**	**Weighted Cost**
Common equity	12.44%	51.00%	6.34%
Long Term Debt	5.60%	44.22%	2.~~47~~48%
Short Term Debt	2.84%	4.78%	0.~~13~~14%
Total		100.00%	**8.~~94~~96%**

2) The second paragraph under III. B. 3. a) (1) states, "Staff's 1.47% estimate of the cost of ST debt is based upon current rates for commercial paper for companies comparable to SBCI's parent." Proposed Order at 74. It should read, "Staff's 1.47% estimate of the cost of ST debt is based upon current rates for commercial paper for companies comparable to ~~SBCI's parent~~ Staff's Telecom Sample." *See* Staff Ex. 12.0 at 23.

3) The second paragraph under III. B. 3. b) (1) states, "…Staff computed the proportionate share of the different maturity dates of SBCI's existing long-term debt." Proposed Order at 75. It should read, "…Staff computed the proportionate share of the different maturity dates of ~~SBCI's~~ SBC's existing long-term debt."

4) The second paragraph under III. B. 3. c) states, "Instead the common stock of its parent company, SBC, that is publicly traded was used as a proxy." Proposed Order at 76. It should read, "Instead ~~the common stock of its parent company, SBC, that is publicly traded was used as a proxy~~, each of the responding parties used a sample of companies with publicly traded common stock as proxies."

5) The last paragraph under III. B. 3. c) (1) states, "Therefore, they conclude, SBCI's model overstates the cost of equity." Proposed Order at 77. For clarification, Staff recommends changing that sentence to read, "Therefore, ~~they~~ Staff concludes, SBCI's model overstates the cost of equity."

6) The last paragraph under III. B. 3. c) (2) states, "Moreover, Staff believes that because oil and gas rates are predicated in large part on already depreciated assets unlike the un-depreciated asset base used for TELRIC calculations, those industries are not appropriate benchmarks." Proposed Order at 78. Staff recommends revising the sentence in question to read as follows:

> Moreover, Staff contends that the average authorized equity returns for gas and electric utilities, which SBCI introduced as a benchmark, cannot reasonably be compared to Staff's cost of equity estimate, as SBCI did not demonstrate that the risk level of the companies included in the average authorized equity returns for gas and electric utilities reasonably reflects that of UNE loop operations.

See Staff IB at 88.

7) The first sentence under III. B. 3. c) (4) should be corrected as follows: "We reject the SBC estimate of the cost of equity ~~based~~ because…[.]" .Proposed Order at 79.

8) The first paragraph under III. B. 3. d) (2) states, "ATT/MCI' divide the remaining proportion of capital into ST (22.35%) and long-term (11.53%) debt based

upon the proportion each represents in SBC's 2002 book value capital structure." Proposed Order at 80. It should read, "ATT/MCI~~'~~ divided the remaining proportion of capital into ST (22.35%) and long-term (11.53%) debt based upon the proportion each represents in ~~SBC's~~ SBCI's 2002 book value capital structure." *See* AT&T / MCI Joint Ex. 2, Attachment TLM-2 at 3 and 12.

9) Staff recommends the third paragraph under III. B. 3. d) (3) be corrected as follows: "We find that, contrary to SBCI's argument, a careful reading of the FCC's TRO order demonstrates ~~however~~ that setting TELRIC rates does not currently require one to assume "full" or "ubiquitous" competition when reality is something less than that." Proposed Order at 80-81.

10) The last paragraph under III. B. 3. d) (3) states, "Staff uses interest coverage ratios from its Telecom Sample companies adjusted to reflect a level of competition consistent with unregulated industrial companies." Proposed Order at 81. It should read, "Staff uses interest coverage ratios from its Telecom Sample companies ~~adjusted to reflect a level of competition consistent with~~, which reflect a level of competition slightly lower than that of unregulated industrial companies."

3. [III.C.4.(a)] NID and Drop Wire Installation Costs

Staff takes exception to the Proposed Order's conclusion regarding travel times for NID and drop wire installers. The Proposed Order accepted SBC Illinois' position and rejected the Staff proposal to reduce the travel time estimates incorporated into SBC's cost estimates. Proposed Order at 111.

The travel time debate focused on travel to and from the shop and travel between drop installations. SBC justified its longer travel times on the claim that

technicians must travel a good distance between drop installations in its existing network. SBC Illinois Ex. 4.2 at 45. Staff criticized the Company's approach, arguing that TELRIC is based on the concept of constructing a network today on a forward-looking basis with current technologies. Under that assumption, Staff contended that technicians would not have to travel significant distances between installations and therefore SBC's time estimates were inflated. Staff Ex. 23 (Lazare Rebuttal) at 15-16. Furthermore, Staff noted that the Company had failed to support its own proposal, which provides further justification for adopting the Staff proposal. Staff Ex. 23 (Lazare Rebuttal) at 13-14. Thus, SBC's travel time estimates reflect the travel times for NID and Drop Wire installations that occur in SBC's embedded network (i.e., installations that do not necessarily occur in close proximity to each other thereby resulting in increased travel times). Under TELRIC's assumption of building a network from scratch, installation of NIDs and Drop Wires should be coordinated so as to reduce the travel time per installation experienced in SBC's existing network. These positions were fully explained in Staff's briefs. *See* Staff Initial Brief at 126-128; Staff Reply Brief at 70-73.

The Proposed Order's rejected Staff's position based on its earlier determination that TELRIC costs need not reflect the costs that would be incurred if a carrier were to rebuild the network from the ground up using the most efficient technology and design:

> We do not agree with CLECs and Staff that TELRIC requires that we base prices on the assumption that a new network will be built from the ground up.
>
> * * *
>
> The only remaining issue here is Staff's proposal to reduce travel times. Consistent with other decisions, we do not find that TELRIC requires, nor would it be practical to assume, that we are considering the

> construction of a brand new network from the ground up. We must consider SBC's current wire centers and the fact that any network, no matter how efficient, will need maintenance and expansion projects. Staff's proposal would ignore these realities.
>
> * * *
>
> . . . Under TELRIC, as we state elsewhere, we are not assuming that a new network would be built from the ground up.

Proposed Order at 27, 111, 127.

Contrary to the Proposed Order's determination, the Federal Communications Commission ("FCC") has determined and held that one of the principle assumptions of TELRIC is that costs should be determined on the assumption that the network is constructed from scratch:

> 34. A central issue contested by the parties is the appropriate discount for Verizon's switches. Verizon's Rhode Island switching rates are based on the assumption that it will not replace any switches in Rhode Island, but only expand switch capacity through growth additions to existing switches. Typically, vendors provide greater discounts for new, replacement switches than for growth additions to existing switches. AT&T and WorldCom contend that Verizon's assumption of no new, replacement switches and only growth additions is inconsistent with TELRIC principles. While the Commission has not to date specified an appropriate split between new, replacement switches and growth additions, we strongly question an assumption of only growth additions, as proposed by Verizon and incorporated in the April 11 rates adopted by the Rhode Island Commission. **Even if some growth additions may be used in a forward-looking network, the absence of any new switches is inconsistent with the assumption in TELRIC pricing of a forward-looking network built from scratch, given the location of the existing wire centers. Although an efficient competitor might anticipate some growth additions over the long run, rates based on an assumption of all growth additions and no new switches do not comply with TELRIC principles.** We also note that the Rhode Island Commission determined that Verizon's assumptions for switch cost recovery in the new UNE rate proceeding will be based on a rebuttable presumption of 90 percent new switches to 10 percent growth additions.

In the Matter of Application by Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon

Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in Rhode Island, CC Docket No. 01-324, Memorandum Opinion and Order, FCC 02-63 at ¶ 34 (rel. Feb. 22, 2002) (emphasis added) (footnotes omitted) ("Verizon 271 Order).

The United States Supreme Court has echoed the FCC's pronouncement that TELRIC pricing assumes a forward-looking network built from scratch:

> Finally, as to the incumbents' accusation that TELRIC is too complicated to be practical, a criticism at least as telling can be leveled at traditional rate making methodologies and the alternatives proffered. "One important potential advantage of the TELRIC approach, however is its relative ease of calculation. **Rather than estimate costs reflecting the present [incumbent] network--a difficult task even if [incumbents] provided reliable data--it is possible to generate TELRIC estimates based on a 'green field' approach, which assumes construction of a network from scratch.**" App. 182 (Reply Comments of the National Telecommunications and Information Administration 24 (May 30, 1996)). To the extent that the traditional public-utility model generally relied on embedded costs, similar sorts of complexity in reckoning were exacerbated by an asymmetry of information, much to the utilities' benefit. See supra, at 13-14, 27.

Verizon Communications, Inc., et al. v. FCC, et al., 535 U.S. 467, 522, 122 S.Ct. 1646, 1678, 152 L.Ed. 2d 701,744 (2002) ("*Verizon*") (emphasis added) (bracketed material in original). The view that TELRIC requires a "built from scratch" assumption was shared by dissenting Justices Breyer as well:

> … [The FCC's] rules create a "start-from-scratch" version of what the Commission calls a "Total Element Long-Run Incremental Cost" system (TELRIC). See A. Kahn, T. Tardiff, & D. Weisman, The Telecommunications Act at three years: an economic evaluation of its implementation by the Federal Communications Commission, 11 Info. Econ. & Policy 319, 326 (1999) (Lodged with the Clerk of this Court) (referring to the FCC's system as "TELRIC-Blank Slate") (hereinafter Kahn). In essence, the Commission requires local regulators to determine the cost of supplying a particular incumbent network "element" to a new entrant, not by looking at what it has cost that incumbent to supply the element in the past, nor by looking at what it will cost that incumbent to supply that element in the future. Rather, the regulator must look to what it

> would cost a hypothetical perfectly efficient firm to supply that element in the future, **assuming that the hypothetical firm were to build essentially from scratch** a new, perfectly efficient communications network. The only concession to the incumbent's actual network is the presumption that presently existing wire centers-which hold the switching equipment for a local area-will remain in their current locations. See In re Implementation of the Local Competition Provision in the Telecommunications Act of 1996, P685, 11 FCC Rcd 15499 (1996) (hereinafter Order) (describing TELRIC as "based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that the reconstructed local network will employ the most efficient technology for reasonably foreseeable capacity requirements").
>
> An example will help explain the system as I understand it. Imagine an incumbent local telephone company's major switching center, say, in downtown Chicago, from which cables and wires run through conduits or along poles to subsidiary switching equipment, other electronic equipment, and eventually to end-user equipment, such as telephone handsets, computer modems, or fax machines located in office buildings or private residences. A new competitor, whom the law entitles to use an "element" of the incumbent firm's system, asks for use of such an "element," say, a single five-block portion of this system, thereby obtaining access to 20 downtown office buildings. **Under the Commission's TELRIC, the incumbent's "cost" (upon which "rates" must be based) equals not the real resources that the Chicago incumbent must spend to provide the five-block "element" demanded, but the resources that a hypothetical perfectly efficient new supplier would spend were that supplier rebuilding the entire downtown Chicago system, other than the local wire center, from scratch.** This latter figure, of course, might be very different from any incumbent's actual costs.

Verizon, 535 U.S. at 540-541, 122 S.Ct. at 1688, 152 L.Ed. 2d at 755 (Breyer J., dissenting) (emphasis added).

Given that the FCC and United States Supreme Court have made clear that TELRIC is in fact based on the assumption that costs should be determined based on the costs to build a complete network from scratch, the Proposed Order errs in rejecting Staff's travel time adjustment based on its total rejection of that very assumption (i.e., that TELRIC costs should be determined based on the costs to build a complete network from scratch).

The Proposed Order's conclusion also appears internally inconsistent. On the one hand, TELRIC assumes that the network is built using current technology. However, the Proposed Order assumes that this current technology was installed sometime in the past, perhaps ten, twenty or thirty years ago. Under this logic, a NID and Drop Wire manufactured in 2004 could have been installed by a technician in 1964. To add to the confusion, the Proposed Order accepts current wage rates as the basis for calculating labor costs for this work. So, in essence, the Proposed Order assumes that modern equipment was installed years ago by labor paid at current wage levels. The end result of these assumptions is a set of costs that are meaningless or, at best, are not TELRIC compliant.

The only logical approach from a TELRIC standpoint is to apply consistent current assumptions to all inputs in the process. Since TELRIC assumes current equipment and current labor rates, then the labor should be current as well. In other words, the assumption should be that the network is constructed today on a going-forward basis. Under that assumption, Staff's proposed revision of the Company's travel times should clearly be adopted. It would be easy to schedule drop installations in close proximity to each other and cut travel times significantly below SBC's estimates if the network were being constructed today. That would lend support to Staff's assumption that a technician could install four drops in one day and one round trip to the shop can be spread out over four installations, reducing the per-unit travel time considerably below the Company's estimate.

There is good reason to adopt the Staff proposal even if the limiting assumption that the network should be assumed to have been built over time is accepted. In an

existing network, opportunities still arise to group customers together and minimize travel times. It would be reasonable to assume that drops may be installed in close physical proximity and travel times can be reduced below the Company's inflated levels which assume customers to be far apart.

Another problem with the Proposed Order's conclusion on travel times is that it only focuses on perceived problems with the Staff position on this issue. It fails to fully examine the assumptions underlying the Company's proposed travel times. The only reference to the Company's approach in the Commission Analysis and Conclusion section of the Proposed Order is the following statement:

> Further, the evidence showed that, contrary to Staff's assumption, SBC's proposal does not contemplate having the technician return to the garage in between every job.

Proposed Order at 111. This conclusion reflects an incomplete analysis. The Company never specified what it assumed concerning the installations performed by a technician during the course of a workday. The Company's statement that it did not expect the technician to return to the garage between jobs is disingenuous because SBC never identified the amount of travel expected for the technician over the course of a workday. SBC never indicated how many installations the technician was assumed to complete between leaving and returning to the garage. Nor did SBC indicate how much travel was assumed between job sites before returning to the garage. *See* SBC Illinois Ex. 4.2 at 44-45.

If the Proposed Order had taken a closer look at the Company's proposal, it would have found it to be woefully lacking. SBC fails to provide any coherent explanation of how its proposed travel times were developed. Thus, there is no credible

evidence in the record to support the travel times the Proposed Order found most reasonable in this case.

Based on the forgoing, Staff recommends that the Proposed Order's conclusions on travel times be rejected in favor of the following language:

> The only remaining issue here is Staff's proposal to reduce travel times. The Commission finds that Staff's proposed revision is reasonable and should be adopted in this proceeding. Staff has demonstrated in this proceeding that the Company's proposal on this issue is fundamentally flawed. The costs developed under TELRIC must be consistent with the assumption that the network is built from scratch. See *Verizon Communications, Inc., et al. v. FCC, et al.,* 535 U.S. 467, 522, 540-41, 122 S.Ct. 1646, 1678, 1688, 152 L.Ed. 2d 701,744, 755 (2002). We agree with Staff that the travel times SBC achieves in connection with its actual embedded network are not representative of the travel times that SBC would experience if it were building its network from scratch. Staff has also provided a reasonable alternative that incorporates the realistic assumption that drops may be installed in close physical proximity and travel times can be reduced below the Company's inflated levels. SBC, for its part, has failed to explain its underlying assumptions or support its proposal in a meaningful way. In sum, the Staff proposal is reasonable and well supported while the Company proposal is arbitrary and not explained. Therefore, we choose to adopt Staff's proposed travel times for drop installations.

Staff further proposes that the statements finding that TELRIC is not based on the assumption that the network is constructed from the ground up be deleted (Proposed Order at 29, 127) because TELRIC in fact requires that cost be based on the assumption that the network is built from scratch.

4. [VI.C.2] Uncollectible Expense

Staff takes issue with the Proposed Order's finding that uncollectible expense as calculated by the Company is proper.

The basis of the Proposed Order's finding is that SBC Illinois has shown that there is no relationship between bad debt expense and revenues. Proposed Order at

249. Very simply put, there cannot be uncollectible expense unless we first acknowledge that revenue exists. There is no dispute that the SBC Illinois will bill revenue to customers. If the billed revenue is collected, then there will be no uncollectible expense. If the billed revenue is not collected, then there will be uncollectible expense. The question of the existence of a relationship between uncollectible expense and revenue is that simple. *See* Staff Initial Brief, at 209-210; Staff Reply Brief, at 88-89.

What is more uncertain, however, is the quantification of that relationship. SBC Illinois' position is that uncontrolled factors determine the amount of uncollectible expense. SBC Illinois Ex. 17.1 (Dominak Surrebuttal), pp. 12 - 15. To be sure, the relationship might be impacted by numerous factors. However, at this time the best available evidence is the historical relationship of revenues and uncollectible expense. Staff Exhibit 29.0 (Smith Rebuttal of SBC), pp. 9 -12. While it might be interesting to speculate about future bankruptcies, we must assume that rates that are being developed in this Docket will be charged to competitive entities and that those entities will survive and continue to compete. If this assumption is not made, then we need to rethink the process of setting rates to ensure that competition comes about and flourishes.

Based on the foregoing, the following changes to the Proposed Order, page 249, are appropriate:

> With respect to the treatment of wholesale uncollectibles, ~~however,~~ we ~~do not~~ find Staff witness Smith's argument to be convincing. The primary premise to his argument is that uncollectibles are a factor of revenue. SBC presented <u>some</u> evidence to ~~the contrary that showed that between 2000 and 2001 and again between 2001 and 2002 UNE and wholesale revenue increased and between 2000 and 2001 wholesale bad~~

~~debt expense increased, but decreased between 2001 and 2002.~~ show that other factors impact uncollectible expense. However, at this time, and until competition is fully established, those relationships cannot be fully understood and it would be inappropriate to establish ~~rates base~~ rates based on those unknown relationships. ~~We agree with SBC that factors other than revenue impact bad debt, such as CLEC bankruptcies.~~ At some future date when the relationship between bad debts and bankruptcies in a competitive environment is known it might be appropriate to incorporate that knowledge, along with the relationship between bad debts and revenues, and perhaps other factors as well. In the mean time, it is certain that a relationship between uncollectible expense and revenues exists, that relationship has been quantified, and, consequently, ~~For these reasons,~~ we adopt ~~SBC's~~ Staff's proposal for the treatment of uncollectible expense.

In the event that the Commission were to reject Staff's recommendation, we believe that the following paragraph from page 249 of the PO should nevertheless be modified.

> With respect to the treatment of wholesale uncollectibles, however, we do not find Staff witness Smith's argument to be convincing. The primary premise to his argument is that uncollectibles are a factor of revenue. It is clear that a relationship between uncollectible expense and revenues exists. However, SBC Illinois presented adequate evidence ~~to the contrary~~ that showed that between 2000 and 2001 and again between 2001 and 2002 UNE and wholesale revenue increased and between 2000 and 2001 wholesale bad debt expense increased, but decreased between 2001 and 2002. We agree with SBC that factors ~~other than~~ in addition to revenue impact bad debt, such as CLEC bankruptcies. For these reasons, based on the evidence contained in the record in this Docket, we adopt SBC's proposal for the treatment of uncollectible expense.

5. [VI.C.3] Wholesale Marketing Expense

Staff does not take exception to the PO's position with regard to wholesale marketing expense; but Staff notes that the PO does not directly dispose of Staff's recommendation.

The following modification should be made to the language on page 253 of the PO.

> We reject CLECs' proposal to apportion wholesale marketing expense between UNEs and all other wholesale products based on revenues. We find that use of a revenue-based allocator will over-allocate marketing expense to those products generating higher levels of contribution than UNEs and under-allocate marketing expense to UNEs.
>
> We also reject Staff's proposal to eliminate all marketing expense. We find that it is reasonable to expect that SBC must of necessity incur some cost to provide information and otherwise service its competitive customers.
>
> We agree with CLECs, however, that Account 6613 should be excluded from SBC's shared cost factor. SBC has provided no data to support its claim that marketing expense includes customer assistance and/or customer information expense in addition to selling expense. Although SBC claims that "virtually all" of the expenses related to customer assistance and information expenditures, it has not provided any support for this assertion. Accordingly, it has not met its burden of proof and Account 6613 should be removed.

6. [IX.A] Preemption, Tariffing and Related Issues

The *Proposed Order* determines that this proceeding is something of a hybrid, having been initially filed as a Section 9-201 tariff proceeding, and thereafter being converted by passage of time and operation of law into a generic proceeding under Section 252 of the Telecommunications Act of 1996. *See* Proposed Order at 288-89. This conclusion is – as Staff noted in its *Initial Brief Regarding the Impact of Various Court Decisions* ("Staff IBRIVCD") – not inherently infirm. *See* Staff IBRIVCD at 5 *et seq*. Indeed, the *Proposed Order* rightly concludes that the substance of this proceeding should govern over its form, and that the filing of tariffs is consistent with the federal regulatory framework. Proposed Order at 288-89. However, several of the *Proposed Order's* conclusions are not entirely consistent with the federal law, and should be amended.

First, the Proposed Order provides that:

> Whether or not SBC voluntarily made this filing is not the central concern stated by the Seventh Circuit in *Bie.* Rather, it is clear from the *Bie* decision that CLECs may not purchase UNEs directly from the tariff that will be the result of this proceeding without negotiating an interconnection agreement with SBC. The Sixth Circuit raised a similar concern in *Verizon v. Strand*, when it vacated state tariffs and noted that:
>
> > the MPSC order permits competitors to purchase the services and elements directly off of the tariff menu, obviating the need to negotiate or arbitrate an interconnection agreement. *Verizon North, Inc. v. John G. Strand*, 309 F.3d 935, 939 (Sixth Circuit)(2002)("*Verizon v. Strand*").
>
> The tariffs that will result from this proceeding, however, will only be available to carriers that enter into an interconnection agreement with SBC.
>
> Proposed Order at 288.

This statement misapprehends the Bie decision. The *Bie* court found that *mandatory* tariffing of UNE rates cannot be reconciled with the federal regulatory framework. Bie, 340 F.3d at 444-45; *see also* Staff IBRIVCD at 9 *et seq*. The Bie court found that the infirmity of the Wisconsin requirement was that it compelled the incumbent to offer UNEs at tariffed rates to carriers without interconnection agreements – in other words, to "bypass" the federal framework of negotiation. Bie, 240 F.3d at 445. In short, the involuntary nature of the tariff filing was a central issue in *Bie*.

Here, as the *Proposed Order* correctly observes, the tariffing in question is not only voluntary, it is proposed by the ILEC. Proposed Order at 288. Accordingly, it is unnecessary to include a reference to this particular question in the *Proposed Order*, and the Staff recommends its deletion.

The Proposed Order also provides that:

> The various court decisions make clear that we may not circumvent the procedural process laid out in TA96. Part of that process involves review by federal courts and only federal courts. This proceeding only concerns

> a question of federal law and no state law is implicated. A caption that was in place prior to these various court decisions should not impact the appeal of this proceeding only in the federal courts.
>
> Proposed Order at 289

This proposition is a questionable one. First, the case undoubtedly presents state issues, including the propriety of the *Proposed Order's* recommended decision regarding the imputation test. Second, the proceeding is one convened under state law, and indeed initiated under a state statute. Concurrent jurisdiction may therefore lie with respect to any appeal taken from the Commission's order in this proceeding. Moreover, the *Proposed Order* gains nothing by asserting that appellate jurisdiction is exclusively federal. Such a recital cannot as a matter of law affect which court has jurisdiction.

Accordingly, the Staff recommends the following changes to the Proposed Order, beginning at page 288:

> In our view, there is no doubt that SBC voluntarily sought and filed rate increases pursuant to Section 9-201 of the PUA. Moreover, SBC has had ample opportunity to argue that this docket is procedurally incorrect. Indeed, the Commission gave SBC the opportunity to refile its cost studies with updated numbers and SBC could have, at that time, re-captioned this proceeding as a generic ratemaking pursuant to Section 252. SBC's quest for higher rates is far from compulsory and, in fact, opposed by Commission Staff.
>
> We do not believe that the caption or procedural posture of this docket in any way impacts the substantive nature of this proceeding. Given that SBC filed its rates before the *Bie* decision, it was reasonable at the time to assume that Section 9-201 was an acceptable vehicle for such decisions.
>
> ~~Whether or not SBC voluntarily made this filing is not the central concern stated by the Seventh Circuit in *Bie*. Rather, it is clear from the *Bie* decision that CLECs may not purchase UNEs directly from the tariff that will be the result of this proceeding without negotiating an interconnection agreement with SBC. The Sixth Circuit raised a similar concern in *Verizon v. Strand*, when it vacated state tariffs and noted that:~~
>
> > ~~the MPSC order permits competitors to purchase the services and elements directly off of the tariff menu, obviating the need to~~

> ~~negotiate or arbitrate an interconnection agreement. *Verizon North, Inc. v. John G. Strand*, 309 F.3d 935, 939 (Sixth Circuit)(2002)("*Verizon v. Strand*").~~

~~The tariffs that will result from this proceeding, however, will only be available to carriers that enter into an interconnection agreement with SBC.~~ The prices contained in the tariff are to be treated as a means to aide negotiations between the parties. The prices contained in a final interconnection agreement may be lower or higher than those contained in the tariff based on the give and take inherent in the negotiation process.

Accordingly, we direct SBC to file tariffs in accordance with the decision contained herein that will incorporate the following language:

> The following tariffs contain rates approved by the Illinois Commerce Commission as being compliant with the TELRIC requirements of the Telecommunications Act of 1996 and the directives of the Federal Communications Commission. The tariffs are intended to facilitate the required negotiation process between SBC and carriers seeking to enter into interconnection agreements with SBC. SBC and competitive carriers may adopt these rates in whole or in part, if at all, as part of the negotiation process required by the Telecommunications Act of 1996.

Additionally, the Commission notes that the rates adopted herein do not impact existing agreements, except to the extent required by provisions within the interconnection agreements themselves.

~~The various court decisions make clear that we may not circumvent the procedural process laid out in TA96. Part of that process involves review by federal courts and only federal courts. This proceeding only concerns a question of federal law and no state law is implicated. A caption that was in place prior to these various court decisions should not impact the appeal of this proceeding only in the federal courts.~~

III. STAFF'S CALCULATION OF RATES RECOMMENDED BY THE PROPOSED ORDER

Findings 4 and 5 of the Proposed Order provide that SBC and Staff shall provide a calculation of the rates adopted by the Proposed Order with their Briefs on Exceptions:

> (4) pursuant to Section 200.875 of the Commission's Rules of Practice, a calculation of the rates adopted herein shall be provided by SBC and Staff with their Briefs on Exceptions; the calculation shall be served on all parties and the parties may respond with their Reply Briefs on Exception;
>
> (5) the calculation and responses thereto shall be filed with the Chief Clerks office and treated as late-filed exhibits;

Staff calculation of the rates recommended by the Proposed Order are attached hereto as Late Filed Exhibits 1 and 2, and are further explained in this section of this Brief on Exceptions.

Staff implemented the following changes to the January 20, 2004 version of LoopCAT and related models filed by SBC in order to compute UNE rates consistent with inputs recommended by the *Proposed Order*. Where the input value recommended by the *Proposed Order* was already incorporated into the January 20 version of LoopCAT, Staff did not change that input.

A. UNE Loop Recurring Cost Studies

1. Major Inputs to Cost Studies

a) Fills

Actual fills were adjusted for bad pairs as instructed by the Proposed Order and to reflect distribution fills based on 1998 fill data. *See* Proposed Order at 61-62. Staff then applied the *Proposed Order* capacity adjustments to these revised actual fills as follows:

The multiplier associated with the 15% capacity adjustments was applied to distribution plant (distribution and distribution installation) for the eight low capacity loop types and the DS1 loops (PreProcessFill Tab of LoopCAT). *See* Proposed Order at 58, 62. The multiplier associated with 7.5% capacity adjustments was applied to (1) feeder fills (2) DLC Chassis fills (PreProcessFill Tab of LoopCAT) and 3) Business Premises Termination fills (Yearly_Input Tab of LoopCAT). Staff made no other adjustments to fills. Id.

Updated fills were also entered into the ACF model[4], which impacted maintenance and other expense ratios. Specifically, Staff updated the Inputs tab of the ACF model as follows: column E at lines 449, 450, 453, 454, 457, 458, 461, and 462; column F at lines 455, 459, and 463; and column F at lines 449, 450, 453, 454, 455, 457, 458, 459, 461, 462, and 463. Amongst other modifications to the ACF model, the changes noted here have the impact of flow through to TELRIC costs via the revised ACFs that are input into LoopCAT.

b) Depreciation

Economic lives and salvage values proposed by AT&T witness Majoros, which the *Proposed Order* recommended adoption, were entered into the ACF model. Proposed Order at 72-73. Economic lives were modified in the Inputs tab of the ACF model in columns D and F, at lines 24-57. The only modification to Gross salvage values was at column J, lines 26 and 38. Modifications to the cost of removal were

[4] SBC's ACF model was provided electronically as ACF_2001_IL_STD_10-15-2002 Adjusted 2003-12-10.xls. This model was submitted with SBC's rebuttal round of testimony on January 20, 2004.

made at column k, lines 27, 29, 30, 31, 45, 49, 50, and 56. As with fill factors, the changes noted here have the impact of flow through to TELRIC costs via the revised ACF's that are input into LoopCAT.

c) Cost of Capital

The *Proposed Order* provided a table of values for debt and equity, along with their relative weighting. Proposed Order at 83. From that table, Staff calculated the cost of capital as 8.96%, the debt ratio as 49%, and the interest rate as 8.33%. Because the values for cost of capital, debt ratio, and interest rate differ from those proposed by SBC, Staff updated the Inputs tab of the ACF model at cells D15, D17, and D18 respectively to reflect the findings of the Proposed Order. Staff notes that the *Proposed Order* indicated that the cost of capital in this proceeding should be 8.94%. Proposed Order at 83. It appears that the *Proposed Order* truncated its calculation of the cost of capital, and is therefore not as precise as the calculation provided by Staff. Based on *ex parte* discussions with SBC and intervenors, Staff is confident that its 8.96% calculation is the most appropriate cost of capital for use in this proceeding.

The combined impacts of changes to ACF model due to fill factors, depreciation, and cost of money flow through to LoopCAT. Staff's revised ACF calculations were entered into cells AI28:AN41 of the Yearly_Inut tab of LoopCAT. Similarly, updated capital cost factors from the ACF model were entered into cells D38:J46 of the Input Tab of the DS1_Loop Circuit Equipment models and DS3_Loop Circuit Equipment Models. Updated capital expense factors were entered into the Inputs Tab of the DS3 Recurring Loop Study. Finally, changes to capital cost factors within the ACF model

also impacted shared and common costs. The changes that impact shared and common costs are described in the Section III.D below.

B. Other Loop Recurring Cost Modeling Input Issues

1. Cable and DLC Installation Factors

The Proposed Order approved Staff's copper installation factors that were entered in cells C15:F18 of the Yearly_Input Tab LoopCAT. Staff's fiber installation factors were entered into cells C26:E29 of the Inputs Tab in AIT Fiber Cost Summary model. *See* Proposed Order at 92-93. This generated new fiber cable costs that were entered into cells B48:D50 of the Yearly_Input Tab of LoopCAT and into the Inputs Tab of the DS3 Recurring Cost Study.

2. DLC Investment cost Issues - Allocation of Shared DLC Components

Since the *Proposed Order* recommended allocation of 21.6 units of common investment to the DS-1 loop, Proposed Order at 105-06, Staff changed cells T53 and AE77 of the Yearly_Input Tab of LoopCAT from 24 to 21.6. However, cells D57 and I64 of the DLC_IDLC_COT Tab of LoopCAT were still set to 24. All these changes were implemented for DS1 loops only.

3. DLC Investment cost Issues - Remote Terminal investment Cost Allocation

The Proposed Order recommended that 25% of common costs be allocated to advanced services. Proposed Order at 109. Consequently, Staff multipled cells I139,I147 and I155 of the DLC _RT_Cabinets Tab of LoopCAT by .75. However since

there is no common cost for Time Slot Interchangers cell I17 on the same spreadsheet was multiplied by 4/3 to reverse out previous change.

Similarly, cells I39 and I92 of the DLC_CEVs tab were multiplied by .75 while cell I19 (Time Slot Interchanger) was multiplied by a ratio of 4/3.

4. FDI Costs

The Proposed Order recommended adoption of the CLEC position to account for directly fed buildings. Proposed Order at 118. Consequently, the formula for cell g41 in the Expanded_Summary Tab of Loopcat was copied from the Pitkin and Turner UNE rate model and inputted into LoopCAT. For DS1 loops the values recommended by Joint CLEC witnesses Pitkin and Turner were multiplied against SBC's existing values.

5. Loop length, Cable size and gauge modeling - Copper Cable Mix

The *Proposed Order* recommended adoption of the CLEC position regarding this issue. Proposed Order at 125-26. To accommodate this change, Staff went to the Yearly_Input Tab of LoopCAT and divided cells BC14:BG73 (aerial cable) by 1.05, cells BG14:BJ73 (Buried Cable) by 1.3 and cells BK14:BN73 by 2.12. In addition Staff replaced the cells E15:E31 of Aerial_xx_Gauge, Buried_xx_Gauge and Underground_xx_Gauge Tabs with the formula provided in the Pitkin and Turner model runs.

C. Labor Rates

Base wage rates were made consistent with the March ruling on this issue. The other expense loading was set at 0.45% of the base wage rate. Support asset loadings were set at zero. See, generally, Proposed Order at 215-17.

The updated labor rate (43xx) was entered in cell A11 of the Yearly_Input Tab of LoopCAT. The other updated labor rate (41xx) was inputted into the Miscellaneous Material cost model that generated new premises termination costs which were subsequently inputted into cells A21:A22 of the Yearly_Input Tab of LoopCAT.

D. Shared and Common Factors

Staff implemented the following changes to the January 20, 2004, version of the Shared and Common Cost Study and related models filed by SBC in order to compute UNE rates consistent with inputs recommended by the *Proposed Order*.

1. The *Proposed Order* recommends adopting the CLECs' proposal to reduce all 67XX costs by the avoided wholesale discount factor. *Proposed Order* at 232. Staff inserted the formula to accomplish the *Proposed Order*'s recommendation in TAB 3 (column N, row 173, 174, and 178 to 185). This factor is also shown on the TAB 1 results page at the top of the page—*****BEGIN CONF** xxx **END CONF*****.

2. The *Proposed Order* rejected SBC's proposal to include the TBO in establishing UNE rates. *Proposed Order* at 236. To reflect the *****BEGIN CONF** xxx **END CONF***** of TBO that the *Proposed Order* recommends being excluded from the final calculation of the Common Cost numerator, Staff inputted (or placed) $0 directly in TAB 1-Result, Line 14 (cell E25).

3. The *Proposed Order* adopted Staff's proposed adjustment to reduce the common cost expense to reflect a decrease in the number of employees. *Proposed Order* at 243. To accomplish this, Staff formulated TAB – Results Line 1 through 9 (cell E11 through E19) for reduction (1 – ***BEGIN CONF xxx END CONF***) to reflect the employee levels contained in Staff Ex. 9.0 (Smith), Sched. 9.4. A computation of Support Assets expense from TAB – Inputs was also performed to reflect the *Proposed Order's* recommended employee level. Staff added cell D335 through D341 in the TAB – Inputs, multiplied by ***BEGIN CONF xxx END CONF***, and the amount of decrease was placed on TAB – Result under Line 11 (cell E22).

4. The *Proposed Order* recommended rejecting Staff witness Smith's proposed treatment of uncollectible expenses and adopted SBC's proposal. *Proposed Order* at 249. Staff, accordingly, added ***BEGIN CONF xxx END CONF*** in TAB – Inputs Line 45 (Cell E53) and this amount is also reflected on TAB – Result, Line 29 (E49) in the shared cost numerator.

5. The *Proposed Order* recommended adopting the CLECs' proposal that Account 6613 should be excluded from SBC's shared cost factor. *Proposed Order* at 253. To accomplish this, Staff inputted ***BEGIN CONF xxx END CONF*** directly in Account 6613 on TAB 2 – Inputs, line 90 (E103), and the calculation also affected the amount shown on the TAB 1 - Results worksheet on line 26, which resulted in ***BEGIN CONF xxx END CONF***.

6. The *Proposed Order* recommended adopting Staff's proposal that the shared and common costs ratios should have the same denominator, which is "Total

Direct Costs." *Proposed Order* at 257. To accomplish this, Staff changed the Result TAB, Line 36 (Cell E58) to directly input 100%. The Total Direct Costs are shown on lines 24 and 39 of the Results worksheet.

7. The *Proposed Order* recommended adopting Staff's proposal that building, land and capital costs should be excluded from the non-recurring costs. *Proposed Order* at 269. To accomplish this, Staff directly inputted *****BEGIN CONF** xx **END CONF***** in TAB – Inputs, Line 118 through 121 (cell 147 through 150). *See also* Staff Ex. 6.0 (Hanson) at 19.

8. The *Proposed Order* also recommended adopting the CLEC's proposal to include all the support asset costs in the shared and common factor. *Proposed Order* at 269. To accomplish this, Staff incorporated support asset work sheet based on 2001 ARMIS data on TAB – Inputs, Line 212 to Line 226 (cell A320 to K342). Staff also imported the calculated results (column K, cell K320 to K342) to the appropriate rows on TAB – Calculation for each support asset capital and expenses. In addition, Staff inputted a formula to reduce *****BEGIN CONF** xxx **END CONF***** of the direct cost for account number 6623, Customer Service Account. *See* Surrebuttal Testimony of Starkey and Fisher, AT&T/Joint CLEC Ex. 1.2P at 27.

E. Annual Charge Factors

As was described previously, changes to fill factors, depreciation, and cost of money impacted the calculation of annual charge factors. *See also* Proposed Order at 262. The modifications described in the sections above for these items are not the only

changes affecting to the ACF model that are necessary. This section describes those additional modifications, as well as modifications to other models that flow from the changes to the ACF model.

1. Investment Factors

Three types of adjustments were necessary to bring the investment and annual expenses into compliance with the *Proposed Order's* recommendations. See, generally, Proposed Order at 264, 268-69. First, non-regulated investment and expenses for land and building needed to be removed from the Inputs tab of the ACF model. Land investment was modified by multiplying cell F93 by 91.18% and G93 by 93.93%. Building investment was modified by multiplying cell F102 by 90.72% and G102 by 93.95%. Annual expenses for Land and Building were modified by multiplying cells F181, F185, and I184 by 91.98%.

Second, collocation investment and expenses needed to be removed from Land and Building. The *Proposed Order* adopted the methodology put forth by CLEC witnesses in the rebuttal testimony of Starkey/Fischer. Proposed Order at 264. To implement this change, Staff multiplied cells F93, G93, F102, and G102 by 0.99716. Additionally, collocation revenues were accounted for by downward cost adjustments to cells AF13, AF15:16 of the Yearly_Input tab of LoopCAT. Figures for these cells were obtained from column I rows 44-45 of the ACF summary Tab.

2. Inflation Factors

Although inflation factors impact ACFs, no modifications to the ACF model were necessary as a result of the *Proposed Order's* recommended decision to remove

inflation from the calculation. Proposed Order at 270. Rather, inflation is handled directly in LoopCAT. Inflation factors were removed by setting cells AI46:AJ59 of the Yearly_Input tab of LoopCAT to 1. Similarly, cells E29:G32 of the Input Tab of the DS1_Loop Circuit Equipment models and DS3_Loop Circuit Equipment models were set equal to 1.

3. Support Asset Factors

The Proposed Order recommends that support assets be entirely recovered via shared and common costs, and not via loaded labor rates. Proposed Order at 268-69. Although the main impact of this decision affects nonrecurring charges, there is also an impact on recurring costs through ACFs. As such, the ACF model was revised by zeroing-out Column I of the Support Asset Expense tab.

4. Shared and Common Costs

Staff notes that changes to the ACF model flow through to the Shared and Common Cost model as well. This is due to three factors. First, capital costs developed in the Results tab of the ACF model are an input to the Shared and Common cost model. The capital cost factors from the Results tab of the ACF model are entered into cells G11 through G51 of the Tab 2- Inputs tab of the Shared and Common Cost model.

Second, capital costs developed in the Results tab of the ACF model are an input into the Support Assets model, which in turn provides input into the Shared and Common cost model. The capital cost factors from the Results tab of the ACF model are entered into cells K7 through K24 of the Capital Costs tab of the Support Assets

model. In turn, cells E305 through E311 in the Tab 2- Inputs tab of the Shared and Common Cost model are modified to reflect changes to cells E22, E26, E27, E28, E29, and F23 in tab SA-3 of the Support Assets model that result.

Third, the annual charge factors developed in the ACF model impact the output in LoopCAT, which also flows into the Shared and Common cost model. Information from the Expanded Summary tab of LoopCAT is summed, than placed into the formulas contained in cells D211 through D218 of the Tab 2- Inputs tab of the Shared and Common Cost model.

F. Rates for Non-Recurring Costs

The following describes how Staff implemented the Proposed Order's recommendations with respect to Non-Recurring charges.

Order Language

Page 173: "Although Staff recommends that SBC not charge anything for the work done by the SSC/LOC or the CPC/HPC, we require SBC to utilize whichever group has the lowest costs and is, therefore, the more efficient."

Page 173: "We agree with CLECs that because the loop is already working, SBC has given us no justification for SBC to do anything other than simply migrate the working loop over to the CLEC collocation arrangement or the transport element."

Resulting Change

LOC/SSC: Zero out all LOC/SSC values (Zero out the values in rows 1-4, 5-8, and 9-12, column D, in Tab 6.1 of the EEL study and the values in rows 1-4, column E, in Tab 6.2 of the Loop study).

CPC/HPC: Zero out all CPC/HPC values (Zero out the values in rows 1-4, 5-8, and 9-12, column D, in Tab 6.1 of the EEL study and the values in rows 1-4, column D, in Tab 6.2 of the Loop study).

Order Language

Page 173: "We find SBC's argument that IDFs help to mitigate premature exhaust of the Main Distribution Frame ("MDF") to be persuasive.

Proposed Change

No change to SBC's existing model. Can use IDFs, but see Page 190 for percentages.

Order Language

Page 182: "We direct SBC to utilize the testing and travel times of whichever group (CP&M/DOG) is lower."

Page 182: "We do not find the SME's estimates to be appropriate and, accordingly, we adopt CLEC's and Staff's adjustments to travel times."

Proposed Change

Replace DOG times in the EEL Study with CP&M times in the Loop Study (Replace the values of 30.00 and 25.00 in Line 51, Columns C and D, Line 105, Columns C and D, Line 159, Columns C and D of Tab 6.2 in the EEL study with the values 15.00 and 15.00.)

Replace the values in Lines 49, 103, 157, 193, 292, 336, 382, 383, and 481, Column C in the EEL study with 9.5.

Replace the values in Lines 3, 79, and 114, Column C of the Loop Study with 9.5.

Order Language

Page 182: "…we adopt CLEC's proposal to reduce the time it takes to perform DS1 and DS3 cross connects." Result of pre-connected quick connect jumpers.

Proposed Change

FOG: Reduce cross connect times to 2:00 minutes for DS1 to voice multiplexing in the EEL study (Replace Row 207 and 213, Columns C and D in Tab 6.2 of the EEL study with 2 minutes.) - See CLEC IB at 263 and Turner 3.0 at 45

FOG: Reduce cross connect times to 2:00 minutes for DS1 and DS3 Loops in the Loop Study (Replace Rows 86, 92 and 121, 127, Columns C and D in Tab 6.3 of the Loop study with 2 minutes.) - See CLEC IB at 263 and Turner 3.0 at 72,73

FOG: Reduce cross connect times to 2:00 minutes for DS1 and DS3 Loops and in the EEL Study (Replace Rows 173, 179, 232, 233, 243, 244, 266, 267, 277, 278, 310, 311, 321, 322, 354, 355, 365, 366, 402, 403, 413, 414 436, 437, 447, 448 Columns C and D in Tab 6.2 of the EEL Study to 2 minutes.)

DOG: Reduce cross connect times to 2.6 minutes for DS1 and 2.0 minutes for DS3 loops in the Loop Study (Replace Line 80, Columns C &D of the Loop Study with 2.6 and Line 115, Column C&D of the Loop Study with 2.00)

DOG: Reduce cross connect times to 2.6 minutes for DS1 and 2.0 minutes for DS3 Loops in the EEL Study (Replace Line 194, 293, 337, 384, 385, Columns C & D with 2.6 and Line 462 Columns C & D to 2.0)

Order Language

Page 182: "Staff and CLECs also note that SBC witness Gomez-McKeon, on cross-examination, demonstrated that the CLEC's proposal for standalone UNE POTS loop FOG activity times for establishing cross connects at the MDF and the IDF were more accurate than SBC's. Accordingly, we adopt CLEC's proposal to [sic] these at three minutes each.

Proposed Change

IDF: Reduce standalone FOG cross connect times to 3 minutes each for IDF and MDF (Replace the value of 8.00 in rows 58, 59, 65, and 66 columns C and D of Tab 6.3, page 37 of 100 in the Loop Study with 3.00.)

Order Language

Page 190: "Staff recommends, and we agree, that because of the inconsistencies identified in SBC's studies, the Commission should require the company to assume Staff's proposed CP&M work group occurrence factor for Standalone POTS UNE loops of around 4%.

Page 190: "…the new EEL DOP rate should be consistent with those adopted above."

Proposed Change

Create a new set of rows in Tab 6.3 of the Loop study. That is duplicate everything in rows 1-7 creating 1A-7A. The old rows where CP&M values for both Standalone and UNE-P loops. Now we want a separate set for each.

Assume the original 1-7 are the Standalone values. Change these by replacing the WGOF in Column H for all Lines 1-7 with 3.99%. (Note, the resulting values now should feed forward only into the standalone roll ups. See the next described change for how to fix this.)

Rows 1A-7A should match lines 1-7 except that the WGOF in Column H for all Lines 1A-7A should be 36.60%. (Note, you need to make sure this now feeds into the UNE-P roll up. Change the references in Lines 5 and 7, Column A of Tab 6.2 so that they grab the values in Lines 7A (not 7), Columns I and J of Tab 6.3.

The CP&M times are already being used for EEL loops (see Page 182).

Order Language

Page 190: "We adopt Staff's updated proposed WGOF for FOG UNE-P POTS loop disconnect activities."

Proposed Change

The WGOF in Loop Study at Lines 73-75 of Tab 6.3 should be set to 4.95%

Order Language

Page 190 "…we direct that the occurrence be reduced to the percentage [of IDFs in COs] proposed by Mr. Turner."

Proposed Change

The Task Occurrence Factor at Lines 58 and 65, Column G in Tab 6.3 of the Loop study should be set to 24.74%. The Task Occurrence Factor at Lines 30, 37, 84, 91, 138, and 145 Column G in Tab 6.2 of the EEL study should be set to 24.74%.

Order Language

Page 190 " We agree that SBC has included the same cross-connect costs in its proposed charges for elements that are routinely cross-connected to one another."

Proposed Change

The Task Occurrence Factor at Lines 229, 231, 233, 235, 237, 240, 242, 244, Column G in Tab 6.2 of the EEL study should be set to zero.

Order Language

Page 190 “CLECs argue that because multiplexing is almost always part of a larger order that included the transport element to which the multiplexing is connected, the WGOF should be set to 0.00 percent. We agree that CLEC’s proposal is reasonable and, therefore, is adopted.”

Proposed Change

Set task occurrence factor in Lines 216, 217, and 220 Column G to zero in TAB 6.2 of the EEL study.

Order Language

Page 191: UNE-P LAC work occurrence factors should be replaced by AMWLAC work occurrence factors.

Proposed Change

No change.

Order Language

Page 191: Assume 50% of CLEC orders for DS1 or DS3s are migrations in the Loop Study.

Proposed Change

HPC and SSC: Mulitply the value in the WGOF column for each value in Lines 94-98, 100, 102-106, 108-110, 129-132, 134, 136-139, 141-143 Column H by 0.5. For example if the value was 100% make it 50%. If the value was 30% make it 15%.

Order Language

Page 195: We adopt Staff’s fallback position of four years for developing disconnect charges.

Proposed Change

The values in column PV COM* in SBC Illinois Ex. 5.1, Schedule KAC-R9, TAB 6 at lines 2, 5, 8, 11, 14, 17, 20, 23, 26, 29, 32, 35, 38, 41, 44, 47, 50, 53, 56, 59, 62, 65, 68, 71 be recomputed assuming a 4 year location life. (You will probably need to adjust this figure for changes in the cost of capital.)

The values in column PV COM* in SBC Illinois Ex. 5.1, Schedule KAC-R8, TAB 6.1 at lines 2, 5, 8, 11 Column B and Tab 6.1.1 at lines 2, 5, 8, and 11 Column B be recomputed assuming a 4 year location life. (You will probably need to adjust this figure for changes in the cost of capital.)

The value in Line 2 of TAB 8.7 of SBC Illinois Ex. 7.1, Schedule DJB-R8 be recomputed assuming a 4 year location life. (You will probably need to adjust this figure for changes in the cost of capital.)

The value in Line 1 of TAB 8.4 of SBC Illinois Ex. 7.1, Schedule DJB-R9 be recomputed assuming a 4 year location life. (You will probably need to adjust this figure for changes in the cost of capital.)

Order Language

Page 210: "We agree with AT&T witness Turner that because there are functioning circuits, no provisioning work, and thus no provisioning charges, should apply. Additionally, we agree with Staff that SBC's proposal is based on an inefficient provisioning system.

Proposed Change

Design & Coordination non-recurring charges in lines 1,3,5,7,9,11,13,15,17, and 19 of the Special Access to UNE Study, Tab 3 should be set equal to $0.

IV. CONCLUSION

WHEREFORE, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in this proceeding and that the Proposed Order be modified as set forth in this Brief on Exceptions.

Respectfully submitted,

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