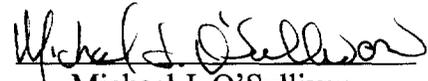
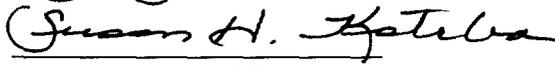


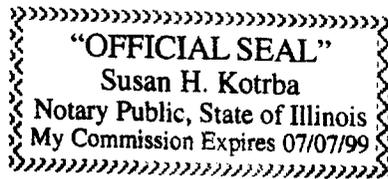
I swear, under penalty of perjury, that the foregoing is true and correct, to the best of my knowledge and belief.

  
Michael J. O'Sullivan

Subscribed and sworn before me this 5<sup>th</sup> day  
of July, 1997.

  
Notary Public

My commission expires \_\_\_\_\_



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**FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY**

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

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In the Matter of

Application of Ameritech  
Michigan Pursuant to Section  
271 of the Telecommunications  
Act of 1996 to Provide In-  
Region, InterLATA Services in  
Michigan

CC Docket No. 97-137

Reply Affidavit of William C. Palmer  
on Behalf of Ameritech Michigan

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

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In the matter of

Application of Ameritech Michigan  
Pursuant to Section 271 of the  
Telecommunications Act of 1996 to  
Provide In-Region, InterLATA Services in  
Michigan

CC Docket No. 97-137

**REPLY AFFIDAVIT OF WILLIAM C. PALMER  
ON BEHALF OF AMERITECH MICHIGAN**

STATE OF ILLINOIS     )  
                                  )     ss.  
COUNTY OF COOK     )

1. My name is William C. Palmer. I am Director of Economic Analysis at Ameritech Corporation. My business address is 225 West Randolph Street, Chicago, Illinois 60606.

2. The principal purpose of this Reply Affidavit is to respond to and rebut the assertions made in opposition affidavits filed on behalf of AT&T by James Henson and on behalf of MCI by August Ankum and Dennis Ricca.<sup>1/</sup> In addition, in this Reply Affidavit

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<sup>1/</sup> I respond principally to assertions made by these affiants regarding recurring and non-recurring rates for unbundled network elements ("UNEs"), interconnection and transport and termination of local traffic and the applicable wholesale discounts for resold services. In addition, although I address both (i) joint and common costs and (ii) collocation issues, Daniel Broadhurst (joint and common costs) and Paul Quick (collocation issues) have submitted reply affidavits on behalf of Ameritech Michigan  
(continued...)

I provide further support for the conclusion that the interim rates on which Ameritech Michigan currently relies in this docket do not exceed the cost-based rates required by Section 252(d)(1) and (2) of the Telecommunications Act of 1996 (the "Act") and that the wholesale discount on which it relies is not lower, or smaller, than that required by Section 252(d)(3) of the Act.

## **RESPONSE TO ASSERTIONS OF JAMES HENSON**

### **A. Background**

3. Prior to joining AT&T in 1995, Mr. Henson was employed by Ameritech Michigan. At Ameritech Michigan, Mr. Henson's duties included overseeing the preparation of cost of service studies, which included forward-looking incremental cost studies of the same sort as those mandated by the Commission's stayed pricing rules. (These studies were technically long run service incremental cost (LRSIC) or total service long run incremental cost (TSLRIC) studies, not the total element long run incremental cost (TELRIC) studies mandated by the Commission, but the principles and methodology employed are essentially the same.) Since going to work for AT&T, Mr. Henson has reviewed, analyzed and testified in regulatory proceedings about Ameritech's forward-looking long run incremental cost studies. These proceedings include arbitration proceedings that took place last fall in each of the five states in the Ameritech region. Thus, Mr. Henson is quite familiar with how Ameritech performs its cost studies and the principles, methods, procedures and assumptions they employ.

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1/(...continued)

that treat these issues in greater depth. Finally, Dr. Debra Aron responds to and rebuts certain of the "economic" assertions made by the AT&T/MCI affiants.

4. The last of the five arbitrations between Ameritech and AT&T took place in Wisconsin in mid-October 1996. While on the witness stand, Mr. Henson was questioned by the Wisconsin arbitration panel about the basic soundness of Ameritech's cost studies. His answers are quite telling and very much at odds with the positions he purports to take in this docket. Specifically, Mr. Henson testified that Ameritech's cost studies employ principles, methods and procedures that are "basically correct" and that the studies themselves are "basically a pretty good product." See AT&T/Ameritech Wisconsin Arb., Wisc. P.S.C., Dkt. Nos. 6720-MA-103 and 265-MA-101, Oct. 17, 1996 ("AT&T Wisc. Arb."), Tr. 1410-11; see also In the Matter of the Review of Ameritech Ohio's Economic Costs of Interconnection, Unbundled Network Elements, Etc., P.U.C. of Ohio, Case No. 96-922-TP-UNC, Feb. 18, 1997 ("Ohio 'Permanent' Cost Docket"), Tr. 21-28.

**B. Henson's Assertions Regarding Ameritech Michigan's Interim Rates For UNEs, Interconnection and Transport and Termination of Local Traffic**

5. As I described in my initial affidavit, the interim rates for UNEs, interconnection and transport and termination of local traffic have four sources:

- (i) For basic unbundled loops, basic unbundled ports, interim number portability and transport and termination of local traffic, interim rates approved by the Michigan Public Service Commission (MPSC) in dockets U-11155 and U-11156.
- (ii) For items in the AT&T Interconnection Agreement for which the MPSC did not set rates in dockets U-11155 and U-11156, the interim rates are those proposed by AT&T in its arbitration with Ameritech Michigan.

- (iii) For certain items covered by the AT&T Interconnection Agreement (i.e., dedicated and shared transport, signaling, call-related databases and collocation), the interim rates are based on Ameritech Michigan's access tariffs, in accordance with the Commission's regulations establishing appropriate interim proxy rates for these items. (See 47 C.F.R. § 51.513) (3), (4), (6) and (7).)
- (iv) As to all remaining items covered by the AT&T and Sprint Interconnection Agreements<sup>2/</sup> (e.g., non-basic loops and non-basic ports), the interim rates are included in an amendment to the Sprint Agreement and are, in all cases, identical to the rates proposed by Ameritech Michigan in the MPSC's "permanent" cost docket, U-11280, which were developed using the Commission's pricing rules (as I described in my initial affidavit and elaborate on below).

All products, services and elements to which Ameritech Michigan is required by the Act and the Commission's Rules to provide access are covered by and made available to AT&T and Sprint under their interconnection agreements. Thus, for all required products, services and elements, there are in Michigan currently effective interim rates.<sup>3/</sup>

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<sup>2/</sup> The products, services and elements covered by and made available under these Agreements are essentially identical.

<sup>3/</sup> As discussed in my initial affidavit, the MPSC has established an interim wholesale discount of 22% that applies to all resold services. The MPSC will establish a "permanent" wholesale discount in the pending "permanent" cost docket, U-11280. Although slightly lower than the AT&T proposal (25%), the interim discount is nearly double the discount suggested by Ameritech Michigan based on calculations

(continued...)

6. Mr. Henson asserts that most of Ameritech Michigan's interim rates are "well in excess of cost." (Henson Aff. at 3). Mr. Henson is wrong. Each of these rates complies with the Act's requirements and does not exceed "cost" as that term is used in the Commission's rules. In the paragraphs that follow, I demonstrate why this is true with respect to each of the four categories of interim rates described above.

(i) **U-11155/56 Rates**

7. In the U-11155/56 dockets, the MPSC established rates for basic loops, basic ports, interim number portability and local transport and termination. In doing so, the MPSC used as a starting point Ameritech Michigan's modified TELRIC studies, but did not, as Mr. Henson asserts, adopt these studies.<sup>4/</sup> What the MPSC did was this: It took the modified studies and stripped out (a) all one-time non-volume sensitive costs, (b) all joint or shared costs, and (c) all common costs. What was left were forward-looking direct incremental costs only, with no allocation at all of joint or common costs. Far from being in excess of cost, these rates are below cost; moreover, they are lower than the cost recovery mandated by the Commission. See Local Competition First Report and Order ¶ 694 ("a reasonable measure of [joint and common] costs shall be included in the prices for interconnection and access to network elements") and 47 C.F.R. § 51.503 and 51.505.

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<sup>3/</sup>(...continued)

employing the Commission's avoided cost methodology. See, e.g., 47 C.F.R. § 51.609.

<sup>4/</sup> The derivation of and assumptions employed in these modified TELRIC studies is described in my initial affidavit (see in particular ¶ 14).

8. Mr. Henson presumably would concede all of this but likely assert that the direct incremental cost component is too high. If so, he would be mistaken. The direct incremental portion is simply the forward-looking TSLRIC that the MPSC has used and approved for some time in setting price floors for retail services -- with only one exception (which is described below). Neither Mr. Henson nor AT&T has ever complained about the retail TSLRIC studies; certainly, neither has ever claimed that the results are "too high." Accordingly, their complaint about these modified TELRICs is at best disingenuous.

9. The single exception alluded to above is this: The modified TELRICs use lower fill factors for loop distribution, loop feeder and line side switching than those used in the retail TSLRICs. Although this has the effect of increasing somewhat certain of the interim rates (i.e., those for basic ports and loops), this should not be cause for complaint from AT&T. That is because the fill factors used in the modified TELRICs are higher -- and therefore generate lower costs and lower rates -- than both those authorized by the Commission in Paragraph 682 of the Local Competition First Report and Order and those advocated by AT&T itself.

10. The fill factors used in the modified TELRICs (and reflected in the U-11155/56 rates) are "target" fill factors. They represent efficient network utilization. That is, they are the utilization levels that reflect optimum use of the network elements in question. As utilization of an element increases, maintenance and related costs increase as well. And there eventually comes a point at which it costs less to add capacity than to increase use of the element in question. No economically efficient firm would exceed that break point; and that is where Ameritech Michigan set its target fill.

11. Paragraph 682 states that the fill factors used to calculate costs and determine rates should reflect "a reasonable projection of the actual total usage of the element." By definition, actual usage will always be less than Ameritech Michigan's target utilization. That is because, as actual usage approaches or reaches the target, an efficient firm will add capacity; actual fill therefore will always be chasing but never catch target fill. (It should be noted that Ameritech Michigan's actual usage at present falls far short of its target fills. Given the proliferation of competitors and competitive facilities that is occurring and will continue to occur, likely at an increased pace, there is no reason to believe that actual usage will grow in the future to reach or even approach target fill.)

12. As for AT&T, and the fill factors it has sponsored, as the Commission is aware, both AT&T and MCI have vigorously advocated that both the Commission and state commissions throughout the United States employ the Hatfield Model to set rates for UNEs. See, e.g., AT&T's Comments and Reply Comments in FCC Dkt. 96-98. See also letter from Jonathan Sallet, MCI's Chief Policy Counsel, to Commission Chairman Reed E. Hundt, dated January 29, 1997; Ohio "Permanent" Cost Docket, Tr. at 37-38. The Hatfield Model, developed at the request of AT&T and MCI primarily for this purpose, employs fill factors that are for the most part lower than Ameritech Michigan's target fills -- and therefore generate higher costs than those generated through the use of Ameritech Michigan's fills. For example, the Hatfield Model uses a range of 50% - 75% for loop distribution, which is on average lower than Ameritech Michigan's 70%; a range of 65% - 80% for loop feeder, which is on average lower than Ameritech Michigan's 75%; and a uniform 80% fill factor for line side switching, which of course is significantly lower than Ameritech

Michigan's 90% factor. Thus, if Hatfield's fills are reasonable -- and neither Mr. Henson, AT&T nor MCI could contend otherwise -- then it necessarily follows that Ameritech Michigan's are conservative and, if anything, too high. In addition, Mr. Henson testified in the arbitrations that had Ameritech followed precisely the guidance set forth in Paragraph 682 of the Local Competition First Report and Order, Ameritech could have used lower fills than it did and, as a result, proposed higher rates than it has. See, e.g., AT&T Wisc. Arb., Tr. at 1405-07. Thus, Mr. Henson himself has conceded that Ameritech Michigan's fills are conservative and probably too high.

**(ii) AT&T's Proposed Rates**

13. Mr. Henson claims that AT&T's proposed rates in the arbitration with Ameritech Michigan were "very conservative" (Henson Aff. at 7) and "exceed efficient, forward-looking costs." (Id. at 9). Mr. Henson makes no effort to substantiate this claim -- for good reason. As I demonstrated above, the U-11155/56 rates, if anything, are below efficient forward-looking costs. And AT&T's proposed rates in the arbitration were even lower. For example, for POTS loops in zone A, the U-11155/56 recurring monthly rate is \$9.31 (compared to the Commission's proxy of \$15.27). AT&T's proposed rate, by comparison, was only \$7.53. Another example is provided by AT&T's proposed rate for the basic line port. The U-11155/56 rate is \$2.12, while AT&T's was only \$.54. Accordingly, the objective evidence establishes, beyond dispute, that the AT&T rates were far below efficient, forward-looking costs -- not in excess of such costs.

**(iii) Rates Based on the Access Tariffs**

14. For dedicated and shared transmission, signaling, call-related databases and collocation, the MPSC simply adopted the Commission's interim proxies. When it established these proxies, the Commission no doubt was mindful that the state commissions that were being directed to employ them were statutorily obligated, in the arbitrations for which such proxies were intended, to set rates that complied with Section 252(d). See Section 252(c)(2) of the Act. Accordingly, these proxies, by definition, comply with the Act's pricing standard.

**(iv) Rates Based on Ameritech Michigan's Proposals in U-11280**

15. These rates have two components: The TELRIC -- or direct incremental cost-- component; and the joint and common cost component. Taking first the TELRIC component, this is identical to the TELRIC used in U-11155/56 -- with one exception. The fills are even higher than those used in these dockets. At the insistence of the MPSC staff, the loop distribution fill factor was bumped up from 70% to 75% and the loop feeder fill factor was increased from 75% to 80%. As I demonstrated above, the TELRIC used to set rates in U-11155/56 was, if anything, too low. It therefore necessarily follows that the same is true of the TELRIC component of Ameritech Michigan's proposed U-11280 rates, which is even lower.

16. With respect to the joint and common cost component, a comparison of what AT&T and MCI have advocated elsewhere is highly instructive. The markup for joint and common costs proposed by Ameritech Michigan ranges from 25% to 29%. The Hatfield Model, by contrast, employs a 33% markup for joint or shared costs and a 10% markup

(over the sum of direct incremental and joint/shared costs) for common or overhead costs. The result is a total markup of well over 50% for joint and common costs taken together. Given this, it is difficult to see how either AT&T or MCI can credibly challenge Ameritech Michigan's shared and common cost markup. It bears noting that the Staff of the Illinois Commerce Commission concluded, in the course of the Ameritech/AT&T and Ameritech/MCI arbitrations, that the appropriate markup is about 36% over LRSIC, and that the Illinois Commerce Commission subsequently concluded not only that this was appropriate, but that the resulting rates were in full compliance with Section 252(d) of the Act.<sup>5/</sup>

**C. Other "Complaints" From Mr. Henson**

**(i) Collocation**

17. Mr. Henson complains that Ameritech Michigan's collocation charges are not sufficiently forward-looking because the underlying cost studies do not assume a "multi-provider environment" -- *i.e.*, they start with a central office that was designed for a single provider, Ameritech. (See Henson Aff. at 20.) Mr. Henson apparently wants Ameritech to assume that its central offices are already set up for use by multiple providers and to simply "eat" the costs associated with modifying them to accommodate the collocation needs of competitive carriers. This would confer a huge -- and unfair -- subsidy on AT&T and other new local exchange carriers. It would also violate the Act's clear directive that the rates for interconnection be based on "the cost . . . of providing" it. Section 252(d)(1)(A)(i).

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<sup>5/</sup> Ameritech Michigan's joint and common costs, and the specific claims of AT&T and MCI that pertain to them, are addressed in detail in the Reply Affidavit of Daniel Broadhurst.

**(ii) Non-Recurring Costs**

18. Mr. Henson urges that service ordering charges be based on fully-automated processes -- with no manual intervention whatever. (Henson Aff. at 20). This is wholly at odds with what has occurred and will continue to occur. Ordering and provisioning will unavoidably include some manual processes going forward. Among other things,

- some competitive local exchange carriers demand manual interfaces and processes;
- some competitive local exchange carriers demand that Ameritech maintain loop ordering through the ASR interface (which requires some manual "handling" of orders) even after Ameritech migrates to EDI 7.0 for loop ordering; and
- complex and non-routine transactions will always require some manual "handling."

19. Mr. Henson claims that Ameritech Michigan proposes to charge a whole bevy of non-recurring charges each time AT&T (or some other competitive carrier) orders what AT&T refers to as the UNE platform combination. (See Henson Aff. at 22-23.) This is simply not true. There is only one ordering charge that would apply -- to compensate for the cost incurred in receiving and processing the order. And there is only one line or service connection charge -- to recover the costs associated with connecting the service, such as central office connection cost, field connection cost assignment cost and circuit design cost. With respect to the billing development charge for unbundled local switching, that is a one time per switch charge intended to compensate Ameritech for the software changes required

to make unbundled local switching available to competitive carriers. It is not a charge that applies each time any UNE combination involving the switch is ordered.

**(iii) Rates For The UNE Platform**

20. Mr. Henson complains that Ameritech Michigan does not have a rate for the UNE platform or what he refers to as "common transport." (See Henson Aff. at 24.) This complaint is meritless. First, the AT&T Interconnection Agreement obligates Ameritech Michigan to provide to AT&T, upon order, a number of combinations, including what AT&T refers to as the UNE platform, at the ridiculously low flat rate of \$9.24 per month. (This should be contrasted with the Commission's Michigan proxy rate of \$15.27 for a simple POTS loop standing alone.) As for "common transport", the Interconnection Agreement obligates Ameritech Michigan to provide shared transport to AT&T at the access tariff rate for the service called "common transport", less the tandem switching component included in that rate.

**(iv) Miscellaneous**

21. Mr. Henson, at p. 21, ¶ 35 and n. 12, in his affidavit, makes the astounding assertion that Ameritech's proposed rates for loops and local switching, multiplied by the total number of Ameritech access lines in its five-state region, exceed the "total operating expenses for the entire Ameritech corporation for 1996." Mr. Henson reaches this result by increasing improperly the total pool of joint and common costs allocable to unbundled loops and switching more than 100 fold. Once the aggregate loops/switching costs are reduced to correct for this error, they fall to a level billions of dollars below the total operating expense number referred to by Mr. Henson. Moreover, even then, the comparison is grossly

misleading; it is a classic apples and oranges proposition. The recommended rates for loops and switching include, and are intended to achieve recovery of, both operating expenses and cost of equity capital. But Mr. Henson is comparing these rates to the corporation's operating expenses only. The fact that AT&T would engage in such an outlandish and grossly misleading exercise only serves to underscore the validity of Ameritech Michigan's proposed rates in U-11280.

### **RESPONSE TO ASSERTIONS OF AUGUST ANKUM**

22. Much of what Dr. Ankum talks about merely repeats or duplicates Mr. Henson's assertions. For example, like Mr. Henson, Dr. Ankum complains that the Ameritech Michigan "interim" rates exceed the cost-based rates mandated by the Act. I will not repeat here the discussion that appears above in response to Mr. Henson's identical claim. That discussion above applies equally to Dr. Ankum's claim. Likewise, like Mr. Henson, Dr. Ankum contends that Ameritech Michigan's fill factors are too low. Coming from the same Dr. Ankum who trumpeted the virtues of the Hatfield model in arbitrations in all five states in the Ameritech region, this contention rings no less hollow than when made by AT&T's Mr. Henson. My discussion above rebutting Mr. Henson on this point applies equally to Dr. Ankum's disingenuous claims about fill factors. In what follows, I address certain of Dr. Ankum's non-duplicative claims about non-recurring costs and rates, and certain of his assertions regarding (a) cost of capital and depreciation and (b) local switching. (Mr. Quick, Mr. Broadhurst, and Dr. Aron address his assertions regarding collocation, shared and common costs, and "economic principles".)

**A. Non-recurring Costs.**

23. Dr. Ankum complains about certain non-recurring rates proposed by Ameritech, including in particular

- service ordering charges (Ankum Aff. at 4-5 and 22-29);
- local switching billing development charges (*id.* at 3, 10-12); and
- the alleged collocation cancellation fee or charge (*id.* at 21-22).

I respond to his assertions about each of these in the following paragraph.

24. **Service Ordering Charges.** Dr. Ankum claims that the loop and port ordering charges are too high because the ordering charge proposed by Ameritech is a weighted average that takes into account and reflects the much higher ordering costs/charges applicable to other products and services. To correct this, he insists that Ameritech Michigan should be required to deaverage its service order charges. But the fact is: Ameritech Michigan has already done that. What Ameritech Michigan proposes in U-11280 is a series of product and service-specific service ordering charges. For example, the proposed charge for loop orders is \$14.70 per order, not the \$49.76 that Dr. Ankum represents to be the case at p. 27, ¶ 45, in his affidavit.

25. Dr. Ankum also asserts that service and product ordering should be fully automated and that the applicable charge should be limited to only \$1.00 per order. I have discussed above why the "100% automated" assumption is wholly unrealistic. With respect to the \$1.00 number, Dr. Ankum is not being completely forthcoming with the Commission. He claims that the \$1.00 per service order is what SWBT charges in Texas, pursuant to a settlement in a Texas docket Dr. Ankum identifies in his affidavit at p. 25, n. 20. First, the

service order process for the very different service in question there -- number portability -- was fully automated. Second, and importantly, the real service order charge under the SWBT settlement is not the \$1.00 -- it is much, much more. Under the settlement, the SWBT customer has a choice: (i) pay a service order charge of \$16.95 per number ported or (ii) pay an up-front charge of \$4,100 and then \$10 per magnetic tape (containing a number of specific telephone numbers) plus \$1.00 for each number on the tape. Thus, not only are Dr. Ankum's assertions not apt, they are grossly misleading.

26. Finally, Dr. Ankum's assertion that Ameritech Michigan's proposed service ordering charges for loops and ports are just too high flies in the face of what AT&T itself proposed in the Michigan AT&T/Ameritech Michigan arbitration and what the MPSC found to be cost-based and compliant with § 252(d) of the Act in both that arbitration and the MCI/Ameritech Michigan arbitration. Mr. Henson and AT&T proposed a per-order charge of \$30.80. This was accepted by the arbitration panel and subsequently blessed by the MPSC. This is the rate that appears in the AT&T/Ameritech Michigan interconnection agreement as well as in the MCI/Ameritech Michigan interconnection agreement that is currently before the MPSC for final approval pursuant to § 252 of the Act.

27. **Switching Billing Development Cost.** To permit Ameritech to render accurate bills to purchasers of unbundled local switching ("ULS"), software changes were required in all end-office switches. This work has been done, at a cost of about \$1 million. Dr. Ankum does not take issue either with the need to have had this work performed or the total cost that was incurred. Instead, he quibbles with the assumptions that Ameritech Michigan used in allocating this cost to individual switches and individual ULS customers.

In coming up with its proposed one-time charge per switch per customer, Ameritech assumed 15 unbundled switches and 25 ULS customers. Dr. Ankum criticizes this assumption, and insists that the cost should be allocated on the assumption that multiple providers will purchase ULS at each end office in the Ameritech region. That is ludicrous. ULS clearly will never be ordered at the overwhelming majority of Ameritech's end offices.

Nevertheless, Ameritech is sensitive to the need to have its cost allocation based on the most accurate forecasts of demand that can be made. To accomplish this, Ameritech has invited prospective ULS purchasers to provide forecasts of ULS usage. Thus far, no such information has been provided. Even so, Ameritech remains committed to establishing as fair and as equitable a means of recovering the billing development cost as possible. To this end, Ameritech reiterates that it will work with the MPSC and other state commissions and its competitors (assuming their cooperation can be obtained) to generate a new forecast (if the current one proves unrealistic); Ameritech also will cooperate and work with its competitors and the state commissions to devise alternative methods of recovering this cost -- should it prove impracticable to come up with what all interested parties ultimately agree is a reliable forecast. Thus, the bottom line is this:

- The cost is real, it had to be incurred,<sup>6/</sup> and it was efficiently incurred.
- No one seriously contends that Ameritech should not be permitted to recover this cost from users of ULS.

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<sup>6/</sup> The work that generated the cost had to be done in order to make ULS available. No one has contended otherwise. Nor could it have been spread out over time as ULS usage grows. The work was basically a one-time software development project. Once done for a single switch, it was essentially done for all switches.

- Dr. Ankum's allocation assumption would ensure that the great majority of the cost would go unrecovered.
- Ameritech has devised what it believes to be a reasonable estimate based on the sketchy information available to it (its competitors have not yet provided the forecasts and other information necessary to make a fully informed judgment about future demand).
- Ameritech will consider alternative methods of recovery; the objective is recovery, and neither over- nor under- recovery in a fair and equitable manner.

28. **Collocation Cancellation Fees.** At pages 4 and 21-22 of his affidavit, Dr. Ankum complains about an alleged \$4,000+ collocation cancellation fee. The answer to this complaint is that there is no such fee or charge -- as Dr. Ankum himself surely must know. No such fee or charge was ever proposed in Michigan. Nor is such a fee or charge being requested in any other Ameritech state.

**B. Cost of Capital and Depreciation**

29. **Cost of Capital.** Dr. Ankum asserts (Ankum Aff. at 6-7 and 44-45) that although the cost of capital used in the modified cost studies that form the basis for the rates proposed in U-11280 -- 11.5% -- might be appropriate for Ameritech Corporation as a whole, it is not appropriate for the wholesale business segment responsible for UNEs, interconnection and related products and services. Dr. Ankum is wrong -- for a number of reasons. First, the 11.5% is the rate that the MPSC several years ago determined was appropriate for use in TSLRIC retail cost studies prepared in what was essentially a

monopoly-provider environment. If 11.5% was appropriate in such an environment, it necessarily follows that it is the minimum number that could be deemed appropriate in today's and tomorrow's environment, which is and will be punctuated by burgeoning competitive pressures and the increased business and financial risk that come with them.

Second, Mr. Henson, AT&T's witness, admitted precisely that. Mr. Henson has testified in several arbitrations and state commission "permanent" cost dockets that the Act and parallel state initiatives will lead (and in fact have already led) to increased competition in telecommunication markets -- including in particular the local exchange market; that this will necessarily increase the business and financial risk that confront Ameritech; and that this increased risk will prompt investors to demand a greater return, which in turn will necessarily increase Ameritech's cost of capital. See e.g., AT&T Wisc. Arb., Tr. at 1401-03; Ohio "Permanent" Cost Docket, Tr. at 83-86.

Third, investors invest in the firm as a whole, not particular segments. Fourth, the wholesale segment of Ameritech which is responsible for UNEs, interconnection and related products and services faces the same, if not greater, risks as the retail side of the house -- as Mr. Henson has admitted in testimony given in arbitrations and "permanent" cost dockets. Specifically, Mr. Henson has acknowledged that if a local exchange customer of Ameritech's retail unit migrates to AT&T (or some other new entrant), that customer will most likely be served, at least initially, through resale or Ameritech's UNEs; that in that scenario Ameritech will still recover its costs plus a reasonable profit (see Section 252(d)(1) of the Act); that some time after the customer migrates, and AT&T's presence in the local market grows, the probability will increase that AT&T will put in its own facilities and begin using them to provide service to

the former Ameritech customer; that in that case Ameritech's wholesale unit will incur the loss that goes with stranded loop (and switching) investment; and that this risk of bypass and stranded investment is therefore, greater on the wholesale side than on the retail side. See, e.g., Illinois Commerce Commission Investigation into Forward Looking Cost Studies of Ameritech Illinois for Interconnection, Network Elements, Etc., I.C.C., Dkt. Nos. 96-0486/96-0569, May 21, 1997 (Illinois "Permanent" Cost Docket), Tr. at 2162-66.

Accordingly, if one were to insist on disaggregating costs of capital, and assigning different numbers to different business segments, the wholesale unit responsible for UNEs, etc., should probably be assigned a higher number than the retail unit, not the other way around.

30. **Depreciation Lives.** In his affidavit, at p. 6, Dr. Ankum asserts that the Act will not quicken the pace of technological change -- apparently for the purpose of supporting his proposition that Ameritech's depreciation lives are too short. The assertion makes no sense. In fact, Mr. Henson, has stated just the opposite under oath. In the arbitrations and in "permanent" cost dockets, Mr. Henson has testified that increased competition will necessarily increase the pace of technological change throughout the telecommunications industry; that this will cause the equipment and systems used by Ameritech to become obsolete more quickly; and that this means that economic lives, and therefore depreciation lives, will become shorter. See, e.g., AT&T Wisc. Arb., Tr. at 1403-05; Ohio "Permanent" Cost Docket, Tr. at 86-7; Illinois "Permanent" Cost Docket, Tr. at 2167-69. Further, it is difficult to see why Dr. Ankum is even challenging the depreciation lives used by Ameritech Michigan in the modified cost studies that form the basis for the rates proposed in U-11280. These lives are precisely the same lives that Ameritech Michigan has used for several years

in its Michigan TSLRIC retail cost studies, and precisely the same lives that the MPSC has determined are appropriate in a monopoly-provider environment. Ameritech Michigan clearly could -- and probably should -- have used shorter lives than it has, which would have resulted in higher costs and higher proposed rates.

### **C. Unbundled Local Switching**

31. Dr. Ankum has taken issue with the rate structure proposed by Ameritech Michigan for ULS, which has both a flat rate portion and a usage sensitive portion. Dr. Ankum suggests (Ankum Aff. at 5-6 and 36-37) that the switching rate should be a flat rate only and should not contain any usage sensitive component. His suggestion should be rejected. Some switch-related costs are traffic sensitive and therefore usage-related and, as a consequence, should be recovered through a usage charge. For example, the key driver used to engineer line interfaces on a digital switch is usage, and different levels of usage in each switching system require different quantities of line interface equipment. The costs of such equipment are appropriately assigned to usage. On the other hand, I readily acknowledge that some switch-related costs are not traffic-sensitive and therefore should not be recovered in a usage charge. For this reason, Ameritech Michigan has proposed to recover switch costs in two charges: The non-traffic sensitive costs through a flat rate port charge and the costs of traffic-sensitive components through a usage charge. And, contrary to Dr. Ankum's assertions, this is precisely what the Commission has stated should be the case. See the Commission's proxy rules which mandate a flat rate for non-traffic sensitive costs of basic line ports and a minutes-of-use rate for the traffic-sensitive components of local switching.

See 47 C.F.R. § 51.513(c)(2) and Order on Reconsideration, CC Dkt. No. 96-98 (September 27, 1996).

### **RESPONSE TO ASSERTIONS OF DENNIS RICCA**

32. Dennis Ricca, on behalf of MCI, makes two assertions, neither of which has any validity. First, he asserts that Ameritech Michigan proposes to charge more than \$130 per order for resale service order processing. (Ricca Aff. at 3, ¶ 8). Second, he asserts that Ameritech Michigan has failed "to make permanent wholesale rates available to new entrants" and that this failure "has acted as a barrier to MCI's entry into the local service market in Michigan." (Ricca Aff. at 6, ¶ 17).

33. With respect to the first assertion, Mr. Ricca is simply wrong. The per order charge is approximately \$30, not \$130. The extra charges Mr. Ricca includes are related to ordering and installation of extra jacks, and obviously apply only when the customer (either Ameritech's or the resale customer of one of its competitors) orders an extra jack.

34. With respect to the second assertion, Ameritech Michigan has not failed to do anything. The MPSC decided, in response to motions filed by AT&T and MCI, to set only interim rates in the arbitrations. Ameritech Michigan asked that permanent rates, including permanent wholesale rates, be established, but that request was rejected. Moreover, the interim discount rate established by the MPSC has hardly operated as a barrier to entry. It is 22%, substantially higher than the discount that results from any reasonable application of the Commission's avoided cost calculation methodology. And, in any event, a "permanent" rate will be set by the MPSC in U-11280, where a final order is expected by July 10.

## CONCLUSION

35. Based on the foregoing, it is clear that Ameritech Michigan's rates for network elements, interconnection, and local transport and termination, as well as its discount rate for resold services, comply with Section 252(d) of the Act. The assertions to the contrary made by AT&T and MCI are either factually wrong or based on gross mischaracterizations of the record facts in this docket.

I hereby swear, under penalty of perjury, that the foregoing is true and correct, to the best of my knowledge and belief.

*William C. Palmer*

William C. Palmer

Subscribed and sworn before me this 5 of July, 1997.

*Susan H. Kotrba*

Notary Public

My Commission expires: 7/7/99

