



**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

In the matter of

**Joint Application by SBC Communications Inc.,)
Southwestern Bell Telephone Company, And)
Southwestern Bell Communications Services, Inc.) CC Docket No. 00-217
d/b/a/ Southwestern Bell Long Distance For Provision)
of In-Region, InterLATA Services)
In Kansas and Oklahoma**

DECLARATION OF

MICHAEL R. BARANOWSKI AND ROBERT P. FLAPPAN

ON BEHALF OF

AT&T CORP.

FCC DOCKET CC NO. 00-217

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Michael R. Baranowski and Robert P. Flappan do hereby depose and state as follows:

I. BACKGROUND AND SUMMARY

A. Michael R. Baranowski

1. My name is Michael R. Baranowski. I am Executive Vice President of FTI/Klick, Kent & Allen, Inc., a subsidiary of FTI Consulting, Inc. (FTI/KKA). FTI/KKA is an economic and financial consulting firm with offices at 66 Canal Center Plaza, Suite 670, Alexandria VA, 22314. In that position, I conduct economic and cost analysis for a variety of clients.

2. I received a Bachelor of Science Degree in Accounting from Fairfield University in 1980. From 1980 to 1981, I was employed as a consultant by Wyer Dick and Company, a transportation consulting firm specializing in railroad regulatory costing. Late in 1981, I joined the economic consulting firm of Snavelly, King and Associates where my

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responsibilities spanned a wide range of railroad engineering, operating and costing functions.

In 1988, I joined the economic consulting firm of Klick, Kent and Allen, Inc. I was a Principal of the firm from 1990 until the firm merged with FTI Consulting in mid-1998, when I became Executive Vice President of FTI/Klick, Kent and Allen.

3. Throughout my career, I have conducted economic and costing analyses for a variety of clients in the railroad, pipeline and telecommunications industries. These include the development of long and short run marginal and incremental cost analyses as well as stand-alone costs. In addition to cost development, a large portion of my work involves the detailed analysis and critique of complex computer costing models. I have testified previously before Federal Communications Commission, the Surface Transportation Board (formerly the Interstate Commerce Commission), the Federal Energy Regulatory Commission and a number of State Public Utility Commissions.

4. Since 1996, I have been directly involved in AT&T's efforts to enter the local telecommunications market. In that regard, I am familiar with the Total Element Long Run Incremental Cost (TELRIC) models submitted by Southwestern Bell Telephone Company (SWBT) in a number of states, including Kansas and Oklahoma.

B. Robert P. Flappan

5. My name is Robert P. Flappan. My business address is 11020 W. 122nd Street, Overland Park, Kansas, 66213.

6. I am employed by AT&T as District Manager of Pricing and Cost. My responsibilities currently include developing and presenting AT&T's positions on local exchange

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carrier pricing and costing issues. My territory includes the states of Kansas and Oklahoma, as well as Arkansas, Missouri and Texas. I also serve as AT&T's Director of Regulatory Affairs for the State of Kansas.

7. I received a Bachelor of Science Degree in Business Administration, with honors, from the University of Missouri-Kansas City in 1981. I received a Master of Science Degree in Business Administration (MBA), with honors, from the University of Missouri-Kansas City in 1983. Since receiving my MBA, I have continued my education by attending USTA Separations Training, the Brookings Institution course on Business and Public Policy, Bellcore courses on the Switching Cost Information System (SCIS), the Common Channel Signaling Cost Information System (CCSCIS) and various other technical, financial and managerial courses.

8. I was employed by AT&T in 1982 at the Bell System Sales Center as a Telemarketing Supervisor where I sold AT&T products and network services. In 1984, I accepted a position with AT&T's Network Organization, where I held positions in Access Management, as a Switched Access Engineer and as a Methods and Procedures Supervisor, and on the Network Services Division Staff. In 1987, I transferred into what is now AT&T's Government Affairs Organization, where I have had interstate and intrastate regulatory responsibilities, and where I have represented and testified for AT&T on technical, economic and policy issues. In April of 1996, I was named District Manager of Pricing and Cost. In January 1999, I assumed responsibility for regulatory affairs in Kansas.

9. Over the last ten years, I have testified before the Public Utility Commissions in Kansas, Oklahoma, Missouri, Arkansas and Texas. Much of my testimony has

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dealt with economic, costing and pricing issues related to local exchange competition.

Attachment 1 to this Declaration describes other regulatory proceedings in which I have testified.

C. Overview Of Our Testimony

10. This Declaration addresses two broad objections to the unbundled network element (UNE) rates that SWBT contends satisfy the “checklist item two” requirement that such rates be just and reasonable and based on the efficient forward-looking cost of providing the network elements. First, we demonstrate that SWBT’s Oklahoma recurring and non-recurring charges for unbundled network elements (UNEs) – which were lifted from nonunanimous stipulations supported by *no* cost study and which are as much as *double* the equivalent Kansas rates – are not remotely cost-based. Second, we show that although the Kansas Corporation Commission (KCC) generally applied forward-looking TELRIC principles in establishing recurring UNE charges, it established non-recurring charges using grossly inflated SWBT proposals that the KCC frankly conceded violate basic principles of forward-looking pricing.

1. Oklahoma

11. The source of SWBT’s Oklahoma UNE rates is not a cost study, a cost-based proposal, or an arbitrator’s determination of cost-based rates. Rather, based upon the recommendation of an administrative law judge, the Oklahoma Corporation Commission (OCC) simply lifted the rates from a non-unanimous (and hotly contested) stipulation between one party (Cox) and the OCC Staff that SWBT agreed to accept. The stipulated rates were not supported by any cost study or analysis. *See OCC ALJ Report*¹ at 158-59. The OCC denied AT&T’s

¹ Amended Report and Recommendation of the Administrative law Judge, OCC Cause Nos. PUD 970000213 & (continued . . .)

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request for discovery on how the stipulated rates were developed (and also into the possibility that a “side deal” was reached between SWBT and Cox). *See OCC Final Order*² at 4. And even the consulting firm hired by the Staff could not support the stipulated rates as cost-based, prompting the Staff’s counsel to take the extraordinary step of seeking to exclude the pre-filed testimony of the Staff’s own witness. *See OCC ALJ Report* at 157.

12. In short, the stipulated rates are nothing more than what one party was willing to accept, and there is no basis upon which one could conclude that they meet the requirements of the Act and the Commission’s pricing rules. Although Cox was certainly free to agree to pay network element rates that exceed forward-looking costs, *see* 47 U.S.C. § 252(a) (“an incumbent local exchange carrier may negotiate and enter into a binding agreement with the requesting telecommunications carrier or carriers without regard to the standards set forth” in the Act), the OCC imposed Cox’s compromise on *all* new entrants. Moreover, Cox is not providing service in Oklahoma via UNEs and thus would have little, if any, incentive to seek rates that would allow for broad scale local service entry via UNEs to Oklahoma consumers. Indeed, with Cox providing service mainly via its cable facilities, it would have an incentive to elevate UNE rates in order to hamper UNE-based providers from entering and competing with Cox.

13. Notwithstanding these facts, OCC approved the stipulated rates “without modification” and without comment, deferring entirely to the ALJ’s recommendation. The ALJ reasoned that so long as the approved rates “fall well within the ranges of the various proposals,”

970000442 (June 30, 1998).

² Final Order, Order No. 424864, OCC Cause Nos. PUD 970000213 & 970000442 (July 17, 1998).

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they can be said to be “based on cost.” *OCC ALJ Report* at 158-159. According to the ALJ, the OCC, “similar to the responsibility of a jury in a civil case, has the discretion to adopt a position in the ‘middle’ of that which is proposed by the parties.” *Id.* at 159. That logic fails where, as here, one party’s proposal is flatly inconsistent with the controlling legal standard.

14. As explained in detail below, SWBT’s proposal, generated by cost studies in which virtually all key assumptions were based upon SWBT’s embedded architecture, technologies, processes and costs, violated the most basic forward-looking principles. Citing its existing cable “fill,” for example, SWBT assumed a network in which 70 percent of capacity is forever idle. SWBT proposed non-recurring charges based *entirely* on manual processes (even while promising to use *electronic* processes to fulfill its obligations to provide reasonable access to OSS). Rather than the Commission and OCC-approved economic projection lives that the states have nearly unanimously agreed should be used to set forward-looking depreciation rates, SWBT proposed the irrelevant (and much shorter) equipment lives it uses for financial accounting purposes. In these and many other ways, SWBT simply ignored the guiding TELRIC principle that rates should be based upon the efficient technologies and processes that an efficient, cost-minimizing provider would deploy today. Thus, the mere fact that the stipulated rates are less than SWBT’s proposals in no way suggests that the stipulated rates are cost-based.

15. The ALJ’s limited discussion of the competing AT&T and SWBT proposals only confirms that the Oklahoma rates cannot possibly be justified as TELRIC-compliant on a “split the baby” theory. In rejecting AT&T’s argument that loop and other rates must reflect an efficiently-sized network, and not simply SWBT’s existing network, for example,

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the ALJ noted that “the Act requires SWBT to unbundle its existing network, not some superior quality network.” *OCC ALJ Report* at 161. That is entirely irrelevant to the forward-looking rate requirement, which demands that SWBT *price* its existing network at efficient rates.

16. And there can be no real doubt that the unsupported Oklahoma rates greatly exceed efficient, forward-looking rates. Although it is obviously impossible to point to specific TELRIC violations in the methodology used to produce stipulated rates that are supported by *no* methodology, SWBT’s request that the Commission endorse both its Oklahoma and its Kansas rates as cost-based easily proves the point. SWBT used the same cost model in Oklahoma and Kansas, and, not surprisingly, given the two states very similar characteristics, estimated similar network element costs in Oklahoma and Kansas (with *higher* cost estimates for Kansas in a few instances). *See* Attachment 2. The Commission’s original *Local Competition Order*³ and the National Exchange Carrier Association⁴ likewise estimate very similar costs for the two states. Yet the stipulated rates in Oklahoma greatly exceed rates for the same elements in Kansas. Indeed, as detailed in Attachment 3 to this declaration, the Oklahoma rates are in some cases *more than twice* the Kansas rates. That is because the Kansas Corporation Commission, unlike the OCC, recognized the forward-looking cost violations in SWBT’s proposals and forced SWBT to re-submit its studies with forward-looking assumptions. Given the recognition by all parties that the relevant costs are about the same, at least one conclusion is

³ First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996. CC Docket No. 96-98, ¶¶ 690-93 (1996).

⁴ 1999 Submission of 1998 Study Results by the National Exchange Carrier Association, October 1999.

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inescapable: If TELRIC is more than just an empty term that can be applied elastically to any outcome, then the Kansas and Oklahoma UNE rates cannot *both* be properly cost-based.

17. The accompanying declaration of Michael Lieberman provides still further confirmation that the Oklahoma rates are excessive. As Mr. Lieberman demonstrates, the conditions necessary to support competitive entry do not exist in Oklahoma, because SWBT's Oklahoma UNE prices are far too high to support mass market UNE offerings. Even taking full account for all the revenues and benefits from being a local service provider, it is profoundly uneconomic for AT&T (or any other entrant) to make a statewide offer of UNE-P based local services.

2. Kansas

18. As the Commission has long recognized, regardless how closely an incumbent LEC's recurring charges are held to efficient forward-looking costs, it can and will evade competition if it is allowed to increase potential competitors' costs significantly through non-cost-based non-recurring charges. *See, e.g., AT&T Communications*, 103 FCC 2d 77, 94 (1985) ("It is evident that nonrecurring charges can be used as an anticompetitive weapon to . . . discourage competitors"); *Expanded Interconnection with Local Telephone Company Facilities*, 8 FCC Rcd. 7341, 7360 (1993) ("absent even-handed treatment, non-recurring reconfiguration charges could constitute a serious barrier to competitive entry"). *See also* 47 CFR § 51.507(e) ("[n]on-recurring charges . . . shall not permit an incumbent LEC to recover more than the total forward-looking economic cost of providing the applicable element").

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19. The KCC generally applied forward-looking TELRIC principles in establishing the recurring charges for SWBT's network elements. With few exceptions, the KCC identified the many TELRIC violations in SWBT's recurring rate proposals, insisted that SWBT adjust its rates to correct for those violations, and refused to approve the rates until SWBT had done so.

20. Unfortunately, the KCC's resolve faltered with respect to the equally important non-recurring charges for those same elements. The KCC again fully recognized that SWBT's proposals – which, among other things, assumed manual processing for most UNEs *100 percent of the time* – flatly violated basic forward-looking principles, and it ordered SWBT to modify its studies in a number of very specific ways to correct for the most obvious errors.

21. SWBT simply ignored the KCC's order, refiled its NRC studies with most of the very same errors, including, for many NRCs, the same erroneous 100 percent manual processing assumption. The KCC was understandably troubled by this insubordination. *See KCC NRC Order*⁵ at 13 (“Staff notes that in spite of direct language in Commission orders, SWBT submitted a cost study based on fully manual processes”); *id.* at 27 (“The Commission specifically directed SWBT to use a fall out rate of 5 percent”). And the KCC acknowledged that SWBT's refusal to comply with the KCC's orders (and TELRIC principles) with regard to non-recurring charges has important implications for its section 271 application: “the [KCC] agreed to support SWBT's [section 271] application . . . premised, in part, on the expectation that final permanent prices for UNEs, including the non-recurring charge component, would be in

⁵ Order Regarding Non-Recurring Charges For Unbundled Network Elements, KCC Docket No. 97-SCCC-149-GIT (continued . . .)

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place and available to CLECs.” *Id.* at 24. Rather than adopt what it admitted was a “practical choice[.]” in the circumstances – “to continue the proceeding until all unbundled network elements needed by CLECs are available with prices supported by accurate and Commission-approved cost data,” *id.* – however, the KCC put the 271 cart before the local competition horse. Frankly acknowledging that it was doing so because it had “agreed to support SWBT’s application before the FCC for InterLATA authority under Section 271,” *id.* at 4, the KCC approved some of the SWBT’s original “overstated” NRC proposals “as is” and used the original SWBT proposals to calculate rates for most of the remaining NRCs, through an entirely arbitrary one third/two thirds weighting of the SWBT and AT&T proposals.

22. The resulting non-recurring charges far exceed forward-looking costs and create an enormous barrier to network-element-based entry. For example, if a Kansas customer ordering local service for the first time at a new address chooses a new entrant’s local service, the new entrant must pay more than \$60 in non-recurring charges alone -- as compared to less than \$40 in Texas, notwithstanding the KCC’s recognition that “[p]rices should be similar for similarly defined elements, especially for those cost elements that use common resources within the five SWBT states: Texas, Missouri, Arkansas, Oklahoma and Kansas.” *KS NRC Order* at 2.

II. THE COMMISSION’S TELRIC METHODOLOGY

23. In its *Local Competition Order*,⁶ the Commission concluded that “national pricing rules” are a “critical component” of the Act’s market-opening provisions and that

(November 3, 2000).

⁶ First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, ¶¶ 690-93 (1996).

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Congress intended for the Commission “to establish regulations to ensure that rates . . . would be economically efficient” and that would “reduce potential entrants’ capital costs” and “facilitate entry by all types of service providers.” *Id.* ¶ 113-14; *see also id.* ¶ 618 (recognizing that it is “critical to implementing Congress’s pro-competitive, de-regulatory national policy framework to establish among the states a common, pro-competition understanding of the pricing standards”). Accordingly, the Commission implemented the Act’s non-discriminatory, cost-based pricing provisions by adopting the total element long run incremental cost (TELRIC) methodology for calculating network element costs. *Id.* ¶¶ 618-732.

24. As the Commission’s Rules and the *Local Competition Order* set forth, TELRIC methodology – which must be used in establishing rates for unbundled elements and interconnection – embodies several principles: First, TELRIC methodology rejects the “recovery of costs other than forward-looking economic costs, including . . . embedded or accounting costs.” *Id.* ¶ 621. Embedded costs reflect past inefficiencies, older technologies, and inefficient operating practices. Recovery of such costs is not permissible under the Act because “new entrants’ investment decisions would be distorted if the price of unbundled elements were based on embedded costs.” *Id.* ¶ 620.

25. Second, the Commission’s TELRIC methodology is “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.” *Id.* ¶ 685; *see also* 47 C.F.R. § 51.505(2)(b)(1) (the costs of an element “should be measured based on the use of the most efficient telecommunications

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technology currently available and the lowest cost network configuration”). Thus, the proper measure of costs will reflect new, efficient equipment purchased at prices that are realistically available to SWBT. By contrast, the Commission squarely rejected “an approach based on existing network design and technology that are currently in operation” because it “is essentially an embedded cost methodology.” *Local Competition Order*, ¶ 684.

26. TELRIC examines forward looking costs “over the long run,” 47 C.F.R. § 51.505(b). The “long run” is “a period so long that all of the firm’s present contracts will have run out, its present plant and equipment will have been worn out or rendered obsolete and will therefore need replacement.” *Local Competition Order*, ¶ 677 n.1682 (quoting William Baumol, *Economic Theory and Operations Analysis*, at 290 (4th Ed. 1977)); *see also id.* ¶ 692 (“In a TELRIC methodology, the ‘long run’ used shall be a period long enough that all costs are treated as variable and avoidable”). Because TELRIC’s long-run view assumes that all equipment may need replacement, the Commission’s Rules require modeling the costs of purchasing new equipment, based on the most efficient technology currently available, at the lowest cost.

27. Finally, the Commission’s TELRIC Rules require that the forward looking cost of a network element include only those “facilities and functions that are directly attributable to, or reasonably identifiable as incremental to” that element. 47 C.F.R. § 51.505(b). Accordingly, under TELRIC, “[c]osts must be attributed on a cost-causative basis.” *Local Competition Order*, ¶ 691. Costs attributable to the provision of retail, interLATA, video, and other services – or the costs of capacity acquired in anticipation of providing such services – are excluded because such costs are not directly attributable to the production of network elements

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for telephone exchange service. The Commission has also made clear that networks are to be sized to meet the “current demand,” which includes only the amount of excess capacity needed to meet short term growth.⁷

III. THE STATE PRICING PROCEEDINGS

A. Oklahoma Pricing Proceedings

28. On July 29, 1996, AT&T Communications of the Southwest, Inc. filed an application seeking arbitration of certain unresolved issues regarding its interconnection agreement with SWBT, including the establishment of cost-based rates. On October 16, 1996, the OCC issued an order bifurcating the proceeding and directing that interim rates for UNEs and transport and termination of traffic would be decided in the first phase of the proceeding and all interim rates would be subject to true-up following OCC approval of permanent rates established in future hearings. Cause No. PUD 960000218 (PUD 96-218), Order No. 406117 (Oct. 16, 1996).

29. On May 2, 1997, Cox Oklahoma Telecom, Inc. (Cox) filed an application for a determination of the costs and permanent rates for UNEs. Cause No. PUD 970000213 (PUD 97-213). Thereafter, SWBT and AT&T agreed to incorporate the second phase of PUD 96-218 into PUD 97-213 for the determinations of the costs of and permanent rates for SWBT’s UNEs. On September 23, 1997, SWBT and AT&T filed a joint application in Cause NO. PUD

⁷ Tenth Report and Order, In The Matter Of Federal-State Joint Board On Universal Service, CC Docket No. 96-45, Forward-Looking Mechanism For High Cost Support For Non-Rural LECs, CC Docket No. 97-160, FCC 99-304, 14 FCC Rcd. 20,156 (Rel. Nov. 2, 1999), ¶¶ 189-90; ¶¶ 200-203.

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970000442 (PUD 97-442) for a determination of the costs of and permanent rates for certain SWBT services other than those UNEs for which rates were to be established in PUD 97-213.

30. Hearings before an ALJ commenced on March 9, 1998. At the beginning of the hearing, Staff counsel announced that it had reach a nonunanimous stipulation with Cox in PUD 97-213 regarding proposed rates for UNEs. SWBT announced that it would not oppose the stipulation or appeal an OCC order that adopted the stipulation *in toto*. Staff counsel also announced a nonunanimous stipulation in PUD97-442. Again, SWBT announced that it would not oppose the stipulation or appeal an OCC order adopting the proposed rates contained in the stipulation *in toto*.

31. The ALJ issued his Report and Recommendation (*OCC ALJ Report*) on June 19, 1998, finding that the stipulations and the rates contained in the stipulations were “lawful, fair and reasonable” and recommending that the OCC “adopt and approve such stipulations *in toto*.” *OCC ALJ Report* at 167. The ALJ made no attempt to identify the appropriate TELRIC-based cost for each element, but instead satisfied himself that the stipulated UNE rates were TELRIC-based simply because they fell within the broad range of rates proposed by SWBT on one hand and AT&T on the other. *OCC ALJ Report* at 159.

32. By Final Order dated July 8, 1998, the OCC accepted the ALJ’s findings and conclusions and approved the nonunanimous stipulations without modification or explanation. Order No. 424864.

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B. Kansas Pricing Proceedings

33. On November 8, 1996, the KCC initiated a docket to establish prices for UNEs and interconnection pursuant to 47 U.S.C. § 252(d)(1). Docket No.97-SCCC-149-GIT. By order issued December 19, 1997, the KCC adopted SWBT's cost model. The second phase of the docket addressed the inputs to the cost model, and on November 16, 1998, the KCC issued its Order Setting Inputs for Cost Studies (*KCC Inputs Order*) and directed SWBT to re-run its cost studies using the inputs determined by the KCC. SWBT filed additional cost study results in December 1998 and January 1999. AT&T, KCC Staff, SWBT and other parties filed comments on January 25, 1999, addressing SWBT's cost study results. On February 19, 1999, the KCC issued its Final Order Establishing SWBT's Prices for Interconnection and UNEs (*KCC Final Order*). Prices for the recurring cost elements were set forth in Attachment A of the *Final Order*, while rates for the non-recurring cost elements were listed in Attachment B of that order.

34. On September 17, 1999, the KCC issued its Order on Reconsideration (*KCC Reconsideration Order*). Revised prices for recurring elements were set forth in Attachment A of the *Reconsideration Order*. The KCC also ruled that SWBT's non-recurring cost studies were "overstated" and directed SWBT re-submit the studies with appropriately forward-looking assumptions. On November 9, 1999, SWBT resubmitted its non-recurring cost studies for review and comment by other parties. On that same date, AT&T also resubmitted its cost studies attempting to rerun SWBT's original cost studies incorporating the KCC's ordered changes. On November 3, 2000, the KCC issued its Order Regarding Non-Recurring Charges for Unbundled Network Elements (*KCC NRC Order*).