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Federal Communications Commission
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)
)
Application by SWBT Communications, Inc.,)
Southwestern Bell Telephone Company, and)
Southwestern Bell Communications Services,)
Inc., d/b/a/ Southwestern Bell Long Distance for)
Provision of In-Region, InterLATA Services in)
Missouri)

CC Docket No. 01-88 /

**COMMENTS OF AT&T CORP.
IN OPPOSITION TO SBC COMMUNICATIONS, INC.'S
SECTION 271 APPLICATION FOR MISSOURI**

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FCC ORDERS CITED

SHORT CITE	FULL CITE
<i>Advanced Services Order</i>	First Report and Order and Further Notice of Proposed Rulemaking, <i>Deployment of Wireline Services Offering Advanced Telecommunications Capability</i> , 14 FCC Rcd. 4761 (1999)
<i>Depreciation Order</i>	Report and Order, Memorandum Opinion and Order, <i>1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, United States Telephone Association’s Petition for Forbearance from Depreciation Regulation of price Cap Local Exchange Carriers</i> , CC Docket No. 98-137, ASD 98-91 (released December 30, 1999)
<i>KS/OK 271 Order</i>	Memorandum Opinion and Order, <i>Joint Application of SBC Communications, Inc., et al, for Provision of In-Region InterLATA Services in Kansas and Oklahoma</i> , CC Dkt. No. 00-217 (rel. Jan. 22, 2001)
<i>Line Sharing Order</i>	Third Report and Order, <i>Deployment of Wireline Service Offering Advanced Telecommunications Capability</i> , CC Dkt. No. 98-147 and Fourth Report and Order, <i>Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , CC Dkt. No. 96-98, 14 FCC Rcd. 20912 (1999).
<i>Line Sharing Reconsideration Order</i>	Third Report and Order on Reconsideration, <i>Deployment of Wireline Service Offering Advanced Telecommunications Capability</i> , CC Dkt. No. 98-147 and Fourth Report and Order on Reconsideration, <i>Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , CC Dkt. No. 96-98 (rel. Jan 19, 2001)
<i>Local Competition Order</i>	First Report and Order, <i>Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , 11 FCC Rcd. 15499 (1996), <i>aff’d in part and vacated in part by Iowa Utils. Bd. v. FCC</i> , 120 F.3d 753 (8th Cir. 1997), <i>aff’d in part and rev’d in part by AT&T Corp. v. Iowa Utils. Bd.</i> , 119 S. Ct. 721 (1999).
<i>Louisiana II Order</i>	Memorandum Opinion and Order, <i>Application of BellSouth Corporation, et al. for Provision of In-Region, InterLATA Services in Louisiana</i> , 13 FCC Rcd. 20599 (1998)
<i>Massachusetts 271 Order</i>	Memorandum Opinion and Order, <i>Application of Verizon New England Inc. (d/b/a Verizon Long Distance) et al For</i>

SHORT CITE	FULL CITE
	<i>Authorization to Provide In-Region InterLATA Services in Massachusetts</i> , CC Dkt. No. 01-9 (rel. April 16, 2001)
<i>Michigan 271 Order</i>	Memorandum Opinion and Order, <i>Application of Ameritech Michigan Pursuant to Section 271 to Provide In-Region, InterLATA Services in Michigan</i> , 12 FCC Rcd. 20543 (1997)
<i>New York 271 Order</i>	Memorandum Opinion and Order, <i>Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York</i> , 15 FCC Rcd. 3953 (1999)
<i>Second Advanced Services Order</i>	Second Report and Order, <i>Deployment of Wireline Services Offering Advanced Telecommunications Capability</i> , 14 FCC Rcd. 19237 (1999)
<i>South Carolina 271 Order</i>	Memorandum Opinion and Order, <i>Application of BellSouth Corporation, et al Pursuant to Section 271 of the Communications Act of 1934, As Amended, to Provide In-Region, InterLATA Services in South Carolina</i> , 13 FCC Rcd. 539 (1997)
<i>Texas 271 Order</i>	Memorandum Opinion and Order, <i>Application by SBC Communications Inc., et al Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Texas</i> , 15 FCC Rcd. 18354 (2000)
<i>UNE Remand Order</i>	Third Report and Order, <i>Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , 15 FCC Rcd. 3696 (1999)

MISCELLANEOUS PLEADINGS CITED

<i>DOJ KS/OK Eval.</i>	Evaluation of the United States Department of Justice, <i>Joint Application of SBC Communications, Inc., et al, for Provision of In-Region InterLATA Services in Kansas and Oklahoma</i> , CC Dkt. No. 00-217 (Dec. 4, 2000)
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**APPENDIX TO COMMENTS OF AT&T CORP. IN OPPOSITION TO
SBC's SECTION 271 APPLICATION FOR MISSOURI**

CC Docket No. 01-88

EX.	DECLARANT	SUBJECT(S) COVERED
A	Michael Lieberman	Margin Analysis and Relative Cost/Rate Comparisons
B	Michael R. Baranowski	Evaluation of SWBT's Cost Studies and TELRIC
C	Scott L. Finney	Operations of SBC's Advanced Services Affiliate; SWBT's Resale Obligations Under Checklist Item 14 With Respect to Advanced Services; SWBT's Obligation to Provide Line Sharing Over Fiber-Fed Loops
D	Walter W. Willard	Nondiscriminatory Access to Operations Support Systems (OSS); Performance Data and Performance Measurements; Ernst & Young Audit.
E	Richard N. Clarke	Small Overstatements in UNE Rates Deters Entry

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**COMMENTS OF AT&T CORP.
IN OPPOSITION TO SBC COMMUNICATIONS, INC.'S
SECTION 271 APPLICATION FOR MISSOURI**

Pursuant to the Commission's Public Notice, AT&T Corp. ("AT&T") respectfully submits these comments in opposition to the application of SBC Communications, Inc., *et al.* ("SWBT") for authorization to provide in-region, interLATA services in Missouri.

INTRODUCTION AND SUMMARY

There is no meaningful local competition for residential customers in Missouri today. Although numerous CLECs have established interconnection agreements with SWBT and participated in negotiations, arbitrations, and other proceedings designed to open SWBT's market to competition, and although some have found a way to offer local services to business customers, none has succeeded in offering local service broadly to residential consumers. SWBT's data show that only 1.31% of residential lines in Missouri are served by a facilities-based competitor, and that only .07% of all residential lines in Missouri are served through

UNEs. The UNE-platform, though nominally available, is not being used in Missouri to provide any significant degree of local residential service.

SWBT's Missouri application thus presents, at bottom, a single, fundamental question: in the absence of any meaningful local residential competition, should the Commission set aside the verdict of the free market and authorize a BOC's long-distance entry? It should not. That is particularly true in Missouri, where an examination of both the competitive checklist and the factors relevant to the public interest confirms that, in numerous respects, SWBT has not yet fully complied with its market-opening obligations. The lack of any meaningful competition in Missouri is a reflection not of the inadequacies of individual CLEC entry strategies, but of a constellation of unmet statutory obligations and entrenched incumbent opposition to competition that has kept the barriers to local entry secure. To grant SWBT's application at this juncture would serve only to solidify SWBT's monopoly control over the residential market in Missouri and allow SWBT to extend that monopoly into the long distance market – precisely the anticompetitive result that Section 271 is intended to preclude.

The looming injury to consumers is not speculative. The recent findings of the Texas Public Utilities Commission ("TPUC") concerning the moribund state of local residential competition in Texas leave no doubt about the consequences of premature interLATA authorization in Missouri. In a report delivered to the Texas Legislature in January 2001, the TPUC concluded that, six months after this Commission approved SWBT's Texas 271 application, "monopoly power exists . . . in residential and rural markets in Texas." Report to the 77th Texas Legislature, "Scope of Competition in Telecommunications Markets in Texas" (Jan. 2001), at 83 (Att. 1) ("*TPUC Report*"). The TPUC also found that SWBT's monopoly power is likely to persist because large and small CLECs alike have reduced or eliminated their residential

service in Texas. *Id.* at 55-58, 80-81. The result, for residential consumers in Texas, is thus precisely the opposite of what the Act was intended to produce: SWBT is now so insulated from competition for its statewide offer of one-stop shopping for local and long-distance services that it not only has attracted hundreds of thousands of new customers but is now able to raise its rates for both local and long-distance services. *Id.* at 62-64, 79, 81.

The outcome in Missouri, if SWBT's application were granted, would undoubtedly be far worse. For in Texas, numerous competitors have made enormous sunk investments in an effort to make local residential competition a reality. One lesson they have learned is that, despite the most determined efforts, residential competition is simply unsustainable without truly cost-based UNE prices. In Missouri, matters are much worse, because the rates are much higher and no competitive carrier has sunk significant capital. In these circumstances, SWBT's monopoly over bundled services would be invulnerable to competitive challenge from day one. And as in Texas, once SWBT's unique bundle of local and long distance services is available, consumers in Missouri could expect quickly to see the price of that service rise. The only way to avoid such remonopolization of the residential market is to deny SWBT authorization to provide long distance service until such time as it has truly opened its local markets to competition, so that numerous competitors can offer consumers the benefits both of one-stop shopping and of a competitive marketplace.

The remainder of these comments describes the substantial work that SWBT has yet to complete in order to fully implement the competitive checklist and otherwise ensure that its local markets are fully and irreversibly open to competition. Part I addresses SWBT's failure to set cost-based prices for unbundled network elements. The lack of local competition should come as no surprise, for SWBT's UNE loop and switching usage rates in Missouri are the

highest in SWBT's five-state region. These high rates are not justified by higher costs – in fact, the relevant Missouri costs generally are the same as, or lower than, the corresponding costs in other states. For example, SWBT's average loop rate in Missouri is more than \$3.00 higher than in Kansas, even though the Commission's Synthesis Model estimates virtually identical costs for the two states. Similarly, SWBT's switching rates are 46% higher in Missouri than they are in Kansas, even though switching costs are lower in Missouri than they are in Kansas. A "margin" analysis of local residential entry using the UNE-platform confirms that entry is not profitable for even the most efficient competitor imaginable – one with no internal costs.

These high UNE-prices reflect SWBT's determination to evade imposition of cost-based rates in accordance with the Commission's TELRIC methodology. Despite participating in years of proceedings, SWBT has yet to seek, and the Missouri PSC has yet to establish, permanent UNE rates for scores of network elements. Many of these interim rates have been pending for more than two years, with no cost-justification in the record to support any of them. As for the permanent rates, all are inflated by a variety of fundamental methodological errors that preclude a finding of checklist compliance. Such errors reflect, at least in part, the failure of the Missouri PSC to undertake the rigorous TELRIC analysis that is required to set cost-based rates.

For example, SWBT's permanent rates are based on cost-studies and MPSC staff findings that assume an impermissible reproduction cost approach tied to "the most current technology deployed in the *existing network recognizing the existing network design and topography*," Staff Report at 2 (emphasis added) (App. G, Vol. 1, Tab 11, Att. C), rather than the TELRIC replacement cost approach that measures costs based on "the use of the most efficient telecommunications technology currently available and the lowest cost network configuration,

given the existing location of the incumbent LEC's wire centers." 47 C.F.R. § 51.505(b)(1). Similarly, SWBT's permanent rates reflect use of accelerated depreciation rates used for financial accounting, rather than the economic-based depreciation rates that the Commission's rules call for. And SWBT's common cost factor – far higher than that used in Kansas and Texas – is based exclusively on the bloated overhead of the pre-1996 SWBT. These errors, plus numerous methodological errors in the calculation of costs for the loop element (*e.g.*, low fill factors) and for the switching element (failure to apply discounts for new switches), combine to produce UNE rates in Missouri that lie well outside the range of rates that faithful application of the Commission's TELRIC rules would produce.

Part II addresses SWBT's failure to implement its checklist obligations, in two important respects, with regard to advanced services. First, SWBT is not providing resale of advanced services, despite its clear obligation to do so under section 251(c)(4) and checklist item fourteen. In this application, SWBT attempts to portray its DSL affiliate, ASI, as a mere wholesaler of DSL transport service to various Internet service providers ("ISPs"), with a few grandfathered retail customers whose accounts are steadily being shifted over to the ISPs. In the marketplace, however, SWBT presents a different face. On its Missouri web page, SWBT offers retail customers "two convenient ways to order DSL" from SWBT, including ordering "DSL transport only." SWBT's print advertising, and its customer care representatives, confirm that stand-alone DSL is available from SWBT as a retail service in Missouri, and that SWBT also offers retail customers a package where SWBT provides both the DSL transport and arranges for Internet access with an ISP, with the customer being billed only a monthly charge to SWBT.

The evidence is thus clear that SWBT is marketing DSL service not merely as a wholesaler, but as a retailer directly to end-users. In these circumstances, SWBT's failure

broadly to make DSL transport available for resale at a discount that reflects the avoided cost of all of its marketing, customer care, and other retailing efforts, flatly violates its checklist obligations and precludes approval of its 271 application. SWBT further violates the checklist by failing to provide competitors with the non-discriminatory access to its operations support systems necessary to allow competitors to order and provision resale DSL.

SWBT also fails to comply with its advanced services obligations in a second respect. The Commission's *Line Sharing* and *Line Sharing Reconsideration Orders* could not be more clear that incumbent LECs must provide line sharing on fiber-fed loops, as well as access for line-sharing on those fiber-fed loops at the central office. SWBT refuses to comply with these obligations. It nowhere even asserts compliance, and its policy, set forth in the M2A, is to limit the availability of line-sharing to copper loop facilities, and to require CLECs to collocate only at remote terminals (and not at the central office) when seeking access to fiber-fed loops for line-sharing. These restrictions are each highly anticompetitive, for they serve to reduce the number of customers to whom CLECs can offer advanced services, degrade the quality of CLEC service, and increase CLEC costs. SWBT's failure to comply with its line-sharing obligations is all the more competitively significant in light of SWBT's continuing efforts to extend the use of fiber in its network. If CLECs were ever able economically to make use of the UNE-platform, their inability to access line-sharing over fiber-fed DLC loops at the central office would significantly restrict their ability to compete with SWBT. SWBT's line-sharing restrictions thus violate checklist items two and four and constitute another independent reason to deny this application.

Part III describes the reasons why SWBT has not fully implemented its duty to provide non-discriminatory access to its operations support systems. In addition to the

limitations on access to OSS for resold DSL noted above, SWBT is not providing CLECs with non-discriminatory access to its repair and maintenance systems. Its database (“LMOS”) for tracking CLEC customers is inaccurate, requiring CLECs manually to report troubles for customers whose service was established prior to an untested SWBT upgrade in late March. This manual handling means that it takes 1-2 days longer to fix a CLEC customer’s service than a SWBT customer’s service, and thus constitutes stark, competition-affecting discrimination.

Equally troubling is the failure of SWBT accurately to report its OSS performance. Not only do SWBT’s performance reports not capture the repair and maintenance discrimination, but SWBT has consistently skewed its performance reports so as to overstate the degree to which CLEC orders are processed electronically rather than with manual intervention. The third-party audit on which SWBT heavily relies here did not catch either of these problems, and in light of SWBT’s inaccurate reporting, the Texas PUC staff recommended a new five-state audit of SWBT’s performance reporting. In these circumstances, SWBT cannot reasonably be found to have carried its burden of demonstrating that competitors have non-discriminatory access to OSS.

Finally, Part IV sets forth the reasons why approval of the Missouri application would not serve the public interest. Section 271 makes clear, and this Commission has acknowledged, that even where (unlike here) a BOC has fully implemented each of its checklist obligations, interLATA authorization is not in the public interest if other relevant factors demonstrate either that its local markets are not open to competition or that they will not remain open to competition. It is plain that the local residential market in Missouri is not yet open to competition, and that it will remain closed to competition unless and until SWBT and the Missouri PSC take affirmative steps to eliminate the remaining significant barriers to entry. Not

only do competitors today serve only a paltry number of residential customers, but the competitors on which SWBT relies have either exited the local market or are in extreme financial distress. None has made investments yet in the Missouri residential market comparable to the investments that CLECs have made to enter the Texas residential market, and yet even in Texas CLEC entry has been so ineffectual that the Texas PUC has concluded that the residential market remains a SWBT monopoly and requires continuing rate regulation.

In these circumstances, to grant SWBT's application now would not prompt CLECs to enter the local residential market in Missouri. If CLECs cannot succeed using UNE-P under the rates and conditions now prevailing in Texas, they certainly will not succeed using UNE-P under the higher rates, and with less vigorous state commission oversight, in Missouri. Nor will consumers benefit from having SWBT as a long-distance provider; the decreases in long distance rates in Texas that coincided with the SWBT's interLATA authorization reflected the pass-through of reductions in access rates, and SWBT is now raising its long-distance rates in Texas with impunity. Approval of SWBT's Missouri application thus would simply allow SWBT, at great speed, to accomplish in Missouri what it is now accomplishing in Texas: raising its customers' rates because it is the only carrier able to provide a bundled offering of local and long distance service. To prevent this corruption of the Telecommunications Act and Section 271, the Commission should deny SWBT's application for Missouri.

I. SWBT'S UNE RATES FOR MISSOURI ARE NOT COST-BASED AND DO NOT SATISFY CHECKLIST ITEM TWO.

SWBT has not remotely satisfied its burden of proving that its Missouri UNE rates comply with TELRIC principles. SWBT's UNE rates are drawn from three disparate sources: (1) a 1997 Missouri PSC rate proceeding that established permanent rates for some

UNEs based on SBC cost studies that, by their own description, violate the most fundamental TELRIC principles; (2) SWBT proposals that the MPSC adopted, without review, as “interim” rates over two years ago; and (3) rates that the MPSC, without review, recently authorized SWBT to import from Texas. *See* SWBT Br. at 28. The hodge-podge of UNE rates that SWBT has cobbled together in Missouri yield the *highest* loop and switching usage rates in SWBT’s five state region. *See* Lieberman Decl., Table 2; Baranowski Decl., Table 2. That is not because costs are higher in Missouri. To the contrary, as detailed below and in the attached declarations of Michael Baranowski and Michael Lieberman, the relevant Missouri costs are, in many cases, lower than the costs in SWBT’s other states. With respect to loops, for example, the Commission’s Synthesis Model estimates virtually identical costs in Missouri and Kansas. The relative rate/cost comparison approach endorsed by the Commission in the *KS/OK 271 Order* (§ 82 n.244) and the *Massachusetts 271 Order* (§ 22) would therefore predict similar loop rates in Missouri and Kansas. The reality, however, is that the statewide average of the Missouri loop rates is more than \$3.00 higher than the statewide average of the Kansas loop rates that the Commission recently found appropriately TELRIC-based. Missouri loop rates are even higher (by \$1.28) than the arbitrarily-determined Oklahoma rates that the Commission struggled to justify earlier this year. But the Commission’s Synthesis Model estimates Missouri loop *costs* to be \$1.35 *lower* than in Oklahoma. Thus, by the Commission’s own analysis, Missouri rates are a full \$2.63 (or 15%) abnormally *higher* than reference to Oklahoma rates would justify. Thus because the Commission previously has established the Oklahoma loop rates as only barely meeting its TELRIC standard, it is patent that Missouri rates that vault cost-adjusted Oklahoma rates by a full \$2.63 must fail the Commission’s TELRIC standard. And with respect to other SWBT states, this comparison is even more stark. Rate/cost comparisons for other elements and

between Missouri and other SWBT states likewise confirm that the great disparities between SWBT’s Missouri rates and its rates in other states cannot be explained by cost differences. *See* Baranowski Decl. ¶¶ 41-42; Lieberman Decl. ¶¶ 20-24.¹

It is also quite clear that SWBT’s extravagant Missouri rates foreclose profitable UNE-based entry. In three of the four Missouri UNE rate zones, a new competitor would lose money on each residential line it serves, even if it had *no* internal marketing and related costs of running its business – *i.e.* the *gross* UNE-P margins in those zones are negative. *See* Lieberman Decl. ¶¶ 18-19. Indeed, SWBT’s Missouri rates are so high that the statewide *average* UNE-P gross margin is negative. *See id.* In these circumstances – *i.e.*, where the subject rates are significantly out of line with rates in adjoining states and are so high that they foreclose competitive entry – SWBT’s Missouri rates clearly cannot qualify for any “presumption” of TELRIC compliance. *See Massachusetts 271 Order* ¶ 22. Rather, the Commission has an obligation independently and seriously to review SWBT’s UNE rates – particularly given the alarming number of those rates that have never even been reviewed by the MPSC.

As demonstrated below, any serious independent review confirms that SWBT’s Missouri rates are inflated by many clear violations of the Commission’s controlling TELRIC rules. Most fundamentally, the SWBT cost studies that were used to generate many key rates, including loop and switching rates, do not estimate the cost of the most efficient “replacement” network, as required by the TELRIC rules, *see* Baranowski Decl. ¶¶ 10-16, but instead, in many critical respects, simply assume “reproduction” of *existing* SWBT facilities, without regard to the availability of more efficient substitutes. That is the very approach that the Commission has

¹ These relative cost comparisons based on the Commission’s Synthesis model are confirmed by making the same comparison using NECA data. *See* Lieberman Decl., Table 3.

repeatedly condemned and is currently challenging in the Supreme Court in *Iowa Utilities Board II*.² This fundamental methodological flaw was compounded by the MPSC’s acceptance of non-TELRIC-compliant assumptions with respect to many of the most significant cost model inputs, including depreciation, common costs, fill factors, and switch discounts. That produced massively inflated permanent rates. And many of SWBT’s “interim” UNE rates came straight from equally flawed SWBT cost studies that were never even reviewed by the MPSC. Incredibly, in ongoing MPSC proceedings SWBT seeks even higher rates to replace many of the key permanent rates established by the MPSC in 1997 (including “glue charge” NRCs that total over \$250 for the UNE platform and vastly inflated recurring loop, switching and transport rates) and, once this proceeding is over, SWBT can be expected to do the same for UNEs that are currently subject only to interim rates. *See* M2A, Attachment 6 (Unbundled Network Elements), Appendix Pricing, Exhibit 1, page 1. On this record, there simply can be no non-arbitrary finding that SWBT has met its Checklist Item 2 burden.

A. The Unexplained Disparities Between SWBT’s Missouri Rates And Its Rates In Neighboring States Warrants A Presumption That SWBT’s Missouri Rates Are Not TELRIC-Compliant.

SWBT’s Missouri loop rates are higher than those in any other state in SWBT’s five state Region. SWBT’s loop rates for Missouri exceed those in Kansas, Oklahoma, Texas and Arkansas by 25%, 8%, 20% and 20% respectively. *See* Lieberman Decl., Table 2. Relative comparisons using the Commission’s Synthesis Model (or the NECA data submitted by SWBT), confirm that loop costs exhibit precisely the opposite relationship – it costs *less* to provide loops in Missouri than in Oklahoma or Arkansas, and Missouri loop costs are about the same as

² *See Verizon Commun., Inc. v. FCC, cert. granted*, 121 S.Ct. 877-89 (2001) (Nos. 00-511, 00-555, 00-587, 00-590 & 00-602).

Kansas costs. And although Texas loop costs are somewhat lower than Missouri costs, that cost difference is not large enough to explain fully the huge rate difference. *See id.*³

Missouri is an outlier with respect to switch usage rates as well. Again, SWBT's Missouri rates are higher than those in any other state in SWBT's five state Region – SWBT's Missouri rate exceeds its Kansas, Oklahoma, Texas and Arkansas rates by 46%, 3%, 61% and 36%, respectively. *See Baranowski Decl.*, Table 2. And again, two of the other states (Kansas and Arkansas) have higher costs than Missouri. The Synthesis Model estimates that Texas switch usage costs are 20 percent lower than those in Missouri, but, again, that cannot explain the 61 percent rate disparity.⁴

The bottom line is this: there can be no reasoned presumption that SWBT has satisfied its Checklist Item 2 burden to demonstrate that its Missouri rates are appropriately cost-based. Indeed, rate and relative cost comparisons, if anything, compel the opposite presumption, particularly given the near complete absence of UNE-based competition in Missouri and the attached showing that such competition is effectively foreclosed at SWBT's current rates. *See Lieberman* at ¶¶ 18-19. At a minimum, however, the Commission has an obligation to subject SWBT's UNE rates serious independent review and to insist that SWBT's claims of TELRIC compliance be supported with complete and competent evidence – including working, electronic

³ SWBT's claim (without citation) that "the actual rates contained in the M2A that were derived from [the arbitrations] . . . are equal to *or lower than* the rates that have universally been recognized as complying with TELRIC," SWBT Br. at 32, is baseless.

⁴ The only SWBT state that exhibits a switching usage rate/cost relationship comparable to Missouri is Oklahoma, where switching usage rates were based on an arbitrary SWBT "compromise," followed by arbitrary "promotional discounts" (neither of which was supported by any cost study or analysis). *See KS/OK 271 Order* ¶ 52 (compromise); ¶¶ 70-71 (discount); appeal pending *Sprint Communications Company L.P. v. FCC*, Docket No. 01-1076 (and consolidated cases Nos. 01-1081, 01-1082, 01-1083, 01-1084) (D.C Cir. filed Feb. 16, 2001).

copies of the SWBT cost studies that produced those rates. As demonstrated below, any serious Commission review will confirm that SWBT has not remotely met its TELRIC burden.

B. SWBT’s Permanent Missouri Rates Are Substantially Inflated By Unlawful “Reproduction Cost” Assumptions.

The Commission’s TELRIC rules require the “cost” upon which UNE rates are based, *see* 47 U.S.C. § 252(d)(1), to be “measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC’s wire centers.” 47 C.F.R. § 51.505(b)(1). This rule requires a “replacement” cost approach and forecloses a “reproduction” cost approach. As the Commission recently explained to the Supreme Court:

The essential objective of any forward-looking methodology is to determine what it would cost, in today’s market, to replace the functions of an asset that make it useful. That is the asset’s ‘forward-looking’ cost (also known as its ‘replacement’ or ‘economic’ cost), as distinguished from the cost of duplicating the asset in every physical particular (sometimes called an item’s ‘reproduction’ or ‘replication’ cost). Thus, under a forward-looking methodology, if an incumbent bought an analog switch in 1985 at a fixed cost of \$150 per line, and an efficient carrier would address the same business need today by purchasing a digital switch at a fixed cost of \$100 per line (more efficient digital switches have supplanted analog switches in the market), the latter figure is the appropriate basis for determining what a new entrant would pay for leasing switching equipment.

Brief of the FCC, *Verizon Commun., Inc. v. FCC*, at 6-7, *cert. granted*, 121 S.Ct. 877-89 (2001) (Nos. 00-511, 00-555, 00-587, 00-590 & 00-602).⁵ The subset of Missouri UNEs for which the

⁵ *See also id.* at 29 (“In competitive markets, the price that a firm would pay or charge to lease particular facilities varies with the cost of obtaining the function of those facilities through some other means, including the use of more efficient substitutes; the firm would not arbitrarily blind itself to the availability of such substitutes”); *Local Competition Order* ¶ 684 (recognizing that failure to adhere strictly to a replacement cost approach could produce rates “that reflect inefficient or obsolete network design and technology”).

MPSC has established permanent rates clearly violate this TELRIC rule, because the SWBT cost studies that generated them concededly relied on numerous reproduction cost assumptions.

As the MPSC Staff Report explained, the SWBT cost models used to compute permanent Missouri UNE Rates were designed to estimate the costs of “the most current technology deployed in the *existing network recognizing the existing network design and topography*.” Staff Report at 2 (emphasis added). SWBT’s own witness concedes that “[p]lant investments [were] computed for each component reflecting the mix of equipment *used today* [*i.e.*, in 1997 when the rates were established].” Smith Decl. at A-7-8 (emphasis added). *Compare Local Competition Order* ¶ 684 (rejecting approaches that would allow incumbent LECs to “recover costs based on their existing operations, and prices for interconnection and unbundled elements that reflect inefficient or obsolete network design”). To be sure, SWBT’s cost studies are not *pure* reproduction cost models (that is, they do not reproduce *every* particular of the existing network), however, reproduction cost – that is, what it would cost today to build a network with the same number of miles of cable or the same mix of equipment – was clearly the rule rather than the exception.

Impermissible reproduction cost assumptions were particularly prevalent in – and substantially inflated the rates associated with – SWBT’s loop cost studies. SWBT’s primary loop cost model, “LPVST,” was developed years ago, presumably to estimate the cost of providing new and existing services over SWBT’s existing facilities. *See* Baranowski Decl. ¶ 13. The primary driver of the LPVST outputs is the SWBT sample survey of SWBT’s actual loops combined with its embedded historical installed cost per cable foot. *See id.* There are few, if any forward-looking modifications made by SWBT to either the survey input data or the historical cable investment per pair. *See id.* Instead, SWBT’s survey data replicates the

inefficiencies of the embedded network by simply assuming the same mix of feeder and distribution cable sizes (*i.e.*, 25-pair cables, 50-pair cable, 100-pair cables and 200-pair cables) in place today. *See id.* That clearly inflates costs, because, for example, the SWBT network from which the survey samples are taken evolved piecemeal over time, with capacity added in increments as actual and forecasted demand increased. *See id.* That often means several smaller cables exist on a route where a single larger cable would be more efficient. LPVST may therefore accurately reproduce SWBT's existing network, but the Commission's TELRIC rule requires rates to reflect the forward-looking replacement costs of facilities that are efficiently sized to meet total demand. *See id.*

SWBT's LPVST model reproduces historical cable placement patterns in other respects as well. *See Baranowski Decl.* ¶ 15. The Missouri PSC Staff Report acknowledged cable placement and sizing concerns, but neither the Staff nor the MPSC itself made any effort to address the problem. Although it is obviously impossible to precisely quantify the full impact of these rate-inflating errors on SWBT's loop rates without access to the electronic cost studies (which SWBT has not provided), the inflation is undoubtedly quite substantial. *See id.* In any event, SWBT's reproduction cost assumptions violate basic TELRIC principles, and its Application must be denied for that reason alone. *See, e.g., New York 271 Order* ¶ 244 ("we will reject the application . . . if basic TELRIC principles are violated").⁶

⁶ SWBT's costs studies also double count numerous costs. *See Baranowski Decl.* ¶¶ 14 n.8. The costs of general purpose computers, for example, are captured in both SWBT's recurring study through a support asset factor and in a separate computer related non-recurring cost computation. *See id.* Likewise, SWBT's models include a markup for the "catch-up" of previously funded post-retirement employee benefits that would not be included in a forward looking model. *See id.* Again, because SWBT has failed to supply electronic versions of its cost models, the full impact of this double counting is difficult to determine. Obviously, however, such double counting has the potential to significantly inflate UNE rates. *See id.*

C. All of SWBT’s Permanent UNE Rates Are Inflated by Depreciation, Common Cost, Power and Engineering Assumptions That Violate Basic TELRIC Principles.

Depreciation. SWBT’s UNE rates for Missouri violate TELRIC by significantly overstating depreciation expense. *See* Baranowski Decl. ¶¶ 18-21. With few exceptions, the Missouri PSC Staff endorsed, and the Missouri PSC approved, the use of SWBT’s financial accounting depreciation lives for computing SWBT’s Missouri UNE rates, rather than insisting that those rates be based on economic depreciation lives, as required by the Commission’s rules. *See* 47 C.F.R. § 51.505(b)(3) (“The depreciation rates used in calculating forward-looking economic costs elements shall be economic depreciation rates”).

The fundamental problem with using financial depreciation lives to compute UNE rates is that those depreciation lives are designed to err on the side of protecting shareholders. They are not designed objectively to estimate the projection lives for sound ratemaking purposes. *See, e.g., Depreciation Order* ¶ 17 (noting that “[o]ther federal regulatory commissions, like the Securities and Exchange Commission, operate under their own authorizing legislation and have statutory duties that differ from the requirements imposed on us by the [1996] Act”). Consequently, financial reporting depreciation lives are generally *lower* than the actual forward-looking economic depreciation lives that must be used to comply with TELRIC standards.⁷ And even if financially accounting lives cannot be ruled out as a possibility in *all* ratemaking circumstances, SWBT plainly has not met its burden of demonstrating that its extremely short

⁷ For the same reasons, Missouri PSC Staff’s “benchmarking” analysis of SWBT’s proposed rates is of no use. The Missouri PSC Staff tested the reasonableness of SWBT’s rates by comparing them to the projection lives computed by examining financial reports submitted to the Securities Exchange Commission by other companies. Because these reports use depreciation methods that are not TELRIC-compliant, that benchmarking analysis provides no useful information. *See* Baranowski Decl. ¶¶ 19 n.10.

financial accounting lives produce TELRIC-compliant rates in Missouri, particularly where, as here, the depreciation lives used by SWBT to price UNEs are not the same lives used to support its retail pricing of intra or interstate services. *See* Baranowski Decl., Table 1.

The use of financial accounting lives significantly inflated all of SWBT's permanent UNE rates. For example, SWBT's Missouri rates are based on an assumed life for digital switches of 9.4 years compared to the Commission's approved digital switch life of 16 years. *See* Baranowski Decl., Table 1. SWBT's assumed average life for aerial metallic cable, a significant driver of loop and transport costs, of 13.7 years compares with a 25 year life approved by the Commission (an 82% difference). *See id.*⁸ In contrast, SWBT's Texas and Kansas rates and Verizon's Massachusetts rates reflect much longer depreciation lives. *See id.*⁹ Of course, the exact impact on UNE rates of SWBT's use of unusually short depreciation lives cannot be computed with any specificity without access to SWBT's cost model. However, the impact of that error is likely to be substantial given the importance of depreciation assumptions and the extent of SWBT's underestimation of depreciation lives. *See* Baranowski Decl. ¶ 21.

⁸ Modern advances in electronics technology to improve the throughput capacity of copper pairs virtually ensure that copper cable will remain the standard for distribution facilities for some time. *See id.* Qwest for one has stated that it “does not have plans to remove [its] . . . copper plant in its 14-state area for the foreseeable future.” *Ex parte*, Letter from Robert B. McKenna, Assoc. Gen. Counsel, to Magalie Roman Salas, Secretary CC Docket Nos. 98-147, 96-98 (March 29, 2001).

⁹ The approved rates in New York and Oklahoma were not taken directly from cost study outputs and thus no such comparison is possible. *See id.* For that reason, the Commission's recent Order granting SWBT's application to provide In-region InterLATA services in Oklahoma provides no precedent for Section 271 authority in a state with rates based on financial accounting depreciation lives. Moreover, although the Commission there discounted a challenge to SWBT's use of financial accounting lives in Oklahoma, it did so only upon a finding that any resulting problems with depreciation were addressed by SWBT's “stipulation results which reduce recurring rates” well below the levels produced by the SWBT cost studies. *See KS/OK 271 Order* ¶ 76. No such stipulation has been proposed in this proceeding.

Common Costs. SWBT's Missouri UNE rates are all inflated by a grossly excessive common cost allocator factor of 16.47%. See Baranowski Decl. ¶¶ 22-25. The common cost factor is designed to reflect costs that cannot be attributed directly to individual services or elements. See *id.* There is a fundamental mismatch between the way SWBT developed its 16.47% common cost allocator and the way in which it is applied. SWBT calculated the common cost allocator factor as the ratio of common expenses to total expenses less common expenses. See *id.* ¶ 24. That factor, however, is applied to costs that include a return on the forward-looking investment. Because return on investment is not reflected in total expenses (used to develop the ratio), common costs are undeniably overstated. See *id.*¹⁰

This error was compounded by the fact that SWBT's common cost factor is based entirely on SWBT's pre-1996 Act monopoly level of common costs and is, therefore, not reflective of the forward-looking common costs that an efficient provider would incur. See Baranowski Decl. ¶¶ 22-23. Indeed, SWBT itself claims that it has become much more efficient since 1996. See *id.* SWBT's common cost factor for Missouri far exceeds the common cost factor approved in the other states (for which that data is available) for which section 271 authority has been granted. For instance, the Kansas Commission recently adopted a factor of only 10%. See *id.* ¶ 25. As explained by Mr. Baranowski, a common cost factor should be no higher than 10%, and recent analysis shows that a forward looking common cost factor should only be about 8%. See *id.*

¹⁰ A more appropriate common cost factor would be the ratio of common costs to *revenues* less common costs. Revenues, unlike expenses, include an implicit return on investment and would thus produce a factor that is comparable to the costs to which it is being applied. See *id.*

Power, Engineering and Other “ACES” Model Errors. The Missouri PSC Staff has recognized that the ACES Model, which inflates all UNE rates with additional capital costs for sales taxes, telecommunications engineering and labor, miscellaneous materials, power equipment and buildings to house equipment, violates TELRIC principles by incorporating numerous embedded cost factors. *See Baranowski Decl.* ¶¶ 26-28. Accordingly, the Missouri PSC Staff made several changes to the ACES model in an attempt to fix those problems. *See id.* However, there remain numerous embedded cost factors in that model. For example, both the power factor and telecommunications engineering factors within ACES are derived from SWBT’s actual experience in providing power for switches and engineering equipment replacements, which includes retrofitting and modifying embedded facilities to accommodate new equipment as well as providing for the removal and disposal of the obsolete equipment being replaced. *See id.* None of these activities is appropriately included in a forward-looking TELRIC estimate of the costs of an efficient replacement network, where buildings are specifically sized and powered to meet the requirements of today’s forward-looking digital switches.

The ACES model also reflects embedded costs for outside plant facilities. For example, forward-looking maintenance expenses for metallic cable are based on SWBT’s historical relationship of metallic cable maintenance expenses to embedded plant investment. No adjustments to historical expenditures were made to SWBT’s ACES model to reflect that the forward-looking facility should be completely new. *See id.* In this regard, the ACES model should, at a minimum, reflect a decrease in the amount of repair and maintenance produced by the existing deteriorating plant and a corresponding reduction in trouble repair and maintenance