**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service.	R.95-04-043
Order Instituting Investigation of the Commission's Own Motion into Competition for Local Exchange Service.	I.95-04-044

PUBLIC EXHIBITS TO COMMENTS OF LSSI CORP., METRO ONE TELECOMMUNICATIONS, INC. AND WORLDCOM, INC. ON THE SBC PACIFIC BELL AMENDED DIRECTORY ASSISTANCE LISTING INFORMATION SERVICE ("DALIS") COST STUDY

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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish A Framework for Network Architecture Development of Dominant Carrier Networks	Rulemaking 93-04-003 (Filed April 7, 1993)
Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks	Investigation 93-04-002 (Filed April 7, 1993)

DECLARATION OF TERRY L. MURRAY IN SUPPORT OF COMMENTS OF LSSI CORP., METRO ONE TELECOMMUNICATIONS, INC., AND WORLDCOM, INC., CONCERNING SBC CALIFORNIA'S DIRECTORY ASSISTANCE LISTING INFORMATION SERVICE

PUBLIC VERSION

I. QUALIFICATIONS OF TERRY L. MURRAY

1. My name is Terry L. Murray. My business address is Murray & Cratty, LLC, 227 Palm Drive, Piedmont, California 94610.

2. I am an economist specializing in analysis of regulated industries. I received an M.A. and an M.Phil. in Economics from Yale University and an A.B. in Economics from Oberlin College. At Yale, I was admitted to doctoral candidacy and completed all requirements for the Ph.D. except the dissertation. My fields of concentration at Yale were industrial organization (including an emphasis on regulatory and antitrust economics) and energy and environmental economics.

3. My professional background includes employment and consulting experiences in the fields of telecommunications, energy and insurance regulation. As a consultant, I have testified or served as an expert on telecommunications issues in

proceedings before state regulatory commissions in California, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Hawaii, Illinois, Kansas, Maryland, Massachusetts, Michigan, Missouri, Nevada, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, Washington and Wisconsin, and before the Federal Communications Commission ("FCC"). I have extensive experience reviewing the cost studies that Pacific Bell Telephone Company ("SBC California" or "Pacific Bell") and other incumbent local exchange carriers have presented to state regulatory commissions in support of their proposed prices for unbundled network elements ("UNEs"), wholesale services and collocation.

4. Before I became a consultant in 1990, I was employed in a variety of positions (including Director of the Division of Ratepayer Advocates) at the California Public Utilities Commission ("Commission") for approximately six years and had significant responsibility for telecommunications matters. I have also taught economics and regulatory policy at both the undergraduate and graduate levels. My curriculum vitae, which is appended as Exhibit TLM-1 to this declaration, provides more detail concerning my qualifications and experience.

II. INTRODUCTION AND SUMMARY

5. LSSi Corp. ("LSSi"), Metro One Telecommunications, Inc. ("Metro One"), and WorldCom, Inc. ("WorldCom") (collectively, "Joint Commenters") have asked me to explain the costing and pricing principles that should apply to SBC California's Directory Assistance Listing Information Service ("DALIS") and to

apply those principles to the proposed prices, and the underlying cost support, that SBC California has submitted for Commission review.

6. The Commission faces a clear choice concerning the pricing of DALIS. SBC California has indicated that it intends to propose what it calls "market-based pricing."[1] Joint Commenters, in contrast, propose that the price for DALIS be based on forward-looking economic cost, as embodied in the Total Element Long Run Incremental Cost ("TELRIC") methodology adopted by the FCC for UNEs and interconnection. Joint Commenters support TELRIC-based pricing for DALIS regardless of whether DALIS is considered a UNE.

7. The FCC has repeatedly found that incumbents such as SBC California have unique and privileged access to directory assistance data and must provide access to that information on a nondiscriminatory basis. Indeed, paragraph 15 of the FCC's *UNE Remand Order*[2] specifically included "Operator Services/Directory Assistance databases" among the call-related databases that must be unbundled. The FCC has also reaffirmed that incumbents must "make available to unaffiliated entities all of the in-region telephone numbers they use to provide nonlocal directory assistance service at the same rates, terms and conditions they

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[1] Reply of Pacific Bell Telephone Company (U 1001 C) to LSSI Corp., Metro One Telecommunications, Inc., and WorldCom, Inc.'s Motion to Strike New Material in the SBC Pacific Bell June 6, 2002 Amended Directory Assistance Listing Information Service ("DALIS") Cost Study and for a Ruling Clarifying that a Price for DALIS Will Be Established in this "Phase" of this Proceeding, August 23, 2002, at 2 ("SBC Pacific Bell has always argued that market-based pricing is appropriate, and will present facts and arguments to support that position when that issue is joined."). *See also* 10/28/02 Meet and Confer Data Request 2 (SBC Pacific Bell Response), attached hereto as part of Exhibit TLM-2.

[2] FCC 99-238, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, CC Docket 96-98, adopted September 15, 1999 (hereafter "*UNE Remand Order*").

impute to themselves"[3] and "comply with the nondiscrimination requirements set forth in section 272(c)(1)."[4]

8. So-called "market-based" prices do not meet these standards, as this Commission has previously concluded.[5] Indeed, "market-based" prices allow SBC California to exploit the market power that it possesses by virtue of the legacy of its former legal local exchange monopoly. As I will demonstrate below, SBC California's proposed "market-based" prices far exceed even its own claimed cost to provide DALIS. The company's desire to impose such high prices provides *prima facie* evidence that DALIS is not offered in a competitive market.

9. In contrast, cost-based pricing is the best means to ensure that SBC California complies with the nondiscrimination requirements of the Act and the FCC's orders. By definition, the true economic cost to SBC California of access to directory listing data is the forward-looking economic cost of providing DALIS. Therefore, as I will explain in more detail below, it is important for both economic and public policy reasons that SBC California's DALIS prices reflect its forward-looking economic cost, *i.e.*, costs that a firm *with SBC California's scope and scale* would experience entering a competitive market.[6] Given the

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[3] FCC Memorandum Opinion and Order, *In the Matter of the Petition of SBC Communications Inc. for Forbearance of Structural Separation Requirements and Request for Immediate Interim Relief in Relation to the Provision of Nonlocal Directory Assistance Services, et al.*, CC Docket No. 97-172, DA 00-514, adopted April 11, 2000 ("*FCC Forbearance Order*") at ¶ 2.

[4] *Id.* at ¶ 15.

[5] D.01-09-054 at 10 ("the market pricing which Pacific proposes in this arbitration is inconsistent with the FCC's directives.").

[6] This approach to developing forward-looking cost estimates is common to both the FCC's "TELRIC" methodology (47 C.F.R. § 51.505(b)) and the Total Service Long Run Incremental Cost

unique advantages that SBC California possesses as a legacy of its former monopoly franchise and its continuing dominance in the local exchange market (which is the root source of directory listing data), any other pricing standard will allow SBC California to leverage its market power to disadvantage potential competitors.

10. This is not to say that the Commission should adopt prices based on either of SBC California's different, mutually inconsistent "updated" cost studies for DALIS. To the contrary, as SBC California's responses to discovery and its deposition testimony[7] in this matter demonstrate, the company's estimates of the costs it will actually incur to provide DALIS are grossly inflated.

11. To understand the numerous errors in SBC California's "updated" DALIS cost studies, it is necessary to understand how SBC California developed those costs. Unfortunately, SBC California did not provide a basic description of its study methodology. Therefore, I will briefly summarize those studies to provide the necessary context.

12. On June 6, 2002, SBC California submitted two different "cost studies" for DALIS. First, as discussed in detail in Joint Commenters' August 6, 2002 motion,[8] SBC California's latest "update" to its analysis of DALIS costs

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("TSLRIC") methodology embodied in the Consensus Costing Principles agreed to by Pacific Bell and other parties and adopted by this Commission in the OANAD proceeding (D.95-12-016, Appendix C; *see especially* Consensus Costing Principle No. 3).

[7] Deposition of Scott Pearsons, Lori Winters, Sally Smith, Karen Jameson, Carol Tanner and Ron Cashin, January 24, 2003, (hereinafter, "Deposition, 1/24/03"). A copy of the complete transcript of this deposition is attached hereto as Exhibit TLM-3.

[8] Reply of Pacific Bell Telephone Company (U 1001 C) to LSSI Corp., Metro One Telecommunications, Inc., and WorldCom, Inc.'s Motion to Strike New Material in the SBC Pacific Bell

introduces an entirely new layer of data acquisition, storage and maintenance costs that did not appear in its prior cost studies. SBC California's "updated" cost study shows these costs as several millions of dollars presented as a "lump" sum, meaning that SBC California refuses even to state how these costs are caused by existing DALIS customers or how they should be assigned to those customers.

13. As I discuss below, SBC California's data acquisition, storage and maintenance costs are based on a hypothetical assumption that SBC California does not exist as a retail provider. They are instead costs that result from a curious exercise in which SBC California apparently instructed its employees to assume that they had no access whatsoever to existing SBC California listing data and instead must purchase those data from other sources and then build new systems to house the listing information and keep it up-to-date. Hence, this portion of SBC California's "updated" cost study is not a study of the company's own forward-looking economic costs at all.

14. In setting cost-based prices for DALIS, the Commission should disregard this aspect of the SBC California DALIS study in its entirety. A study of the costs of a hypothetical wholesale-only provider of DALIS does not provide a basis for nondiscriminatory pricing of DALIS nor does it comply with the TELRIC methodology. I explain the basis for these conclusions and recommendations in Sections III.C.1 and III.C.2 below.

June 6, 2002 Amended Directory Assistance Listing Information Service ("DALIS") Cost Study and for a Ruling Clarifying that a Price for DALIS Will Be Established in this "Phase" of this Proceeding, August 23, 2002.

15. Second, SBC California supplied an updated estimate of the cost that it actually expects to incur to provide DALIS as a service on a forward-looking basis.[9] That study, which is an update to the material that SBC California previously presented to the Commission, consists primarily of costs for a product support staff,[10] "database maintenance" costs for time spent correcting listings errors identified by DALIS customers,[11] and the computer processing time needed to extract update records.

16. SBC California attempts to develop the total monthly recurring cost that it will incur to provide DALIS to seven customers, each of which will receive 19 update files per month. SBC California then divides that cost by an estimate of the total DALIS records supplied each month. In doing so, SBC California exaggerates its forward-looking cost in at least four important respects:

- It underestimates the number of DALIS records per month.
- It overstates the cost of computer processing time.
- It assumes that numerous, unsupportable layers of manual employee work effort will be involved in providing "maintenance" and "customer support."
- It includes the cost for providing the cost of manually processing physical tapes that are shipped to DALIS customers when, in fact, many DALIS

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[9] These costs are what SBC California characterizes as its "TSLRIC" DALIS service study results. Deposition, 1/24/03, Pearsons, Tr. 6-7.

[10] SBC California 6/6/02 DALIS study, p. 4, lines 2-5b.

[11] SBC California 6/6/02 DALIS study, p. 4, lines 10-10d.

customers already receive those records in an electronic feed (or would like to do so.)

17. Each of these errors must be corrected before the Commission can make any use of this portion of the SBC California DALIS cost study to arrive at cost-based prices for DALIS. In Section III.C.3 below, I provide a detailed discussion of these errors and propose possible corrections that would produce a more reasonable estimate of SBC California's forward-looking economic cost to provide DALIS.

18. I recommend that the Commission establish cost-based prices for DALIS that reflect my corrections to the SBC California monthly recurring cost per listing and nonrecurring cost, plus a markup to recover shared and common costs, based on the Commission-approved shared and common cost markup for wholesale products such as UNEs. These corrections include the creation of a separate rate element for tape delivery.[12] The current Commission-approved shared and common cost markup for SBC California is 21%. Therefore, my recommended costs and prices for DALIS are as follows:

Rate Element	Units	Revised Cost	Price
Recurring (Update listing files)	Per Listing	$0.0006	$0.0008
Optional Tape Delivery	Per Tape	$13.33	$16.13
Non-Recurring (Base File)	Per Base File Order	$2,954.37	$3,574.79

Note: Price includes 21% markup for common costs.

[12] A complete version of my corrections to SBC California's cost study is provided as Proprietary Exhibit TLM-4 to this declaration.

III. DISCUSSION

A. The Commission Should Establish Cost-Based, Nondiscriminatory Prices for DALIS

19. DALIS may or may not be a UNE in California. In either case, DALIS is a wholesale product that SBC California provides to direct competitors under conditions that give SBC California both the incentive and the ability (absent regulatory controls) to gain an unfair competitive advantage. In its decision in the MCImetro/ Pacific Bell arbitration, A.01-01-010), the Commission acknowledged and acted upon the FCC's prior findings concerning the source of this potentially unfair advantage:

> The FCC found that incumbents enjoy a competitive advantage with respect to the provision of directory assistance service as a result of their legacy as monopoly providers of local exchange service, and their "dominant position in the local exchange and exchange access markets."[13]

20. This monopoly-born competitive advantage provides an incumbent such as SBC California with "access to a more complete, accurate and reliable database than its competitors."[14] SBC California obtains most listings "for free" as an artifact of its control of local exchange service to most customers in California. Moreover, when competitors do provide service to California end-users, they typically provide their listing data to SBC California in exchange for, *e.g.*, having an SBC affiliate provide a white page listing and directory delivery. Thus, SBC California

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[13] D.01-09-054 at 7, quoting *FCC Forbearance Order* at fn. 42.

[14] *FCC Forbearance Order* at ¶ 2.

has more direct and complete access to DALIS data than any potential competitor currently possesses or will possess for the foreseeable future.

21. Both this Commission and the FCC have recognized the need to ensure that SBC California does not use its market power to establish unreasonable prices for directory listings and thereby to disadvantage competitors. As the Commission observed:

> Even if DAL is not a UNE, pricing of DAL is subject to strict nondiscrimination requirements under the Act and FCC orders. As the FCC recognized in its DAL Provisioning Order, this nondiscriminatory access requirement extends to pricing. In its order, the FCC recognized that ILECs continue to charge competing DA providers discriminatory and unreasonable rates for DAL. Although the FCC declined to support a specific pricing structure for DAL, it encouraged states to set their own rates consistent with the nondiscrimination and reasonable pricing requirements of Section 251(b)(3).[15]

22. The FCC's *DAL Provisioning Order* does indeed make clear that pricing for directory assistance listings must be nondiscriminatory:

> Section 251(b)(3) of the Act and the Commission's rules prohibit LECs from charging discriminatory rates, for access to DA databases, to competing directory assistance providers that fall within the protection of that section (i.e., those that provide telephone exchange service or telephone toll service). Thus, LECs must cede access to their DA database at rates that do not discriminate among the entities to which it provides access. Further, failure to provide directory assistance at nondiscriminatory and reasonable rates to DA providers within the protection of section 251(b)(3) may also constitute an unjust charge under section 201(b).[16]

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[15] D.01-09-054 at 7, citation to Provision of Directory Listing Information under the Telecommunications Act of 1934, As Amended, CC Docket No. 99-273, FCC 01-27, released January 23, 2001 ("*DAL Provisioning Order*") omitted.

[16] *DAL Provisioning Order* at ¶ 35.

23. The true economic cost to SBC California of access to directory listing data is the forward-looking economic cost of making those data available; therefore, cost-based pricing for access to directory listing data is the best means to ensure that SBC California complies with the nondiscrimination requirements of the Act and the FCC's orders. Forward-looking, economic cost provides the best approximation of the cost that SBC California actually incurs to use those listings to provide its own services. Hence, the Commission will achieve a nondiscriminatory result by applying that same cost to competitors.

24. As I noted above, the FCC specifically requires that the incumbent's price to competitors for directory assistance data cannot be higher than the cost that it imputes to its own nonregulated operations.[17] But, that requirement alone is not a sufficient safeguard for competition. At the level at which SBC reports its financial results to the investment community, such intracompany transfers are entirely invisible. Such transfers from one corporate pocket to another do not change SBC's reported earnings at all and are therefore not a meaningful restraint on SBC's behavior.

25. Instead, as I explained above, the best means to ensure that SBC California does not discriminate between its operations and its competitors' operations is to ensure that DALIS is available to competitors at the same forward-looking economic cost that SBC California experiences as a result of its scale and scope.

[17] Even if imputation were otherwise a sufficient safeguard (which it is not), it would not be a remedy in this case as SBC California apparently does not believe that it has any obligation to impute its reported DALIS costs. *See* SBC California Response to Data Request Set 2, Request 11, attached hereto as part of Exhibit TLM-2) and Deposition, 1/24/03, Pearsons, Tr. 194.

Forward-looking economic cost, unlike transfer pricing to affiliates, establishes an economically meaningful benchmark for nondiscrimination that promotes fair competition and prevents SBC California from exploiting its legacy monopoly power over this critical input.

26. Although the FCC declined to establish a specific pricing structure for directory assistance information, it found that states could do so and cited approvingly a New York decision to set cost-based, nondiscriminatory prices for the incumbent's provision of nonlocal directory assistance information.[18] Thus, a decision by this Commission that adopts cost-based, nondiscriminatory prices would be entirely consistent with the FCC's statements.

B. <u>The Commission Should Reaffirm Its Rejection of "Market-Based" Pricing for DALIS</u>

27. As I noted in the introduction to this declaration, SBC California has previously proposed "market-based" pricing for DALIS and this Commission has resoundingly rejected that proposal. Nonetheless, the company apparently intends to re-argue its prior position.

28. Any suggestion by SBC California that "market-based" prices are somehow appropriate for wholesale competitors obtaining DALIS would be misguided and baseless. There is no reason to believe that SBC California's proposed DALIS prices reflect the levels that would pertain in a *competitive* retail market, much less a competitive *wholesale* market.

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[18] *Id.* at 38, citing Opinion and Order in Module 1 (Directory Database Services), Case 98-C-1375, Opinion No. 00-02, State of New York Public Service Commission (Feb. 8, 2000).

29. The best available evidence on this point is how well the margins over cost included in SBC California's proposed prices track with the return levels that are common in competitive markets. TELRIC includes a market-based return on SBC California's economic cost; therefore, TELRIC-based prices approximate the prices that a firm operating in a competitive market might charge. If SBC California's proposed prices substantially exceed TELRIC-based prices, that fact is itself an important indication that SBC California does not operate in a competitive market for the provision of DALIS.

30. SBC California's proposed "market-based" DALIS price of $0.0585 per listing[19] far exceeds its own claimed forward-looking economic cost of *** **BEGIN PROPRIETARY $[redacted] END PROPRIETARY** ***.[20] Adding the currently authorized 21% shared and common cost markup to SBC California's estimate of the per-listing cost for DALIS would do little to close the gap between the allegedly "market-based" price and a cost-based price for the same function. A 21% markup added to SBC California's per-listing TSLRIC would produce a "cost-based" price of *** **BEGIN PROPRIETARY $[redacted] END PROPRIETARY** ***, which is still roughly an order of magnitude lower than SBC California's proposed "market-based" price. As competitive markets tend to

[19] 10/28/02 Meet and Confer Data Request 2 (SBC Pacific Bell Response), attached hereto as part of Exhibit TLM-2.

[20] These comparisons are based on SBC California's purported "TSLRIC" costs, which are the only estimates that the company has provided of *its own* forward-looking economic costs. In comparing SBC California's proposed prices to its claimed TSLRIC costs, I am not conceding that the TSLRIC costs are accurate. Even those figures are inflated, as I will demonstrate below. Nonetheless, the comparison provides a useful perspective on the extent to which the company's allegedly "market-based" prices exceed its own admitted costs.

drive prices toward cost it is hard imagine that SBC California's proposal is the outcome of a competitive pricing scheme.

31. Even this level of analysis takes any SBC California claim that its proposal is justified as "market-based" too seriously. SBC California's deponents were unaware of any attempt by the company to study what a market-based price for DALIS would be.[21] SBC California apparently has not performed even the basic step of defining what market it had in mind, let alone performing an actual analysis of prices in that market. SBC California's notion that simply setting prices at a level it finds attractive with no supporting analysis is a "market-based" approach once again indicates that SBC California does not operate in a competitive market.

32. In summary, regardless of whether DALIS is considered a UNE, there are compelling reasons for the Commission to use forward-looking economic cost as the benchmark for determining whether SBC California's prices to competitors for this product are nondiscriminatory. The cost to SBC California for the same functionality is forward-looking economic cost; moreover, even so-called "market-based prices" would reflect forward-looking economic cost *if the product were offered in a competitive market.* Even SBC California's own, inflated version of TSLRIC demonstrates that its proposed prices to competitors for DALIS far exceed forward-looking economic cost and thus far exceed the prices that would prevail if SBC California offered these functions in a truly competitive

[21] Deposition, 1/24/03, Pearsons, Tr. 179-180.

market. For all of these reasons, I conclude that SBC California's proposed prices are discriminatory and that the Commission should set the prices for DALIS at (properly calculated) forward-looking economic cost plus a markup for forward-looking shared and common costs.

33. As the FCC stated when it implemented the TELRIC-based pricing requirement for UNEs,

> Adopting a pricing methodology based on forward-looking, economic costs best replicates, to the extent possible, the conditions of a competitive market. In addition, a forward-looking cost methodology reduces the ability of an incumbent LEC to engage in anti-competitive behavior. Congress recognized in the 1996 Act that access to the incumbent LECs' bottleneck facilities is critical to making meaningful competition possible. As a result of the availability to competitors of the incumbent LEC's unbundled elements at their economic cost, consumers will be able to reap the benefits of the incumbent LECs' economies of scale and scope, as well as the benefits of competition. Because a pricing methodology based on forward-looking costs simulates the conditions in a competitive marketplace, it allows the requesting carrier to produce efficiently and to compete effectively, which should drive retail prices to their competitive levels.[22]

34. In its decision affirming the FCC's TELRIC methodology, the U.S. Supreme Court similarly found that the Act establishes a "novel ratesetting *designed to give aspiring competitors every possible incentive to enter local retail telephone markets*, short of confiscating the incumbents' property."[23] The Court observed that "Congress called for ratemaking different from any historical practice, to

[22] First Report and Order, *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98); Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers (CC. Docket No. 95-185)*, FCC No. 96-325 (rel. Aug. 8, 1996) (hereafter "*Local Competition First Report and Order*") at ¶ 679.

[23] Verizon Communications, Inc. v. FCC, 122 S.Ct. 1646, 1661 (2002) (emphasis added).

achieve the entirely new objective of *uprooting the monopolies that traditional rate-based methods had perpetuated*."[24] "For the first time, Congress passed a ratesetting statute *with the aim* not just to balance interests between sellers and buyers, but *to reorganize markets by rendering regulated utilities' monopolies vulnerable to interlopers*, even if that meant swallowing the traditional federal reluctance to intrude into local telephone markets."[25]

35. All of these benefits of opening up the incumbent's former local exchange monopoly will be endangered if the Commission allows SBC California to create a barrier to entry by charging prices for DALIS that exceed forward-looking economic costs. The new entrant's economic cost for producing the competitive retail service equals the price that it must pay to SBC California for any inputs that it purchases from the incumbent plus the direct economic cost of those inputs that it provides itself. By contrast, SBC's economic cost for producing the same retail service is simply the sum of its direct economic costs for all of the inputs it uses and any retail-only costs caused by that service alone. Thus, if SBC California charges dependent competitors more than its direct economic cost for DALIS, SBC's economic cost of providing the competitive retail service will be lower than the new entrant's cost by an amount equal to the markup in price for DALIS, other things being equal. That creates a barrier to entry.

36. The higher economic cost that new entrants face as a result of having to purchase inputs from the incumbent at a price in excess of direct economic cost is an

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[24] 122 S.Ct. at 1660 (*citing* H.R. Conf. Rep. No. 104-230, p. 113 (1996)) (emphasis added).

artificial barrier to entry as opposed to a natural barrier to entry. This difference in the direct economic cost of new entrants versus SBC is not the result of any inherent difference in the underlying cost to society for the use of the same facilities. Thus, SBC California's creation of such a barrier to entry denies Californians some of the benefits of local competition that they would receive absent such anti-competitive behavior.

37. For all of these reasons, I recommend that the Commission establish a price for DALIS that reflects the efficient, forward-looking economic cost to provide directory assistance listings for a carrier with SBC California's scale and scope, regardless of whether the Commission finds DALIS to be a UNE. To prevent unfair competition, this price should reflect the benefits of the legacy of monopoly provisioning of local exchange service, which has enabled SBC California to build a database of unparalleled accuracy and completeness with all of the cost advantages inherent as a result of its "dominant position in the local exchange and exchange access markets."[26]

C. SBC California's "Updated" Cost Studies Do Not Provide an Appropriate Benchmark for Cost-Based, Nondiscriminatory Pricing of DALIS.

38. DALIS is a relatively simple product. The relevant underlying data, *i.e.*, directory listings and listings updates, typically come to SBC California at no cost as a byproduct of its other lines of business. SBC California's retail customers

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[25] 122 S.Ct. at 1661 (emphasis added).

[26] *FCC Forbearance Order* at fn. 42.

provide their desired listing information when obtaining basic service, and it is my understanding that competitors also typically forward their end-user listings to SBC California at no charge as well (this enables competitors to include their end-users in the dominant SBC-controlled paper directories).[27] Customers expect that their listings will be available and maintained accurately. Thus, maintaining directory assistance listing information and doing any work necessary to make it accurate is part and parcel of the cost of basic exchange service.

39. The DALIS product consists of regularly pulling new, changed or discontinued listings from a computer database, transmitting it to the DALIS customers and resolving any quality problems (which should be rare) and format changes. Thus, the core of the DALIS product is a simple matter of pulling updated records out of a computer database that is generated as a byproduct of the service order process. As WorldCom witness Mr. Caputo explains in his concurrently filed declaration, pulling and transmitting those records is the type of process that can be entirely or almost entirely automated.

40. SBC California's primary access to the underlying DALIS data provides it with significant scope and scale economies in providing the DALIS service. SBC California is the first party to know when most listing changes occur (because it receives the change request directly from its customers). SBC's comprehensive

[27] WorldCom witness Mr. Caputo explains that WorldCom provides its listings to SBC California without charge pursuant to the interconnection agreement between the two companies. Caputo Declaration, ¶ 8.

listing data results in significant demand internally to SBC, as part of the DALIS product and quite possibly for other uses as well.[28]

41. As I noted in the introduction to this declaration, SBC California has submitted two different "cost studies" for DALIS. First, SBC California supplied an updated estimate of the cost that it actually expects to incur to provide DALIS as a service on a forward-looking basis.[29] SBC California's own analysis indicates that this actual work effort results in a cost of only *** **BEGIN PROPRIETARY** $[redacted] **END PROPRIETARY** *** per listing. Even this relatively *de minimis* cost estimate is inflated, as I will explain further below.

42. Second, SBC California produced an all-new so-called TELRIC cost study on June 6, 2002. That study includes results that are labeled as "data acquisition,"[30] "data storage"[31] and "data maintenance/update."[32] This aspect of the SBC California study reflects a novel interpretation of TELRIC that I have never encountered in any of the literally dozens of UNE cost cases in which I have participated since the FCC adopted its TELRIC methodology in 1996.[33]

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[28] SBC California Response to WorldCom's 2nd Set of Data Requests, Nos. 4 & 7, attached hereto as part of Exhibit TLM-2. This combined response lists eight different products that use listings records as an input. In some cases, such as DALIS, a particular product will use the same records multiple times.

[29] These costs are what SBC California characterizes as its "TSLRIC" DALIS service study results. Deposition, 1/24/03, Pearsons, Tr. 6-7.

[30] SBC California 6/6/02 DALIS study, p. 8, parts 1A and 1B.

[31] SBC California 6/6/02 DALIS study, p. 8, part 2.

[32] SBC California 6/6/02 DALIS study, p. 8, part 3.

[33] My curriculum vitae, Exhibit TLM-1, identifies the proceedings in which I have participated since January 1, 1997. In addition to these proceedings, during late 1996, I also participated in several first-round arbitration proceedings in California, Connecticut, Illinois, Maryland, Pennsylvania, Virginia and Wisconsin.

43. SBC California's interpretation of TELRIC (at least, as applied to its current DALIS cost study) requires one to imagine that SBC California's entire retail operation and all its outputs entirely cease to exist.[34] In this case, SBC California literally assumes that it has no contact with end-user customers at all[35] and thus can only offer DALIS by first purchasing listings for the current SBC California local exchange service territory from whatever entity it imagines would replace SBC California as the provider of retail basic exchange service.

44. SBC California's own cost study expert, Mr. Pearsons, acknowledged during his deposition that, to the best of his recollection, SBC California and its predecessor companies had not taken an analogous approach in any other "TELRIC" study:

> Q. Is there any other TELRIC study that you can recall that Pacific has filed with the Commission where you make the same assumption that you imagine there is no function that exists at SBC that does the same thing any more?
>
> A. (Mr. Pearsons:) Offhand I can't think of any.[36]

I am familiar with most of the "TELRIC" studies that Pacific Bell and its successors have filed since 1996 and can confirm Mr. Pearsons' recollection: the current "TELRIC" DALIS study takes an approach that differs significantly from the company's prior cost studies.

45. SBC California's "updated" DALIS cost studies are not appropriate to consider in any manner as a benchmark for cost-based, nondiscriminatory pricing of DALIS for at least three reasons: (1) the new study concerning DALIS data acquisition,

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[34] Deposition, 1/24/03, Pearsons, Tr. 6-7.

[35] Deposition, 1/24/03, Pearsons, Tr. 8.

storage and maintenance does not capture costs for a company of SBC California's actual scale and scope; (2) the "TELRIC" study's fundamental premise is inconsistent with the TELRIC methodology; and (3) both of the SBC California studies' assumptions are demonstrably inaccurate.

1. SBC California's New Study of Supposed DALIS Acquisition, Storage and Maintenance Costs Does Not Reflect the Forward-Looking Economic Costs for a Company of SBC California's Actual Scale and Scope.

46. As I noted above, SBC California's new "TELRIC" costs consist of reported costs for "data acquisition," "data storage" and "data maintenance/update." Data acquisition costs are essentially the cost of buying listings data at what SBC California imagines would be the average price a wholesale-only company would have to pay to obtain the entire set of SBC California's current DALIS listings from third parties.[37] Data storage costs are the costs for buying new "midrange" computers, *i.e.*, computers much smaller than the mainframe systems SBC California actually uses to process DALIS records to support a new company with no relevant economies of scale and scope.[38] Data maintenance/update costs relate to the crew that SBC California imagines it would need to hire to staff this new DALIS-only business, which includes a support team much larger than the one SBC California's actual operations involve today (as reflected in the "TSLRIC"

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[36] Deposition, 1/24/03, Pearsons, Tr. 11.

[37] Deposition, 1/24/03, Pearsons, Tr. 137-139 and 148-149.

[38] Deposition, 1/24/03, Smith, Tr. 51-52.

study) plus an additional crew to do all of the listings corrections that SBC California's current retail operations currently perform.[39]

47. SBC California admits that none of the costs in its "TELRIC" analysis are "directly attributable to the DALIS product in Pacific's current operation."[40] Hence, even if these costs were relevant to a forward-looking cost analysis, they would not be attributable to any individual product or service. In a properly conducted TELRIC study, costs that are not directly attributable to any specific UNE are considered to be either "joint" costs (*i.e.*, costs attributable to two or more products and services,[41] which this Commission has termed "shared" costs) or "common" costs (*i.e.*, costs that cannot be "attributed directly to individual elements or services" but instead are "incurred by the firm's operations as a whole"[42]). Common costs thus are by definition associated with all of the firm's operations, wholesale and retail.

48. At best, therefore, the costs in SBC California's so-called "TELRIC" analysis are shared or common costs and should not be recovered exclusively from DALIS customers. SBC California acknowledges that the categories of cost included in

[39] Deposition, 1/24/03, Smith, Tr. 69-71. In making this assumption, SBC California apparently presumes that the incumbents from whom it buys retail listings will not perform any meaningful quality control function. Hence, SBC California effectively assumes that its new all-wholesale operation would be paying substantial retail rates for listings data of consistently poor quality that would require a large fulltime staff to correct.

[40] Deposition, 1/24/03, Pearsons, Tr. 171.

[41] *Local Competition First Report and Order* at ¶ 676.

[42] 47 C.F.R. § 51.505(c)(1); *see also Local Competition First Report and Order* at ¶ 694 (common costs are those "that are common to all services and elements (e.g., salaries of executives involved in overseeing all activities of the business)").

its "TELRIC" analysis are currently recovered from its retail customers;[43] hence, recovering (an even higher, purely hypothetical level of) those costs through DALIS prices would constitute impermissible double-recovery.

49. But, the problems with SBC California's so-called "TELRIC" analysis go far beyond double-recovery. SBC California admits that the costs in its "TELRIC" study require assumptions that are so fundamentally incompatible with its TSLRIC study that the two sets of costs literally could not both be incurred "in the same world."[44] Indeed, SBC California goes so far as to admit that the two studies are studies of "two different cost objects,"[45] *i.e.*, they are not studies of the same thing. Specifically, SBC California suggests that its new study is a study of a "wholesale" product, while its TSLRIC study is of a "retail" product.[46]

50. The twist on the typical wholesale/retail distinction is that SBC California has invented a scenario in which its estimate of wholesale costs is much higher than its study of the cost to provide the same product on a retail basis. SBC California's TSLRIC estimate of the cost it will incur to provide DALIS is *** **BEGIN PROPRIETARY** [redacted]. **END PROPRIETARY** *** In contrast, SBC California's TELRIC study estimates that an all new wholesale-only operation without access

[43] Deposition, 1/24/03, Pearsons, Tr. 139-140, 152.

[44] Deposition, 1/24/03, Pearsons, Tr. 148-149.

[45] Deposition, 1/24/03, Pearsons, Tr. 11.

[46] *Id.* It further admits that no one would ever buy both products simultaneously as they are merely two different ways of calculating the cost to provide the same thing. *Id.*, Tr. 142-143.

to SBC California's existing retail data would incur *** **BEGIN PROPRIETARY** [redacted]. **END PROPRIETARY** *** SBC California admits that its "TELRIC" study also assumes that the new "wholesale-only" company would incur more than *** **BEGIN PROPRIETARY** [redacted].[47] **END PROPRIETARY** *** SBC California is apparently suggesting that any wholesale-only operation that attempted to compete with it would incur vastly higher costs than does SBC's current integrated retail/wholesale operation.

51. In short, the costs in SBC California's supposed TELRIC study are, at best, an attempt to estimate costs that a company *other than SBC* with no telephone customers of its own whatsoever might incur should it chose to offer a DALIS product. If anything, SBC California's imaginative exercise of starting a new company without the scale and scope economies for obtaining customer listing data stemming from its dominant market share for retail local exchange service merely confirms the vastly higher costs that other competitors would incur, relative to SBC California's own DALIS-related costs, should they attempt to obtain directory listing data from any source other than SBC California. In other words, SBC California has provided a compelling "impairment" analysis that makes a strong case for considering DALIS to be a UNE. Regardless of whether

[47] Deposition, 1/24/03, Tr. 139-141.

DALIS holds formal UNE status, it is essential that the Commission require SBC California to make listings data available to other parties at a reasonable, cost-based price. This is the only approach that promotes full and fair competition.

2. The Fundamental Premise of SBC's "Updated" DALIS Study Is Inconsistent with the TELRIC Methodology That Study Purportedly Embodies

52. One reason that SBC California's "updated" DALIS cost study produces such unreasonable results is that the fundamental premise of the study is inconsistent with the very TELRIC methodology that the study purports to embody. The fundamental premise of the "TELRIC" version of the SBC California cost study is that:

> in the TELRIC environment, it's a wholesale only environment, and therefore you don't have the retail access to the data from end users, so we would not only have to acquire all the data, we would have to put for systems and maintenance, maintaining those systems, to be able to have a database that would house all this information.
>
> Today we are relying on our retail side of the business for a lot of that.[48]

In other words, SBC California has injected into its "TELRIC" study all of the additional costs that it can avoid as a result of its legacy as the dominant provider of retail local exchange service—which are the source of the market power that SBC possesses relative to other competitors that must obtain directory listings. Building these costs into the price for SBC California's directory listing service would allow the company to exploit this market power and gain precisely the

[48] Deposition, 1/24/03, Pearsons, Tr. 7. *Also see* Tr. 148-149

unfair competitive advantage that cost-based pricing of DALIS is intended to prevent.

53. SBC California relies on a federal district court decision to claim that a TELRIC cost study must calculate DALIS costs as if SBC California were not also a retail provider of local exchange service.[49] The Commission should be aware that SBC California's quotation from the federal district court decision omits contextual sentences before and after the quoted passage that can be read differently from the way that SBC California apparently interprets this language. Specifically, the Court stated:

> The FCC makes clear that in calculating common costs and allocating those costs to the direct costs of providing UNEs, all costs of retail services must be excluded, in order to calculate "the total forward-looking costs of operating the wholesale network." Id. (emphasis added). In other words, the TELRIC methodology calculates the forward-looking cost to ILECs of providing UNEs, in a hypothetical competitive market in which the ILEC is a wholesaler, leasing UNEs to CLECs. The ILEC's retail operations (selling telephone services to consumers) are therefore irrelevant to the TELRIC pricing method, and must be excluded. As the FCC stated: "Retailing costs, such as marketing or consumer billing costs associated with retail services, are not attributable to the production of network elements that are offered to interconnecting carriers and must not be included in the forward-looking direct cost of an element." Id. ¶ 691; see also id. ¶ 694 ("[F]or the purpose of pricing interconnection and access to unbundled elements, which are intermediate products offered to competing carriers, the relevant common costs do not include billing, marketing, and other costs attributable to the provision of retail service.").[50]

[49] SBC California Response, 8/23/02, pp. 3-4.

[50] *AT&T Communications of California, Inc., et al., v. Pacific Bell Telephone Company et al.*, Civ. No. C. 01-02517 CW (N.D. Cal., Aug. 6, 2002), *mimeo*, p. 7 (emphasis in original).

SBC California's quotation omits the first sentence of this passage and the phrase "In other words," at the beginning of the second sentence (which make clear that the material SBC California addresses is the federal district court's understanding of how to calculate common costs under TELRIC and *not* how to calculate the direct cost of UNEs). SBC California's quotation also omits the federal district court's concluding quotations from the FCC's *Local Competition First Report and Order*, which indicate that TELRIC excludes "retailing" costs, *i.e.*, retail-only costs such as marketing and consumer billing costs. Given this context, and my understanding of TELRIC principles as an economist who has participated in dozens of UNE pricing proceedings, the interpretation of the federal district court's language that seems most consistent with the underlying economic principles is simply that a TELRIC study must exclude all retail-only costs.

54. I understand that the federal district court decision in question is the subject of a pending appeal. Regardless of the outcome of that appeal, the Commission should reject SBC California's bizarre application of the federal district court's language to the pricing of DALIS because that interpretation is impossible to reconcile with the expressed intention of the FCC's TELRIC methodology.

55. In its *Local Competition First Report and Order*, which adopted the TELRIC methodology, the FCC noted that, "[a]s a result of the availability to competitors of the incumbent LEC's unbundled elements at their economic cost, consumers will be able to reap the benefits of the incumbent LECs' economies of scale and

scope, as well as the benefits of competition."[51] One of the key economies of scale and scope that SBC California and its affiliates enjoy is the ability to share the cost of obtaining directory listings between the retail local exchange operations and all other related lines of business. A cost study that assumes away the existence of the retail local exchange operations therefore assumes away the very economies of scale and scope that the FCC intended to capture through TELRIC-based pricing.

56. Moreover, a cost study that assumes away these economies of scale and scope cannot provide a basis for nondiscriminatory pricing. SBC, as a corporation, will not incur the extraordinarily high data acquisition, storage and maintenance/update costs that are the subject of SBC California's bogus "TELRIC" study for DALIS. Therefore, SBC, as a corporation, need not establish retail prices that recover these nonexistent costs, regardless of how it chooses to establish transfer prices (or impute costs) between SBC California and other affiliates that use directory listings information.

57. If the Commission were to allow SBC California to charge other competitors for these illusory costs, however, the price that those competitors pay for DALIS would become a true economic cost to the unaffiliated competitors. They would have no choice but to attempt to recover those costs through their retail pricing, giving SBC California and its affiliates an unfair competitive advantage. At any level of retail prices, SBC California and its affiliates would achieve higher

[51] *Local Competition First Report and Order* at ¶ 679.

profits than would equally efficient competitors saddled with uneconomically high DALIS prices. The end result of such unfair competition would likely be both excessive profits for SBC and excessive retail prices for California consumers, a result that is neither pro-competition nor pro-consumer.

3. The Assumptions of SBC's "Updated" DALIS Study Are Severely Flawed and Inaccurate

58. In addition to the overarching invalidity of its TELRIC methodology, SBC California's "updated" DALIS cost study contains several other severely flawed and inaccurate assumptions. These errors pervade the "data acquisition," "data storage" and "database maintenance/update" costs that are all new in this version of the DALIS cost study (which, as I have explained above, should not be included in a TELRIC analysis at all) and the modified per-listing cost.

a) SBC California's "Data Acquisition" Cost Estimate Is Flawed.

59. The "data acquisition" costs in SBC California's "updated" DALIS cost study consist of a "weighted average" cost per record for initial load and for additional listings multiplied by the total listings for both SBC- and non-SBC incumbent local exchange carriers. SBC California uses an unreasonable weighted average cost per record. It includes its own records in the number of records used in its total annual cost calculation, but it presumes that the weighted-average cost of acquiring all of these records (including its own retail records) would equal the weighted average cost that it pays other incumbents (Verizon and independents or