Kevin K. Zarling
Senior Attorney

Suite 900
919 Congress Avenue
Austin, Texas 78701-2444
512 370-2010
FAX: 512 370-2096

August 26, 2002

FILED[2]
AUG 2 6 2002
Missouri Public Service Commission

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65101

Re: Case No. TO-2001-438

Dear Judge Roberts:

Attached for filing with the Commission is the original and eight (8) copies of the Joint Sponsors' Response to Southwestern Bell Telephone Company's Application for Reconsideration and/or Rehearing in the above-referenced docket.

I thank you in advance for your cooperation in bringing this to the attention of the Commission.

Very truly yours,

Kevin K. Zarling (jes)

Kevin K. Zarling

Attachment
cc: All Parties of Record

BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION

In the Matter of the Determination of Prices, Terms, and Conditions of Certain Unbundled Network Elements.	)))	Case No. TO-2001-438

JOINT SPONSOR'S RESPONSE TO SWBT'S APPLICATION FOR RECONSIDERATION AND/OR REHEARING

Come Now AT&T Communications of the Southwest, Inc, MCImetro Access Transmission Services, LLC, Brooks Fiber Communications of Missouri, Inc., MCI WorldCom Communications, Inc., Birch Telecom of Missouri, Inc., XO Missouri, Inc., NuVox Communications of Missouri, Inc., McLeodUSA Telecommunications, Inc., TCG Kansas City, Inc., and TCG St. Louis, Inc. (collectively "Joint Sponsors"), and for their Response to SWBT's Application for Reconsideration and/or Rehearing state to the Commission:

Introduction

Contrary to SWBT's complaints, the Commission's Report and Order is lawful and reasonable. There are aspects of the Report and Order that Joint Sponsors still believe would have been better decided if the ruling were different,[1] just as there are provisions that SWBT does not like, but such matters concern the Commission's exercise of judgment and discretion within the bounds of the law and the record evidence. Given the amount of time that has been devoted to this proceeding by the Commission, and the level of detail involved in its consideration of the evidence, there is no reason for any reconsideration or rehearing at this time.

[1] Joint Sponsors are compelled by SWBT's purported reservation of rights to state that they also "reserve the right" to present evidence on such issues in any future proceedings.

Section 386.500 RSMo provides that the Commission shall grant an application for rehearing if "in its judgment sufficient reason therefor be made to appear." Whether or not this statute applies to the instant case[2] and the instant Report and Order,[3] presumably the Commission would apply the same basic standard to SWBT's pleading. SWBT has failed to establish sufficient reason to grant its Application for Reconsideration and/or Rehearing. The Commission should deny SWBT's Application.

The Commission's decisions on the four issues identified in SWBT's Application are neither radical nor unprecedented, contrary to SWBT's characterizations. Further, the Commission's decisions on these points do not violate FCC rules or otherwise contradict TELRIC principles. Assuming SWBT correctly implements the Commission's decision when it reruns its cost studies, the resulting rates will be TELRIC-compliant.

Notwithstanding SWBT's gratuitous complaints about the issues list, the issues were contained in the testimony and the list merely organized the information (successfully) for Commission determination. SWBT was in no way prejudiced by anything except the discretionary decisions that it made when preparing its testimony as to what information to make available and what information to withhold.

---

[2] As the Commission states at page 5 of the Report and Order, this case has its origins in Case No. TO-99-227. In that prior case, the Commission made a favorable recommendation to the FCC on SWBT's Missouri 271 application, based in part upon SWBT's incorporation of provisions into the M2A that made the rates to be addressed herein interim pending resolution of this case. While not a mandatory arbitration under Section 252 of the Telecommunications Act of 1996, the rate issues presented herein were similar to rate issues that the Commission addresses in such arbitrations and the Commission expressly stated that it was acting within its jurisdiction under that statute. (Report and Order, p. 158). The Commission has previously expressed as to whether that formal statutory procedures apply to its resolution of such issues. See, e.g., Arbitration Order Regarding Motions for Clarification and Reconsideration, p. 3-5, Case No. TO-97-40 (October 2, 1997). See also Section 536.110.2 RSMo (rehearing not generally applicable to administrative decisions).

[3] In the Report and Order (p. 167), the Commission directs SWBT to rerun cost studies and submit the results, including the resulting UNE prices, for review and comment by the other parties and, thereafter, consideration by the Commission. Consequently, the Report and Order is interim in nature and would not appear to be directly subject to the provisions of Section 386.500.

Issue 46 Should SWBT use the latest FCC-approved asset lives?

In its Report and Order, the Commission correctly directed SWBT to use FCC-approved asset lives. (Pages 35-37). The Commission clearly explained its decision. Nonetheless, SWBT continues to dwell on the past, and pejoratively classifies any change in practice (i.e. changes from Case No. TO-97-40) as "radical". SWBT conveniently ignores that the FCC-approved asset lives themselves have changed since Case No. TO-97-40 was decided and further fails to remind the Commission that SWBT itself proposed changes to the TO-97-40 results (SWBT Brief p. 43). Despite SWBT's self-imposed blinders, the fact of the matter is that the Commission's decision regarding depreciation is supported by the record (i.e. the testimony of witness Rhinehart cited in the Report and Order). Further, the decision is fully consistent with the law, including various FCC confirmations that use of its prescribed asset lives is appropriate in the process of setting UNE rates pursuant to TELRIC principles. See Memorandum Opinion and Order, FCC 99-1 (January 1999); Report and Order, FCC 99-397 (December 1999); Second Report and Order, FCC 00-396 (November 2000). As noted in Joint Sponsors' Briefs, other states have used these asset lives for these purposes. The Commission wisely rejected SWBT's attempt to pick and choose FCC parameters to suit SWBT's manipulative purposes (i.e. of artificially inflating UNE rates), and instead required SWBT to use all such parameters to assure consistent results. There is no reason to reconsider that decision.

Issue 85 What target capital structure should be used for the UNE leasing business?

In its Report and Order, the Commission correctly recognized (indeed all parties agreed) that it was engaged in the process of determining, in its discretion and judgment, based on the record evidence, the capital structure of a hypothetical company solely engaged in the business of leasing UNEs to CLECs. (Report and Order, p. 66-70). The Commission thoroughly explained its analysis. The Commission rejected SWBT's opinion evidence that the risks of such a hypothetical enterprise would be those of holding companies that own LECs and a variety of other businesses. The Commission accepted the opinion evidence of Staff and Joint Sponsors that the hypothetical enterprise would be less risky than such diversified holding companies (i.e. it is one of the least risky of the holding companies' various ventures). The Commission concluded, based on the evidence, that in its judgment and discretion the capital structure of the hypothetical monopolistic provider of UNEs "would look a lot like SWBT would have looked before the coming of retail competition". Accordingly, the Commission accepted the 46 percent debt to 54 percent equity capital structure advocated by Staff (which is not a "book value" for SWBT[4]) because it concluded that structure "most closely approximates the capital structure of that hypothetical company."

Contrary to SWBT's arguments, the Commission did not violate TELRIC principles in making this decision. The Commission did not select embedded values. To the contrary, the Commission expressly and specifically worked to identify the forwarding-looking capital structure of a hypothetical enterprise. It relied on qualified expert testimony identifying that forward-looking capital structure. Staff witness Johnson affirmed that he was presenting an opinion "based upon a reasonable economical

[4] If the Commission had used SWBT book values, the capital structure would be 62.3% debt and 37.7% equity, according to SBC's 2001 Annual Report (p. 46), which would have resulted in a WACC of 9.37%.

and efficient capital structure." (Ex 24, Johnson Direct, p. 80-81, Tr. 985). The Commission's decision was based on record evidence, followed the law, and need not be reconsidered.

Contrary to SWBT's arguments, no error is demonstrated by the slight difference between the cost of capital determined by the Commission in this case versus the cost of capital determined by the Commission in Case No. TO-97-40. Dr. Johnson specifically testified that "debt and equity costs are not dramatically different at this time." (Ex 24, Johnson Direct, p. 82). SWBT improperly attempts to sweep aware the entirety of the Commission's detailed analysis of WACC, including the separate analysis of cost of equity, cost of debt and capital structure, by making a simplistic comparison of resultant WACC figures. Further, SWBT ignores the Commission's own legitimate conclusion that the risks at issue are those of a hypothetical provider of only monopoly UNEs, and not the overall ILECs that SWBT continues to propose as surrogate entities (referring to ILECs bearing increased risks at page 6 of the Application). The Commission's WACC decision can only be evaluated by examining each component, as the Commission itself explained in its discussion of Issue 82. SWBT does not challenge the Commission's decisions regarding cost of debt and cost of equity, and as shown herein SWBT's objections to the Commission's decision regarding capital structure are not well made. The record supports the decision and SWBT's comparison to prior results affords no insight whatsoever.

Joint Sponsors would point out that SWBT has benefited greatly from the conservative approach taken by the Commission in its determination of cost of equity. Notwithstanding its reluctance to use the 12 percent cost of equity endorsed by Staff

witness Johnson, that figure was supported not only by Dr. Johnson's testimony, but also by the conflicting opinions of the other experts that established a range of cost of equity figures for the Commission to consider that included Dr. Johnson's figure. Further, the Commission had full discretion, based on Joint Sponsor witness Hirschleifer's testimony, to set cost of equity as low as 10.27 percent.[5] Instead, the Commission conservatively used Dr. Avera's 13 percent figure - the highest figure the Commission could have selected based on the evidence.

SWBT cites to information from outside the record (i.e. footnote 16), that played no part in the analysis provided by the expert witnesses or performed by the Commission, and asserts that the WACC should be higher. Joint Sponsors are aware of information that suggests that SWBT has instead benefited from having the WACC determined without consideration of the very significant market changes that have occurred since December 2001 when testimony was presented in this case. For example, there is little doubt that the appropriate cost of debt would be significantly lower if based upon present conditions rather than conditions prevailing a substantial period of time prior to the submission of testimony (as reflected in the age of the data used by the witnesses).[6] None of that makes any difference, however, because none of it is in the record. On the record, Dr. Johnson testified that the risk attending the business of providing UNEs has, if anything, decreased. (Tr. 990-91).

---

[5] Joint Sponsors note that the Commission appears to have misinterpreted Dr. Johnson's testimony regarding the constant growth DCF method, as he merely stated it would be one thing he would look at, not an exclusive tool as the Commission seems to believe. (Tr. 991). Dr. Avera further admitted the constant growth DCF method is unrealistic. (Tr. 130-32).

[6] SBC has reported long-term debt yields of 6.08% and short-term debt costs of 2.07%. Annual Report, p. 39.

It is plain from pages 8-9 of SWBT's Application that it is simply rearguing its position in the case that its risks as a monopolistic provider of UNEs are equivalent to the risks faced by a firm operating in a competitive market. The Commission expressly, and correctly, rejected this patently erroneous argument. As Dr. Johnson explained, "it isn't appropriate to assume a high equity ratio; one that translates into unnecessarily high costs." (Ex 24 Johnson Direct p. 82). He further testified on cross-examination by SWBT that: "A company choosing to build a network and raising capital to do so would be able to raise capital with a higher component of debt and a lesser component of the high-cost equity. So it is not necessary to invest 80-some percent equity to build a network of this type. That's the key issue." (Tr. 988-89). Mr. Hirshleifer agreed. (Ex 29 Rebuttal p. 7, 33, 39-40). More importantly, the Commission agreed at pages 66-70 of the Report and Order.

The Commission should deny SWBT's request for reconsideration and/or rehearing regarding the WACC.

Issues 140 & 183 Fiber Fill Factor

SWBT begins its arguments at page 9 of its Application by misstating the Commission's Order - - the Commission's Order did not "increase" SWBT's fill factor for fiber interoffice facilities from 40% to 90%. Rather, the Commission merely adopted the same fiber fill factor for interoffice facilities that it adopted in Case No. TO-97-40. (Report and Order, p. 93 – 94). The fact that SWBT's embedded fiber fill factor in its cost studies is a ridiculously low 40% does not make it TELRIC-compliant, as the Commission's Order cogently observed. SWBT's Application really presents no new arguments, except to now suggest that it will no longer have certain UNEs available to

sell to CLECs. The fact that the largest CLECs in Missouri have argued for a 90% fill factor for interoffice fiber more than 4 years after the Commission previously established a 90% fill factor certainly belies SWBT's argument.

In truth, SWBT's argument comes down to what it always comes down to, which is an assertion that SWBT will not recover its costs. At page 10 of its Application, SWBT sums up by arguing: "Forcing a firm to operate at a 90% utilization would increase fiber costs because the cables would no longer be efficiently sized to account for future growth." Such a statement reveals that SWBT still does not accept that TELRIC requires that UNE rates should not result in CLECs paying for an ILEC's "future growth" as though the CLECs were the ILEC's captive retail customers. This is particularly true when, as SWBT has conceded, there is an oversupply of fiber. (Tr., p. 267). SWBT can engineer its network however it wants, including making the same mistake many ILECs and CLECs have made by deploying too much fiber, but CLECs who buy UNEs from SWBT should not have to pay for SWBT's mistake by paying for SWBT's excessive fiber capacity.

SWBT has not addressed any of the rationale used by the Commission in Case No. TO-97-40 or in this Report and Order, except to argue that SWBT has deployed far too much fiber and that the CLECs should pay for it. SWBT has provided no basis for the Commission to reconsider its decision on this issue and SWBT's Application on this issue should be denied.

Issue 305 Fallout rate for automated systems.

Again, SWBT's Application fails to raise any new arguments. SWBT's arguments are that the Commission erred by its apparent reliance on the fallout rates of

SWBT's EASE system, and by failing to essentially adopt the fallout rates in Performance Measure ("PM") 13.1 related to SWBT's §271 compliance. However, the Commission's rationale on its fallout decision, for automated systems and the type of UNE orders at issue here, is an unassailable and astute application of TELRIC. This issue is not about what actual fallout percentages SWBT is achieving today, nor about what actual fallout percentages are appropriate for compliance with SWBT's §271 obligations. This issue is about what kind of forward-looking fallout rate is appropriate to use in setting SWBT has provided no basis for the Commission to reconsider its decision on this issue and SWBT's Application on this issue should be denied. a TELRIC-compliant rate. The Joint Sponsors' Reply Brief, at page 92, thoroughly argued the concept of "long run" in the context of setting TELRIC rates, and the Joint Sponsors will not repeat those arguments here except to say that the Commission's "reliance" on the fallout rates from SWBT's EASE system in this instance is perfectly consistent with the FCC's rules and orders on TELRIC. In their Reply Brief, the Joint Sponsors pointed out that SWBT has never explained why the "simple" migration and feature activation orders that achieve a 1% fallout rate in EASE should not also obtain a 1% or 2% fallout rate in the LEX or EDI UNE ordering systems. The Commission's finding that TELRIC principles require that such highly automated UNE order types should obtain fallout rates comparable to SWBT's most efficient processes for such order types is reasonable and amply supported by the record. (*See* Turner Rebuttal, Ex. 27, p. 127).[7] SWBT has

[7] In addition, the Joint Sponsors' Reply Brief at pages 92 – 93 also pointed out how the record conclusively proved that SWBT's proposed fallout rates are tainted by a systematic flaw in SWBT's cost study methodology. In the Overview/Methodology section for this study, which was attached to the Direct Testimony of SWBT Witness Makarewicz, the methodology description reads: "Forward looking is defined as the most efficient method of performing the defined activity during the study period, given SWBT's **existing** systems and network design." Ex. 12, Sch. TJM-17, pg. 2 of 6, ¶ 4. (emphasis added)

provided no basis for the Commission to reconsider its decision on this issue and SWBT's Application on this issue should be denied.

Conclusion

For all the foregoing reasons, the Commission should deny SWBT's Application for Reconsideration and/or Rehearing.

Respectfully Submitted,

Kevin K. Zarling, TX 2249300
AT&T Communications of the Southwest
919 Congress, Suite 900
Austin, Texas 78701-2444
(512) 370-2010
(512) 370-2096 (FAX)
kzarling@lga.att.com

Attorneys for AT&T Communications of the Southwest, Inc., TCG St. Louis and TCG Kansas City

CURTIS, OETTING, HEINZ,
GARRETT & O'KEEFE, P.C.

Carl J. Lumley, #32869
Leland B. Curtis, #20550
130 S. Bemiston, Suite 200
St. Louis, Missouri 63105
(314) 725-8788
(314) 725-8789 (FAX)
clumley@cohgs.com
lcurtis@cohgs.com

SWBT has not modeled the most efficient ordering systems in the "long run" as defined by the FCC's TELRIC rules. Accordingly, to adopt SWBT's embedded fallout rates would be an error.

Attorneys for MCImetro Access Transmission Services, LLC, Brooks Fiber Communications of Missouri, Inc., MCI WorldCom Communcations, Inc., XO Missouri, Inc., NuVox Communications of Missouri, Inc., AT&T Communications of the Southwest, Inc., TCG St. Louis and TCG Kansas City

Bradley R. Kruse, IL Bar # 6200370
6400 C Street SW
Cedar Rapids, Iowa 52406-3177
(319) 790-7939
(319) 790-7901 (FAX)
bkruse@McLeodUSA.com

Attorney for McLeodUSA Telecommunications

Rose Mulvany Henry, KS Bar No. 16209
Birch Telecom of Missouri, Inc.
2020 Baltimore Ave.
Kansas City, Missouri 64108
(816) 300-3731
(816) 300-3350 (FAX)
rmulvany@birch.com

CERTIFICATE OF SERVICE

A true and correct copy of the foregoing document was mailed this 26th day of August, 2002, to the persons listed on the attached service list, by U.S. Mail postage paid.

Office of Public Counsel
P.O. Box 7800
Jefferson City, Missouri 65102

General Counsel
P.O. Box 360
Jefferson City, MO 65102

Paul G. Lane
Southwestern Bell Telephone Co.
One Bell Center, Room 3520
St. Louis, MO 63101

Paul Gardner
Goller, Gardern & Feather
131 High Street
Jefferson City, MO 65101

Stephen F. Morris
WorldCom Communications
701 Brazos, Suite 600
Austin, TX 78701

Mary Ann Young
P.O. Box 14959
Jefferson City, MO 65110

Sheldon K. Stock
Greensfelder, Hemker & Gale
10 South Broadway, Suite 2000
St. Louis, MO 63102-1774

Michael Sloan/Paul Hudson
Swidler, Berling, Shereff, Friedman
3000 K Street NW, Suite 300
Washington, D.C. 20007

Morton Posner
Allegiance Telecom of MO
1919 M Street NW, Suite 420
Washington, D.C. 20036

Carol Keith
NuVox Communications
16090 Swingley Ridge Road, Suite 500
Cheseterfield, MO 63017

David J. Stueven
IP Communications Corp.
6405 Metcalf, Suite 120
Overland Park, KS 66202

Mark Comley
Cathleen A. Martin
Newman, Comley & Ruth
601 Monroe, Suite 301
Jefferson City, MO 65101

Bradley R. Kruse
McLeod USA Telecom.
P.O. Box 3177
Cedar Rapids, IA 52406-3177

John T. Davis
Fidelity Communications
64 North Clark
Sullivan, MO 63080

Rose Mulvany
Birch Telecom of Missouri, Inc.
2020 Baltimore Avenue
Kansas City, MO 64108

Jonathan Canis/Michael Hazzard
Kelley Drye & Warren
1200 19th Street NW, Suite 500
Washington, D.C. 20036

Carl J. Lumley
Leland B. Curtis
Curtis, Oetting, Heinz & O'Keefe
130 S. Bemiston, Suite 200
St. Louis, Missouri 63105