BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of MFS Communications Company, Inc., Petition for Arbitration Pursuant to 47 U.S.C. Section 252(b) of Interconnection Rates, Terms, and Conditions With Southwestern Bell Telephone Company.	)))))	**Case No. TO-97-23**

ARBITRATION ORDER

Issue Date: November 6, 1996

Effective Date: November 7, 1996

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APPEARANCES

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and

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Michael F. Dandino, Senior Public Counsel, and **John B. Coffman**, Senior Public Counsel, Office of the Public Counsel, Post Office Box 7800, Jefferson city, Missouri 65102-7800, for the Office of the Public Counsel and the public.

ADMINISTRATIVE LAW JUDGE: **Dale Hardy Roberts, Chief.**

ARBITRATION ORDER

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I. Procedural History

On July 17, 1996, MFS Communications Company, Inc. (MFS) filed a petition for arbitration pursuant to Section 252(b) of the Telecommunications Act of 1996 (the Act) in which MFS requested arbitration of interconnection between MFS and Southwestern Bell Telephone Company (SWBT) pertaining to rates, terms and conditions. *See* 47 U.S.C. § 252(b). On July 19, 1996, the Commission issued notice of the request for arbitration and directed SWBT to respond to the request. On August 12, 1996, SWBT filed its response to the petition for arbitration.

On September 9, 1996, the Commission convened the formal arbitration proceedings in this matter. Prior to that date and in preparation for the arbitration, the parties jointly filed an Issues Memorandum

which set out the unresolved issues. The parties numbered and set forth the unresolved issues as follows:

(1) What loop facilities will SWBT make available to MFS?

(2) Should all loops be priced the same?

(3) How should loops be priced? Should the Commission consider the cost studies presented by SWBT setting out the economic costs of unbundled network elements or apply the proxy cost ceiling as issued by the Federal Communications Commission (FCC)?

(4) How should the price of local loops be deaveraged?

(5) What cross-connect facilities should be made available and at what price?

On September 30, 1996, initial briefs were filed by the Office of the Public Counsel (Public Counsel), SWBT and MFS. On October 7, 1996, reply briefs were filed by SWBT and MFS.

Prior to the arbitration in this case, on August 8, 1996, the Federal Communications Commission (FCC) issued its order captioned ***Implementation of the Local Competition Provisions in the Telecommunications Act of 1996***, CC Docket No. 96-98 (hereafter the FCC order). This order included, *inter alia*, directives as to how state commissions might arrive at certain costs by using an FCC designated cost study which it entitled Total Element Long Run Incremental Cost(s) or TELRIC. However, on October 15, 1996, the United States Court of Appeals for the Eighth Circuit issued a stay as to certain provisions of the FCC order. The Eighth Circuit's order stayed the directives regarding the pricing rules studies. ***See Iowa Util. Board v. Federal Comm. Comm'n***, No. 96-3321 (8th Cir. Oct. 15, 1996). Order Granting Stay Pending Judicial Review.

II. Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact.

1. What loop facilities will SWBT make available to MFS?

SWBT has stated that it will make available 2-Wire 8 decibel (db) Analog Loops with conditioning to 5dB. SWBT will provide 2-Wire Basic Rate Interface (BRI) Loops and 4-Wire DS1 Digital Loops. MFS requested these three loop facilities but also the provision of 2-Wire High bit rate Digital Subscriber Line (HDSL) and 2-Wire Asymmetrical Digital Subscriber Line (ADSL) loops. SWBT has stated that the 2-Wire HDSL and the 2-Wire ADSL loops requested by MFS are not yet technically feasible and therefore cannot be offered by SWBT at this time. If or when HDSL and ADSL are technically feasible, SWBT will offer them to MFS.

Although MFS requested the five previously mentioned loops, it acknowledged at the arbitration that the 2-Wire ADSL and HDSL loops are not technically feasible at this time. The parties have agreed to move forward with the testing and provision of HDSL and ADSL, and both SWBT and MFS anticipate those services being available in mid-1997.

The Commission finds that Section 251(c) of the Act requires the incumbent local exchange companies (LECs) to provide requesting carriers (i.e. "competitive LECs" or "CLECs") with nondiscriminatory access to network elements on an unbundled basis at any technically feasible point. It is therefore appropriate that SWBT offer 8dB loops, with conditioning to 5dB, ISDN-BRI loops, and DS1 loops. In addition, SWBT shall make available ADSL and 2-Wire HSDL capable loops to MFS as soon as the

technology is deemed technically feasible. This technology is expected to be available in the first half of 1997.

2. Should all loops be priced the same?

SWBT has argued that 8dB loops, ISDN-BRI loops, and DS1 loops utilize different equipment and therefore have different costs.

MFS believes that any loop based upon forward-looking technology should be capable of supporting a variety of forward-looking technologies. Therefore, MFS argues, the price of the loop should not be dependent upon its use.

Section 251(c)(3) requires that the incumbent LEC provide access to unbundled elements to the extent that it is technically feasible. The Act also requires that if requested and if technically feasible, the incumbent LEC must take steps to condition existing loop facilities to enable requesting carriers to offer services not currently provided over such facilities. If such conditioning is necessary, the requesting carrier would bear the cost of compensating the incumbent LEC for such conditioning.

The Commission finds the difference between the two positions is based upon the parties' mutual misunderstanding. The parties are discussing two different items. MFS requested the ability to purchase loops capable of providing ISDN-BRI while SWBT is offering the ISDN-BRI service including the loop and all necessary electronics. MFS stated that it would be providing its own electronics to provide the ISDN-BRI service and did not need equipment from SWBT. Both parties acknowledge that it is technically feasible to provide unbundled access to loops capable of ISDN-BRI or other advanced services.

The Commission finds that if MFS wishes only to purchase loops capable of providing ISDN-BRI service and not the actual service, then SWBT should provide access to those loops. To the extent that the loop needs actual modifications to provide advanced services, MFS would have to bear the cost of the modifications made by SWBT. These additional costs could be recovered by SWBT through either a recurring or nonrecurring rate element.

3. How should loops be priced? Should the Commission consider the cost studies presented by SWBT setting out the economic costs of unbundled network elements or apply the FCC's proxy cost-price ceiling?

SWBT contends that it has performed the total element long run incremental cost (TELRIC) studies which it argues comply with the Act. SWBT argues, therefore, that the rates based upon those studies should be adopted by the Commission.

MFS, on the other hand, has argued it is inappropriate for the Commission to consider the cost studies presented by SWBT in the context of this arbitration. MFS argues the Commission should adopt the FCC's proxy cost-price ceilings until it has an opportunity to consider and develop costing methodologies that conform with the Act's costing requirements.

Public Counsel did not take a position on this issue at the arbitration. However, Public Counsel expressed its concern that the Commission and the parties have not had sufficient opportunity to review SWBT's TELRIC studies to make the necessary findings to support pricing the elements based on the studies.

The FCC Order defines the TELRIC costing methodology that the states are required to use in determining arbitrated rates. The Order also contains a state-specific default proxy ceiling that can be used until

states complete their review of TELRIC studies. States may also determine their own proxy cost to use on an interim basis.

The Commission finds the SWBT studies do not meet FCC guidelines and should not be used as the basis for pricing the unbundled elements. With proper modifications, these studies can be used on an interim basis as a surrogate study for pricing the unbundled elements. The Commission finds it appropriate to utilize Modified Cost Studies based upon SWBT's studies, as an interim pricing method of the unbundled elements. All parties herein acknowledged that the Commission can develop its own interim method for pricing the unbundled elements. After an appropriate interim period the Commission will review the status of the cost studies and the cost data gathered during the interim period. The Commission also finds it appropriate to monitor the ongoing status of the FCC order now stayed. The Commission will, after an interim period, consider whether it should make the interim rates permanent in accord with its Modified Cost Studies or approve a different cost study or model.

The Proposed TELRIC studies submitted by SWBT were modified by the Commission to create the Modified Cost Studies. The Modified Cost Studies are presented as an alternative method of setting interim pricing. The Modified Cost Studies cover the 5dB Local Loop, 8dB Local Loop, db Loop Loss Conditioning, ISDN-BRI Service, DS-1, and Cross-Connects. The db Loop Loss Conditioning is applied to 8dB local loops to reduce the db loss to 5dB. The cost studies identified charges for both a 5dB Local Loop and for the db Loop Loss Conditioning required to provision a 5dB loop.

A. Modifications to Recurring Costs

Four primary modifications were made to the monthly recurring studies submitted by SWBT to arrive at the Total Modified Cost. The four modifications were: Changes to Depreciation Schedules, Elimination of Income Tax as an Expense, Adjustment of the Inflation Factors, and Exclusion of Bad Debt as a Cost to SWBT. These four modifications are described in detail below. The Commission considered modifications to the fill factors for poles and conduits, and to the cost of money figures, however, these modifications cannot be made at this time because of *insufficient data.*

(1) Modification to Depreciation Schedules

The original cost studies submitted by SWBT had very aggressive depreciation schedules. They contained very short asset lives and low to negative salvage values. This led to a very rapid depreciation of the components of the local loop which increased the monthly cost of the local loop. The Commission has modified SWBT's depreciation schedules to reflect the 1994 Company Proposed Rates Depreciation Schedule.[1] This schedule was supplied by the Commission's Depreciation Department. It is important to note that the depreciation rates found in the Company Proposed Rates allow for faster depreciation than the depreciation rates ordered by the Commission.

(2) Elimination of Income Tax

The original cost studies submitted by SWBT contained the cost of Income Tax as a cost of doing business. Income Tax is an appropriate cost *under rate of return regulation but not in a competitive environment.*

[1]This depreciation schedule was supplied to the Commission by SWBT in its Triennial Depreciation Rate Review and subsequently implemented with modifications in the Commission's Telephone Authority Order No. 997.

Income Tax is a tax on profits and is not a normal operating expense. For this reason, the Commission eliminated Income Tax as a cost.

(3) Adjustment of Inflation Factors

The original cost studies submitted by SWBT contain three-year inflation factors meaning the costs reflect the inflation that is expected to occur over the next three years. The contract between SWBT and MFS is only for two years. Therefore, a two-year inflation factor is appropriate. In adjusting SWBT's inflation figures, it was assumed that inflation would be constant over the three-year period. Therefore, the three-year factors were multiplied by two-thirds to arrive at a two-year factor.

(4) Exclusion of Bad Debt as a Cost to SWBT

The original cost studies submitted by SWBT ignored the fact that bad debt will be reduced or eliminated by wholesaling their services. This reduction in bad debt should be recognized as a reduction in the cost of provisioning the local loop as bad debt is an expense associated with the local loop. Bad debt was not included as a reduction in the costs of cross connects. This amount of bad debt was calculated by dividing the total bad debt by the number of access lines.

B. Modifications to Nonrecurring Costs

The Proposed TELRIC studies submitted by SWBT also contained nonrecurring costs for the unbundled elements. These studies also require modifications. The studies contained charges for installation and disconnection of a service. This assumes that all local loops leased by a CLEC will later be disconnected. SWBT supplied no information to show that this would occur. Therefore, the Modified Cost Study separated the connection and disconnection costs into two different rate elements to be charged when the connection and disconnection actually occur.

The SWBT studies also contained charges for items such as problem resolution, equipment shortage resolution, and trouble reconciliation. SWBT proposed to charge costs of these items to the CLEC each time a network element was requested, implying that SWBT would incur these costs every time a network element was requested. In reality, these problems should not occur each time a loop or cross-connect is provisioned. In the absence of information that indicates how frequently these events occur, the Commission's Modified Cost Study removed these elements from the nonrecurring costs.

The 5dB Local Loop, 8dB Local Loop, ISDN-BRI, and DS-1 cost studies submitted by SWBT contained a Service Order Charge that applied each time a CLEC ordered a local loop. This charge assumed all orders would be done manually and would require approximately 30 minutes of labor to complete the ordering process. SWBT did acknowledge that, in the future, the ordering could take place electronically but did not supply cost information for electronic ordering of local loops. In the absence of information that indicates how the actual ordering would take place, either electronically or manually, and the costs of electronic ordering, the Modified Cost Study removed this charge from the nonrecurring costs. When the permanent prices are set, the appropriate costs of the Service Order can be included.

The db Loop Loss Conditioning cost study that applied the conditioning necessary to provision a 5dB local loop contained nonrecurring charges, as well as nonrecurring charges associated with the local loop. These nonrecurring costs also contained a Service Order Charge that applied, in addition to the local loop service order charge, each time a CLEC ordered db Loop Loss Conditioning. SWBT failed to provide any

supporting documentation for either of these nonrecurring costs, which are not included in the interim prices. When the permanent prices are set, the appropriate costs may be included.

C. Other Modification Considerations

The cost for the ISDN-BRI service includes all electronics required to provide ISDN-BRI. MFS stated that it wished to purchase loops capable of provisioning the ISDN-BRI service and use its own electronics to provide the service. SWBT witnesses J. Michael Moore and William Deere stated that many of the loops currently providing 8dB service could also provide ISDN-BRI service with little or no modifications. In this case where no modification is required, MFS should be allowed to purchase ISDN-BRI capable loops at the 8dB loop price. If the loops need actual modifications, such as adding a U-loop repeater, then MFS must pay SWBT for the modifications.

D. Modifications to SWBT's Forward-Looking Common Cost Studies

In addition to its TELRIC studies, SWBT presented a cost study identifying forward-looking common costs. SWBT added such common costs to the element costs identified in its TELRIC studies to arrive at what it intended was the total cost of the network elements. SWBT proposed to recover the common costs using a fixed allocator, applied as fixed percentage markup over the incremental element costs. This method is allowed in the FCC Order. The Order also allowed for a second approach that would allocate only a relatively small share of the common costs to certain critical network elements such as the local loop. This method was not chosen by SWBT. SWBT's Forward-Looking Common Cost Study contained several problems that require modification by the Commission.

SWBT's Common Cost Study contained a cost category called "Total Network Operations - General Supervision." This cost is directly attributable to the local loop, ISDN-BRI service and DS-1 services. It is not a common cost. Further, the labor costs associated with provisioning these three services already contain supervision costs. Therefore, costs contained in Total Network Operations - General Supervision were removed from the Common Cost category and are assumed to be recovered by the labor factors contained in the TELRIC studies.

SWBT also proposed to recover the common costs by applying them as a percentage of Total Element Expenses, not as a percentage of Total Non-Retail Expense. Since Total Element Expense is much less than Total Non-Retail Expense, this caused SWBT's proposed Common Cost Fixed Allocator to be higher. Since these common costs are incurred as a result of all non-retail operations of the company, it is more appropriate to recover the common costs as a percentage of Total Non-Retail Cost. The Commission's modifications result in a fixed common cost allocator of 14.1 percent. SWBT proposed a common cost allocator of 17.76 percent.

4. How should the price of the loops be deaveraged?

SWBT proposed that the local loops be de-averaged by exchange into three categories based upon their current rate groups. The table below summarizes the proposed zones.

Proposed Geographic Rate Zones

Geographic Zone	Current Rate Group	Total Access Lines in Primary Service Area
1	C and D	greater than 60,000
2	B	5,000 - 59,999
3	A	0 - 4,999

SWBT asserts that these classifications appropriately reflect the factors influencing loop costs such as wire center density, size and loop length.

MFS proposed that local loops be geographically deaveraged by wire center into three rate groups based upon loop length. MFS stated that the loop length is the primary determinate of loop cost and should be the basis for the geographic zones. Under MFS's proposal, the loops would be divided into the three groups based upon loop length with approximately one-third of the local loops in each group. MFS did notbase its proposal in exchanges because it only possessed loop length data. MFS witness Michael Porter stated that MFS did not oppose deaveraging by exchange.

The FCC Order requires states to create a minimum of three cost-related zones to implement deaveraged rates for interconnection and unbundled elements. The Commission finds that the local loops should be deaveraged by exchange.

Neither SWBT nor MFS provided sufficient evidence that the zones they proposed reflected the actual cost of providing service in that exchange. Additionally, neither party presented sufficient evidence to determine if loops costs are adequately determined only by loop length, as MFS asserts, or if loop costs were determined by loop length, loop density and other factors, as SWBT asserts. Because the FCC Order requires that the rate groups be cost based, the Commission must develop at least three cost-based rate zones.

On an interim basis, the Commission will adopt SWBT's proposed zones. At a later date, the Commission may reconsider this method and may adopt a permanent method for determining rate zones based upon actual experience gained through interconnection.

5. What cross-connect facilities should be made available and at what price?

SWBT has maintained that the type of cross-connect depends upon the type of facility the competitive local service provider designates. SWBT also included the use of Switched Maintenance Access System (SMAS) test equipment in the cross-connect element. SWBT stated that the SMAS equipment is necessary to test the local loop at the Main Distribution Frame (MDF), before the loop is cross-connected to MFS's equipment. SWBT witness William C. Deering testified that the SMAS equipment would allow SWBT to isolate a potential problem to determine if the problem occurred on the local loop side of the MDF or with the cross-connect. SWBT asserted that being able to isolate the problem to this level is necessary to ensure comparable levels of maintenance and repair service on loops serving MFS customers. The level thus provided MFS would equal levels that SWBT achieves on loops serving its own customers.

SWBT has conducted TELRIC studies establishing the cost of the cross-connects and these studies should be the basis for determining the price of the connect. These studies include the costs of installing and maintaining SMAS equipment to test the unbundled loops as part of the costs of the cross-connect.

MFS asserts that the cross-connects do not depend upon the type of loop and should be priced the same for any type of loop. MFS also objects to the inclusion of the SMAS equipment in the cost of the cross-connect. MFS feels SWBT should make access to its operating support systems, including SMAS, available on an unbundled basis at a price based upon a TELRIC study. MFS does not feel it is necessary for SWBT to be able to test the loop at the MDF but instead could test the loop on a dial-up basis through MFS's collocated switch.

Testing on a dial-up basis would not allow SWBT to determine if the problem occurred on the SWBT side of the MDF or on the MFS side. MFS stated that this is acceptable and pointed to the interconnection agreement between the two companies which contains significant financial penalties if MFS incorrectly requests service from SWBT when the problem is actually on the MFS side. With dial-up testing, MFS could examine the cross-connect to determine if the problem was on its side. If the problem was not found at that time, MFS could request that SWBT test the loop to find the problem. If MFS incorrectly determined the problem was on the SWBT side, MFS would liable for penalties. MFS did acknowledge that SWBT might choose to use the SMAS equipment for SWBT's benefit but if they choose to use the equipment, MFS should not have to pay for it. MFS suggests $0.21 per month recurring rate for each cross-connect.

The Act requires the incumbent LECs to provide requesting carriers with "nondiscriminatory access to network elements on an unbundled basis at any technically feasible point." The Order does not provide any proxy ceiling for the Commission to use on an interim basis.

The Commission finds that SWBT has not provided sufficient evidence to show that the use of the SMAS equipment is necessary to provide equal-in-quality service. If MFS wishes to purchase the use of the SMAS equipment as an unbundled element, it should be able to but not coerced to do so. MFS and SWBT acknowledged that their interconnection agreement contains penalty provisions for false repair requests. The Commission finds that such provisions protect SWBT from incurring costs because MFS lacks adequate testing facilities. Therefore, the Commission finds the use of the SMAS equipment a separate network element.

The Commission finds that neither party presented sufficient cost information on the price of the cross-connects for the Commission to use in determining the arbitrated price of the cross-connects. The TELRIC study submitted by SWBT does not meet FCC guidelines and also includes the use of the SMAS test equipment. MFS proposed a rate but did not provide any supporting cost data.

The TELRIC studies submitted by SWBT for cross-connects included the use of the SMAS test equipment. Because of the format of the recurring cost portion of these studies, it is impossible to separate the proposed TELRIC for the SMAS equipment from the proposed TELRIC for the cross-connect wire. It is possible to separate the TELRIC for the SMAS equipment from the TELRIC for the transmission equipment required to provide a cross-connect to another central office in a virtual collocation arrangement. The cost of a cross-connect within the same central office consists of a pair of cables and is very low. On a monthly basis, the cost would be almost zero. Therefore, the Commission finds that the monthly recurring charge for a cross-connect within the same central office be zero. Cross-connects to different central offices that require transmission equipment should be priced at a level that allows SWBT to recover the cost of the necessary equipment. The rates for each type of cross-connect are attached.

The Commission finds it reasonable and necessary to make appropriate adjustments to the cross-connect cost study submitted by SWBT and use these adjusted numbers on a interim basis. SWBT's cross-connect cost study will be modified to separate the costs associated with the SMAS equipment from the rest of the costs included in the cross-connect cost

study. This will enable the Commission to adopt interim prices for both the cross-connect and the SMAS test equipment.

The Commission would, on such an occasion, look for data based upon actual interconnection experience for both review of costing and a review as to the potential necessity of the SMAS element. The Commission cannot sanction any activity which may impair the reliability of the network. The Commission finds that where reliability costs are incurred those costs should be incurred or allocated on a competitively neutral basis.

III. Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

SWBT and MFS are telecommunications companies as defined under Section 386.020, R.S. Mo. (1994), and as such are subject to the Commission jurisdiction as set out in Chapters 386 and 394 of the Missouri Statutes.

The Commission has jurisdiction in this case pursuant to the terms, conditions and requiements set out in the Telecommunications Act of 1996, to be codified at 47 U.S.C.

IT IS THEREFORE ORDERED:

1. That the issues set out by the parties within the Issues Memorandum and at the Arbitration shall be settled consistent with this order using the Total Modified Element Cost(s) as set out in Attachment A. Southwestern Bell Telephone Company and MFS Communications Company, Inc., shall negotiate a final agreement for submission to Missouri Public Service Commission consistent with this order.

2. That all objections and motions not previously ruled upon are hereby overruled and denied.

3. That this Report And Order shall become effective on November 7, 1996.

BY THE COMMISSION

Cecil I. Wright
Executive Secretary

(S E A L)

Zobrist, Chm., Kincheloe, and
Drainer, CC., concur.
Crumpton, C., concurs, with
concurring opinion to follow.
McClure, C., absent.

Dated at Jefferson City, Missouri,
on this 6th day of November, 1996.

Summary of Monthly Recurring Costs
Based upon PSC Modifications to Cost Study Data Submitted by Southwestern Bell Telephone

	Modified TELRIC Cost	Allocation of Common Cost	Total Modified Element Cost
8db Analog Loop			
Geographic Zone 1	$10.11	$1.43	$11.54
Geographic Zone 2	$17.34	$2.44	$19.78
Geographic Zone 3	$28.11	$3.96	$32.07
ISDN-BRI			
Geographic Zone 1	$26.77	$3.77	$30.54
Geographic Zone 2	$36.50	$5.15	$41.65
Geographic Zone 3	$52.76	$7.44	$60.20
DS 1			
Geographic Zone 1	$80.59	$11.36	$91.95
Geographic Zone 2	$92.62	$13.06	$105.68
Geographic Zone 3	$104.38	$14.72	$119.10
Cross Connects with SMAS Test Equipment			
MDF to Cage, Same CO			
2 Wire Analog	$1.36	$0.19	$1.55
4 Wire Analog	$2.73	$0.38	$3.11
2 Wire Digital ISDN-BRI	$1.36	$0.19	$1.55
2 Wire Digital DS 1	$7.33	$1.03	$8.36
MDF to Cage, Different CO			
2 Wire Analog	$3.27	$0.46	$3.73
4 Wire Analog	$4.39	$0.62	$5.01
2 Wire Digital ISDN-BRI	$7.83	$1.10	$8.93
MDF to SWBT Multiplexor			
2 Wire Analog	$3.27	$0.46	$3.73
4 Wire Analog	$4.39	$0.62	$5.01
2 Wire Digital ISDN-BRI	$7.83	$1.10	$8.93
Cross Connects without SMAS Test Equipment			
MDF to Cage, Same CO			
2 Wire Analog	$0.00	$0.00	$0.00
4 Wire Analog	$0.00	$0.00	$0.00
2 Wire Digital ISDN-BRI	$0.00	$0.00	$0.00
2 Wire Digital DS 1	$4.60	$0.65	$5.25
MDF to Cage, Different CO			
2 Wire Analog	$1.90	$0.27	$2.17
4 Wire Analog	$2.55	$0.36	$2.91
2 Wire Digital ISDN-BRI	$6.46	$0.91	$7.37
MDF to SWBT Multiplexor			
2 Wire Analog	$1.90	$0.27	$2.17
4 Wire Analog	$2.55	$0.36	$2.91
2 Wire Digital ISDN-BRI	$6.46	$0.91	$7.37
Conditioning			
Local Loop dB Loss Conditioning	$4.98	$0.70	$5.68

Attachment A