

**PUBLIC UTILITIES COMMISSION**505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298

December 28, 2004

Agenda ID #4184  
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 01-02-024 ET AL.

This is the draft decision of Administrative Law Judge (ALJ) Duda. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN by PSW  
Angela K. Minkin, Chief  
Administrative Law Judge

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Attachment

Decision **DRAFT DECISION OF ALJ DUDA (Mailed 12/28/2004)**

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

Joint Application of AT&T Communications of California, Inc. (U 5002 C) and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Switching in Its First Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050.

Application 01-02-024  
(Filed February 21, 2001)

Application of AT&T Communications of California, Inc. (U 5002 C) and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Loops in Its First Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050.

Application 01-02-035  
(Filed February 28, 2001)

Application of The Telephone Connection Local Services, LLC (U 5522 C) for the Commission to Reexamine the Recurring Costs and Prices of the DS-3 Entrance Facility Without Equipment in Its Second Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050.

Application 02-02-031  
(Filed February 28, 2002)

Application of AT&T Communications of California, Inc. (U 5002 C) and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Interoffice Transmission Facilities and Signaling Networks and Call-Related Databases in Its Second Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050.

Application 02-02-032  
(Filed February 28, 2002)

Application of Pacific Bell Telephone Company (U 1001 C) for the Commission to Reexamine the Costs and Prices of the Expanded Interconnection Service Cross-Connect Network Element in the Second Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050.

Application 02-02-034  
(Filed February 28, 2002)

Application of XO California, Inc. (U 5553 C) for the Commission to Reexamine the Recurring Costs of DS1 and DS3 Unbundled Network Element Loops in Its Second Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050.

Application 02-03-002  
(Filed March 1, 2002)

## **OPINION RESOLVING BILLING ADJUSTMENT ISSUES**

### **I. Summary**

This decision resolves outstanding issues in this proceeding relating to the adjustment, or “true-up,” of interim unbundled network element (UNE) rates to permanent rate levels now that permanent rates have been adopted for Pacific

Bell Telephone Company d/b/a SBC California (SBC-CA) in Decision (D.) 04-09-063.

This order lifts the stay of billing adjustments established through Ordering Paragraph 4 of D.04-09-063, and orders payment of billing adjustments as follows:

- Ten carriers whose cash or cash equivalents indicate they possess cash at least 10 times the amount of their true-up debt shall pay their true-up obligations immediately, within 10 days from this order.
- All other carriers shall pay in equal installments over 12 months, subject to interest and late payment penalties.
- All billing disputes arising from payment of the true-up shall be handled through arrangements in existing interconnection agreements.
- True-up payments should be calculated based on a 10% shared and common cost markup, rather than the current 21% in UNE rates, subject to adjustment following adoption of a corrected markup in Application (A.) 04-03-013 (the 2004 SBC-CA UNE Reexamination proceeding).

## **II. Background**

In May 2002, the Commission adopted D.02-05-042 setting interim rates for certain UNEs that SBC-CA sells to competitive local exchange carriers (CLCs). In D.02-09-052, the Commission expanded the scope of the UNEs subject to interim discounts to include all UNE switch ports. The interim UNE rates in these two orders were adopted subject to true-up, either up or down, once permanent rates for SBC-CA were set.

In September 2004, the Commission issued D.04-09-063 adopting permanent UNE rates for SBC-CA, and ordering SBC-CA to calculate any billing adjustments owed to or by interconnecting carriers for the difference between interim rates set earlier in D.02-05-042 and D.02-09-052 and the new permanent rates. At the same time, the Commission stayed payment of these billing adjustments pending a review of the size of the actual true-up amounts and the outcome of further proceedings to consider the necessity for mitigation of potentially financially burdensome true-up payments. Furthermore, the Commission noted a recent order by the Ninth Circuit Court of Appeals<sup>1</sup> regarding the shared and common cost markup included in SBC-CA's UNE rates. Given this Ninth Circuit order, the Commission ordered that further proceedings would also consider whether and how to implement any shared and common cost markup revisions along with the true-up. (D.04-09-063, Ordering Paragraph 4.)

Following a prehearing conference held on October 13, 2004, the Administrative Law Judge (ALJ) determined the following issues would be considered in this phase:

- SBC-CA's calculation of the true-up amounts and the proper forum for carriers to resolve potential disputes over these calculations. True-up payments involve not only what carriers owe SBC-CA for increased UNE rates, but what SBC-CA owes other carriers where final rates are lower than interim rates.

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<sup>1</sup> *AT&T Communications of California, Inc. v. Pacific Bell Telephone Company*, 375 F.3d 894 (9th Cir. 2004).

- Whether payment of the billing adjustments will have negative effects on the competitive local exchange market or constitute a financial hardship for certain CLCs.
- Whether the Commission should order mitigation, including but not limited to long-term payment options and interest limits, to alleviate possible negative effects of true-up payments.
- Whether SBC-CA should include in the true-up calculation an adjustment of the 21% shared and common cost markup that a recent Ninth Circuit Court of Appeal order holds was incorrectly calculated.

On October 22, 2004, SBC-CA filed its preliminary calculation of the true-up payments it is owed by CLCs and wireless carriers. SBC-CA's preliminary figures indicate it is owed approximately \$100 million.<sup>2</sup> In more detailed comments filed on November 1, 2004, SBC-CA urges the Commission to resolve the true-up phase of this proceeding quickly. SBC-CA proposes that carriers make true-up payments immediately if their publicly available financial information indicates they have sufficient cash or cash equivalents available to cover true-up payments. For all other carriers, SBC-CA suggests a deferred payment plan.

Responses to SBC-CA's true-up payment proposals were filed on November 19, 2004 by Arrival Communications Company (Arrival), AT&T Communications of California, Inc. (AT&T), the California Association of

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<sup>2</sup> SBC-CA requested confidential treatment of individual carriers' true-up payments, and that request is granted by this order.

Competitive Telephone Companies (CALTEL), Covad Communications Company (Covad), MCI,<sup>3</sup> MPower Communications Corp. (MPower), Pac-West Telecomm, Inc. (Pac-West), RCN Telecom Services, Inc. (RCN), and jointly by XO California, Inc. and Allegiance Telecom of California, Inc. (XO/Allegiance).<sup>4</sup> Rebuttal comments were filed on December 8, 2004 by AT&T, SBC-CA, and jointly by The Utility Reform Network and the Commission's Office of Ratepayer Advocates (TURN/ORR). The issues raised by the parties in these various rounds of comments are addressed in turn below.

### **III. Financial Hardship Concerns and Payment Options**

SBC-CA maintains that publicly available financial data indicates that several carriers who owe true-up payments possess ten times more cash or cash equivalents than their payment obligation. Therefore, SBC-CA suggests the following eleven carriers are not financially challenged by immediate payment of their true-up obligations: SBC-CA, AT&T, MCI, Sprint, MPower, Cox Communications Inc., Covad, RCN, Talk America, XO/Allegiance, and Z-Tel.

For all other carriers, SBC-CA proposes they pay their true-up obligations, including interest accrued, in six equal payments over six months. Interest would continue to accrue on all unpaid balances and late payment charges would apply if a carrier fails to make a timely payment of an installment.

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<sup>3</sup> On December 7, 2004, MCI filed a notice of withdrawal from the true-up portion of this proceeding for issues related to the period of time prior to September 23, 2004, based on a settlement it had reached with SBC-CA.

<sup>4</sup> On November 19, 2004, Vycera Communications, Inc. filed a notice of withdrawal from the proceeding because it had reached a settlement of true-up issues with SBC-CA.

According to SBC-CA, interest on true-up payments should not be waived because SBC-CA should not be required to give free loans to its competitors.

In addition, SBC-CA contends that all credits and debits from the same carrier, or from carriers with common parents, must first be determined before the net amount is paid. For example, SBC-CA owes XO for lower DS-1 rates, while XO's affiliate Allegiance owes SBC-CA true-up payments for UNE rate increases. Under SBC-CA's proposal, these amounts would be offset before true-up payments are finalized.

Pac-West supports SBC-CA's proposal whereby carriers that are financially capable, based on cash on hand, would make true-up payments immediately. Pac-West contends that delay of the true-up payment it is owed by SBC-CA causes financial hardship for Pac-West.

In contrast to SBC-CA's proposal, AT&T recommends extending monthly true-up payments over 12 months rather than six, without interest or late fees. According to AT&T, this would limit competitive harm to carriers in keeping with Public Utilities Code Section 709 and its goals of promoting competition and consumer choice and avoiding anticompetitive conduct.<sup>5</sup> AT&T urges the Commission to consider the effects of the true-up on carriers' financial condition and ability to compete and highlights that review of publicly available financial information for SBC-CA's parent company, SBC Communications, Inc. (SBC) indicates SBC would not experience any material financial impact if true-up

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<sup>5</sup> Public Utilities Code Section 709 sets forth policies for telecommunications in California which include encouraging the deployment of new technologies, promoting economic growth and job creation, avoiding anticompetitive conduct, removing barriers to open and competitive markets and promoting fair product and price competition.

payments were deferred, since the entire true-up amount is, by AT&T's rough calculations, only 0.1% of SBC's annual revenue. AT&T asks the Commission to consider relative financial strength and market share of competitors when evaluating financial hardship from true-up payments. Applying these criteria, AT&T proposes all competitors should be allowed to use a 12-month payment plan.

Similar to AT&T, CALTEL and TURN/ORR propose a 12-month deferral of payment obligations for carriers that have a financial hardship. CALTEL contends this allows carriers sufficient time to raise the necessary funds and integrate the costs into their business operations, with a single lump sum payment due at the end of the deferral period. For the carriers from which SBC-CA seeks immediate true-up payments, CALTEL requests a hearing to examine several measures of financial hardship such as "revenue flows, debt ratings, market share decreases, entire market declines, and industry guidance." (CALTEL, 11/19/04, p. 3.) Finally, CALTEL suggests a further mitigation for financial hardship wherein SBC-CA would waive the first \$1 million of the amount it is owed from all carriers.

Another CLC, Arrival, requests a payment period longer than six months because of the extraordinarily long two and half year period that interim rates were in effect. Arrival opposes SBC-CA's suggestion to use cash on hand as a measure of financial hardship and argues that SBC-CA's proposal does not address the competitive harm to CLCs from large true-up payments.

XO/Allegiance state they are willing to waive any deferred payment plans and make true-up payments immediately subject to verification of the proper amount and to SBC-CA making the payments it owes to XO and Allegiance at the same time. Based on interconnection agreement amendments (ICAs),

SBC-CA owes XO/Allegiance payment related to a contractually agreed upon true-up of DS-1 and DS-3 UNE loop prices. XO contends that payment of this true-up has not been stayed and there is no reason this true-up should not occur immediately. TURN/ORR echo the position of XO that true-ups related to contractual arrangements between SBC-CA and CLCs are not the subject of this proceeding and should be settled separate and apart from the true-ups covered by this decision.

RCN disagrees that it can make an immediate true-up payment, as suggested by SBC-CA, because its parent company, RCN Corporation, filed for reorganization under Chapter 11 of the Bankruptcy Code in May 2004. According to RCN, it cannot rely on its parent company's cash to make payments of pre-petition debt, such as the true-up, without Bankruptcy Court approval. Therefore, RCN contends it should be categorized as a carrier facing financial hardship.

**Discussion.** First, we will address whether true-up payments constitute a financial hardship. SBC-CA does not dispute that the true-up payments are a financial hardship for many carriers. The issue is whether we should require immediate true-up payment by those carriers that SBC-CA defines as not facing a financial hardship, or whether to apply mitigations to all carriers, as suggested by AT&T, CALTEL and others.

We find that SBC-CA has proposed an objective standard, based on public information, for measuring whether individual carriers have the financial ability to pay. SBC-CA has identified 11 carriers, including itself, that possess cash or cash equivalents at least ten times the amount of their true-up obligation. This is a reasonable financial standard for determining who can pay and no further inquiry into each carriers' financial situation is necessary. The CLCs have known

since a proposed decision issued in May 2004 that a true-up was inevitable. Thus, the following carriers with cash available should now pay their obligation: SBC-CA, AT&T, MCI, Sprint, Mpower, Cox, Covad, Talk America, XO/Allegiance, and Z-Tel. All other carriers are assumed to have a financial hardship requiring mitigation.

We exclude RCN from the list of carriers required to pay immediately because, as RCN has noted, its parent corporation has filed for bankruptcy and its cash cannot be used to pay the true-up obligation. SBC-CA does not object to RCN receiving the same payment terms as those extended to other carriers. (SBC, 12/8 p. 5.)

Despite our immediate payment requirement, the 10 carriers listed above will still have the bulk of their cash left intact, since they possess cash at least 10 times the amount of their true-up debt. We agree with SBC-CA that competition is unlikely to be harmed when the amount owed by a CLC is minimal, i.e., 10% or less, compared to the cash they have available.

Moreover, there is limited value in further inquiry into the relative financial position and market share of SBC-CA versus its competitors, or other market trends, as suggested by AT&T and CALTEL. We agree with SBC-CA that these proposed criteria for determining hardship fail to establish a link between SBC-CA's cash position and market share and the ability of other carriers to make their payments. The fact that SBC has more cash or market share than other carriers does not mean other carriers are harmed by true-up payments. Further, the carriers identified by SBC-CA, other than RCN, do not dispute their cash position. Therefore, we find the 10 carriers we have identified can make their true-up payments and still retain reasonable financial resources. In sum, the further review that AT&T and CALTEL promote would be of limited value

because it would consume resources with limited benefit and needlessly delay true-up payments.

The second critical issue is the payment period for those carriers that are not required to pay immediately. For all carriers that do not meet the SBC-CA cash standard, we find that 12 months is a reasonable time period for true-up payment. Although SBC-CA initially proposes a six-month payment period, it later concedes it does not object to a 12-month payment period for carriers facing hardship. (SBC-CA, 12/8/04, p. 12.) We will require carriers to pay in 12 equal installments because this is an obligation that carriers have anticipated, and they should work to gradually decrease it rather than defer it for another year. A 12-month payment period should mitigate competitive harm to smaller carriers by giving them time to integrate these costs into their operations. During the 12-month period, the unpaid balance will continue to accrue interest at the three-month commercial paper rate<sup>6</sup> and carriers should pay any late fees that apply.

We agree with SBC-CA that all credits and debits from the same carrier, or from carriers with common parents, should be determined before the net amount is paid. Moreover, we find that true-up payments regarding DS-1 and DS-3 UNEs that carriers may have contractually arranged are outside the scope of today's order. The stay we ordered in D.04-09-063 was not intended to apply to contractual true-up obligations. Those payments should proceed according to the terms and conditions of applicable interconnection agreements.

We reject CALTEL's proposal that SBC-CA waive \$1 million from each carrier's true-up obligation. We agree with AT&T that this proposal is discriminatory because carriers with a small true-up obligation could see the

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<sup>6</sup> This interest rate was initially set in D.02-05-042, p. 50.

entirety of their obligation waived, while AT&T would only receive a small waiver. Instead, AT&T suggests that if any amount is waived, it should be a percentage of the carrier's true-up amount rather than a set amount. We will not order any waiver of true-up amounts because we made clear when we adopted interim rates that they were subject to true-up. Waiving a portion of true-up obligations now would not fully compensate SBC-CA for what we have determined are its forward-looking costs. In our view, a 12-month payment period for carriers with financial hardship is sufficient mitigation.

#### **IV. Billing Disputes**

SBC-CA proposes that any billing disputes arising from true-up payments should be handled in the same manner as billing disputes are handled today, i.e., through existing interconnection agreements, which describe a process of escalation and formal dispute resolution. AT&T, CALTEL, MCI, and Pac-West agree with this position.

Covad, MPower and RCN contend SBC-CA has not provided them the backup information necessary to evaluate SBC-CA's calculation of true-up amounts. These carriers generally ask the Commission to order SBC-CA to provide appropriate supporting information and sufficient time for review of billing records before rendering any bill for the true-up. Arrival maintains the Commission should play an active role in resolving disputes over the calculation of true-up payments because the dispute resolution process in interconnection agreements is onerous and expensive. Covad contends SBC-CA has failed to recognize contract amendments incorporating ISDN and DS-1 rates in true-up calculations. SBC-CA disagrees with Covad's assertion that ISDN rates are subject to true-up.

**Discussion.** We agree with SBC-CA and the other carriers that billing disputes over true-up payments should be handled through the procedures set forth in interconnection agreements. We decline to insert the Commission into the process of resolving any disputes when interconnection agreements already address this issue. Arrival has made an unsupported assertion that the dispute resolution process is onerous and expensive. We doubt it could be any more onerous or expensive than Commission involvement on the same topic. As to the ISDN issue raised by Covad, this is a contractual true-up dispute, similar to those raised by XO/Allegiance, which is beyond the scope of the true-up ordered in D.04-09-063.

Several carriers ask the Commission to ensure that SBC-CA provides adequate information to verify their true-up bills. SBC-CA contends it has provided the information requested. Again, we will refrain from involvement in these disputes, but we strongly urge SBC-CA to provide adequate supporting information for its bills.

## **V. Shared and Common Cost Mark-up**

AT&T contends the current 21% shared and common cost, or “overhead,” markup included in SBC-CA's permanent UNE rates is illegal based on a recent decision of the Ninth Circuit Court of Appeals remanding the Commission’s markup calculation. The Ninth Circuit found that the Commission improperly implemented the methodology calculating the shared and common cost markup by attributing some common costs to wholesale operations that should have been attributed to retail operations. (*AT&T v. Pacific Bell*, 375 F.3d 894.) For this reason, AT&T maintains the markup must either be removed or corrected before true-up payments are made, and this adjustment of the markup should apply from the date the Commission first applied the 21% markup, i.e. November 19,

1999. Moreover, AT&T asserts the Commission has the authority to order retroactive adjustments of the markup, even though the Commission declined to exercise its discretion to order retroactive adjustments in response to an earlier remand of the markup calculation. (*See* D.02-09-049, p. 25.) In AT&T's view, the current situation can be distinguished from the earlier markup remand where the Commission declined any retroactive adjustment as not promoting competition and not worth the administrative burden given offsetting impacts of the adjustment.<sup>7</sup> (*Id.*, pp. 25-27.)

Finally, AT&T argues that because it must pass the true-up on to its customers, requiring it to pay an inflated true-up payment now based on what it considers an illegal 21% markup, only to reduce the payment later once the markup is corrected, will unnecessarily burden its customers. AT&T provides what it claims is a straightforward correction of the markup calculation based on the Ninth Circuit's decision and the calculations supporting D.98-02-106, where the components of the markup calculation were first derived. According to AT&T, these corrections result in a revised markup of 10%.

Covad, MCI, MPower, RCN, and TURN/ORR echo the views of AT&T that the Commission should include an adjustment to the markup as part of all carriers' true-up payments. MPower and RCN contend it will not cause financial hardship for SBC-CA to wait for its true-up payments until the Commission can calculate the correct markup. Therefore, they recommend the Commission order

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<sup>7</sup> Indeed, the full rate impact was not known at the time of D.02-09-049, because even though the markup increased from 19% to 21%, the Commission required SBC-CA to implement further revisions to recurring rates to remove the effect of double-counting. This change later resulted in a small net decrease in UNE rates, as shown in D.03-07-023.

carriers to pay 50% of their true-up payments at this time, and the remaining 50% once the markup is reconsidered. Similarly, TURN/ORR question why the Commission would require CLCs to pay a true-up amount that includes a 21% markup the Ninth Circuit has found to be unlawful. Further, they note that any adjustment to the true-up amount to lower the shared and common cost markup would not have a material impact on SBC-CA's revenues, whereas payment of an unlawfully high markup would hamper competitive investment by CLCs.

SBC-CA opposes any adjustment to or deferral of the mark-up as part of the current true-up payments. According to SBC-CA, the 21% markup included in true-up payments is legal and unaffected by the Ninth Circuit's remand order because the remand did not issue until November 2004, after the September 2004 issuance of D.04-09-063 ordering true-up payments. Even now, the case is remanded to the district court and it is unclear if the district court will further remand the matter to the Commission. SBC-CA contends it is premature and speculative to conclude the Commission would actually change the markup percentage and apply any change retroactively. In SBC-CA's view, deferring the markup payment until a future date only creates yet another true-up and prolonged uncertainty.

Further, SBC-CA contends AT&T's latest proposed markup revisions, which result in a 10% markup proposal, are contrary to positions it has taken earlier before the Commission. Therefore, based on the doctrine of judicial estoppel, AT&T is prevented from now changing its position on the correct way for the Commission to calculate the markup. Specifically, SBC-CA asserts that since AT&T previously identified a maximum of \$163 million in retail costs that should be removed from the numerator of the markup calculation, it cannot now advocate removal of retailing costs that are close to four times this amount.

Even if the matter is eventually remanded to the Commission, and the Commission decides to modify its mark-up calculation, SBC-CA maintains the Commission can only adjust the markup prospectively. Specifically, in D.02-09-049, the Commission revised the markup from 19% to 21% but declined to order this revision retroactively, noting it would create uncertainty in the struggling telecommunications sector and be inconsistent with Public Utilities Code Section 709. (D.02-09-049, p. 26.) In addition, SBC-CA argues that retroactive rate adjustments are typically unlawful, or at a minimum, highly disfavored, because they disrupt parties' settled expectations of transactions that are already complete. (SBC-CA, 12/8/04, p. 19.)

**Discussion:** It is undisputed that the Ninth Circuit has remanded to the District Court the issue of how the Commission has calculated the markup. While AT&T and other carriers view this remand as proof that the current 21% markup incorporated into rates is excessive and unlawful, SBC-CA asks us to ignore that the court found error in the 21% markup because the court's mandate issued after the decision ordering the true-up. In SBC-CA's view, we should continue to apply the 21% markup to UNE costs until ordered by the District Court to modify the markup, and even then, only prospectively. We find it unreasonable to ignore the Ninth Circuit's remand order, and essentially pretend it has not issued.<sup>8</sup> Clearly, the court has found the calculations supporting the 21% markup unlawful and if we ignore this fact now, we only face dealing with

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<sup>8</sup> Indeed, despite SBC-CA's claim the remand may never reach the Commission, we are aware that SBC-CA has actually asked the District Court to remand the markup issue to the Commission. We consider it very likely the District Court will remand the issue shortly.

the issue later rather than sooner. Even if the District Court handles the remand itself without involving the Commission, the result of any action by the District Court will undoubtedly require Commission action to trickle down into UNE rates.

Thus, the issue we now face is whether to modify the markup immediately as part of the true-up payments, or order preliminary true-up payments while we review the markup elsewhere. While it is appealing to immediately modify the markup and settle this matter after five years of litigation, we cannot do so based on the cursory showing presented by AT&T. We agree with SBC-CA that aspects of AT&T's newest calculations are significantly different than positions it has taken in prior pleadings before this Commission and we cannot accept them without further scrutiny. AT&T has argued over several years in the original OANAD proceeding and its rehearing, and then in District Court, for removal of \$163 million in retail costs. Its now asks for a new approach involving removal of approximately four times that amount. SBC-CA, on the other hand, does not present any new markup calculations given its adamant insistence that the markup should remain at 21%.

While we agree with SBC-CA that it is premature to recalculate the markup as AT&T has proposed, we also agree with AT&T that it is unreasonable to demand carriers pay the full 21% markup when the Ninth Circuit has found it in error and there is uncertainty as to whether the 21% will be modified upon remand. It is more reasonable to order payment of a lesser amount and finalize true-up payments after markup remand issues are resolved. We are loath to the idea of yet another true-up, but our options are slim. We will order payment of the majority of the true-up at this time and take care of remaining markup issues in A.04-03-013 (the 2004 SBC-CA UNE Reexamination proceeding), where carriers specifically requested review of the markup percent. We will direct the assigned ALJ to issue a ruling in A.04-03-013 setting an expedited schedule for review of the markup so as to fully comply with the remand order and to bring quick finality to this long debated topic.

Therefore, we direct carriers to make their true-up payments for the period from May 2002 to September 2004, subject to the payment terms described earlier in this order, and to incorporate a 10% rather than a 21% markup. In other words, carriers should calculate their true-up payments assuming that the permanent UNE rates include a markup of only 10%. We emphasize that the 10% markup figure we adopt today for true-up purposes should not be confused with the 10% proposed by AT&T. It is mere coincidence that these numbers are the same. We decline to endorse or adopt AT&T's calculations, preferring to save them for review in A.04-03-013. Rather, we choose a 10% markup because it is approximately half the current 21% rate, it is similar to the 9% markup Verizon now proposes in the Verizon UNE phase of Rulemaking 93-04-003, and the markup is unlikely to be lower than this amount. If we ultimately adopt a higher markup percent in A.04-03-013, carriers can pay the rest to SBC-CA. As TURN/ORR point out, SBC-CA will not be materially impacted if it has to wait for a small portion of its true-up, whereas overpayment could hamper competitive investment by CLCs.

A final determination of the markup percentage will be made in A.04-03-013. If the matter is remanded by the District Court to the Commission, we will set a new markup percent in A.04-03-013 and a further order in that proceeding will resolve the final true-up payments based on a corrected markup percentage. In that proceeding, we will also address what markup should apply prospectively and whether retroactive adjustment of the markup to November 1999 is appropriate. If the matter is not remanded to the Commission or the Commission determines in A.04-03-013 that the markup percent should remain at 21%, a further order in A.04-03-013 will direct carriers to pay the remaining balance to SBC-CA for the difference between a 10% and 21% markup. We find

this approach more reasonable than the proposals of RCN and MPower to pay half the true-up obligation now and half after markup issues are settled. There is no reason to withhold 50% of the entire true-up payment when a much smaller amount is in question.

Through our action today to order true-up payments with a 10% markup, we clearly disagree with SBC-CA's position that any adjustment to the markup can only be prospective. Instead, consistent with the earlier markup remand we resolved in D.02-09-049, we find that when faced with a remand, the Commission has the discretion to correct a ratemaking error retroactively. Indeed, this is exactly what SBC-CA argued in previous pleadings in this proceeding when AT&T and MCI opposed a retroactive change to the markup in response to the previous remand order.<sup>9</sup> In D.02-09-049, we noted that:

[SBC-CA] disagrees that a retroactive adjustment to UNE rates would constitute "retroactive ratemaking." Rather, [SBC-CA] maintains that the Commission, pursuant to federal law, has the authority to "undo what is wrongfully done by virtue of its order," even where its statutory authority to fix rates is "prospective only." (*United Gas Improvement Co. v. Callery Properties, Inc.*, 382 U.S. 223, 229-30 (1965).) (D.02-09-049, mimeo. at 24.)

In that same order, the Commission concluded that SBC-CA was correct, the Commission has authority to order retroactive rate adjustments in response to a remand order, and in support the Commission cited the following passage from a D.C. Circuit order:

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<sup>9</sup> Interestingly, SBC-CA's claims of judicial estoppel regarding AT&T's markup calculations would seem to apply equally to SBC-CA's apparent change in arguments regarding retroactive adjustments in response to remand orders.



“[t]here is ... a strong equitable presumption in favor of retroactivity that would make the parties whole. As we have stated, “when the Commission commits legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made. *CPUC*, 988 F.2d at 168.” (*Exxon Company, USA v. FERC*, 182 F.3d 30, 49 (D.C. Cir. 1999), as cited in D.02-09-049, mimeo. at 24-25.)

The Commission also noted support for its conclusion that retroactivity is within its discretion by citing the following D.C. Circuit Court passage:

“We have previously held that administrative agencies have greater discretion to impose their rulings retroactively when they do so in response to judicial review, that is, when the purpose of retroactive application is to rectify legal mistakes identified by a federal court.” (*Verizon Telephone Cos. v. FCC*, 269 F.3d 1098,1111 (D.C. Cir. 2001), as cited in D.02-09-049, p. 25.)

In D.02-09-049, the Commission chose not to implement a retroactive markup correction, reasoning it was not warranted given offsetting rate impacts and the administrative burden involved, and finding that a retroactive markup increase could hurt competitive carriers. Given our previous conclusion that the Commission has discretion to retroactively adjust rates in response to a remand order, we will incorporate a markup change as part of the interim rate true-up, from May 2002 to September 2004, because the parties anticipated a rate change, and because leaving a 21% markup in place, which the Ninth Circuit has found unlawful and is likely to modify on remand or order the Commission to modify, could impair competition. We find that consistent with the Commission’s actions in D.02-09-049 to remove barriers to open and competitive markets, the Commission can exercise discretion on the issue of retroactivity when faced with a legal error in a prior rate. SBC-CA’s UNE rates have been interim since May

2002, and parties expected a true-up. In sum, the circumstances surrounding this remand allow adjustment of the markup percentage back to the date when interim rates went into effect, subject to correction when a markup percentage is finalized in A.04-03-013. We will not prejudge in this order whether to apply a markup revision retroactively to November 1999.

## **VI. Motions for Confidentiality**

On October 22, 2004, SBC-CA filed a motion requesting confidential treatment of the billing adjustment amounts it calculated for each carrier. According to SBC-CA, the amounts owed to or by SBC-CA involve company-specific financial information pertaining to numerous CLCs.

Similarly, in a November 12, 2004 motion, Pac-West requested confidential treatment of information related to the amount of true-up payment it is owed by SBC-CA. If this information were revealed, it is conceivable that competitors could ascertain market share and other sensitive competitive information regarding competitor operations.

On November 19, 2004, AT&T requested confidential treatment of portions of its reply comments in the true-up which contain information that SBC-CA considers proprietary, namely information pertaining to calculation of the shared and common cost markup. AT&T states that it will provide the information to those parties who have signed nondisclosure and protective agreements applicable to this proceeding. Similarly, on December 8, 2004, SBC-CA requested confidential treatment of portions of its rebuttal to AT&T's calculations concerning the shared and common cost markup.

The information addressed by these motions involves business-sensitive data of SBC-CA and competitive telecommunications carriers, which, if revealed, could place these carriers at an unfair business disadvantage. The Commission

has granted confidential treatment to information of this type in the past and it should do so here as well.

### **VII. Comments on Draft Decision**

The Commission mailed the draft decision of the ALJ in this matter to the parties in accordance with Section 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed by \_\_\_\_\_ and reply comments were filed by \_\_\_\_\_.

### **VIII. Assignment of Proceeding**

Carl W. Wood is the Assigned Commissioner and Dorothy J. Duda is the assigned Administrative Law Judge in this proceeding.

### **Findings of Fact**

1. In D.04-09-063, the Commission stayed payment of any billing adjustments, or true-up payments, pending the outcome of further proceedings on the potential mitigation and the shared and common cost markup.
2. The following carriers possess cash or cash equivalents at least 10 times the amount of their true-up obligation: SBC-CA, AT&T, MCI, Sprint, MPower, Cox, Covad, Talk America, XO/Allegiance, and Z-Tel.
3. The parent company of RCN has filed for bankruptcy and its cash cannot be used to pay RCN's true-up obligation.
4. In D.02-05-042, the Commission directed that true-up payments should include interest at the three-month commercial paper rate.
5. The stay of true-up payments in D.04-09-063 does not apply to contractual true-ups arranged through parties' interconnection agreements.
6. SBC-CA and interconnecting carriers typically resolve billing disputes through terms and conditions in existing interconnection agreements.

7. The Ninth Circuit found that the Commission improperly implemented the methodology calculating the shared and common cost markup.

8. AT&T's proposal for a 10% markup is significantly different from positions it has taken in prior proceedings related to the markup.

9. Several filings in this true-up phase contain company-specific information regarding the amounts of the billing adjustments owed by each carrier and information pertaining to SBC-CA's overhead costs.

### **Conclusions of Law**

1. SBC-CA has proposed an objective, cash-based standard for measuring whether individual carriers have the financial ability to pay their true-up obligation.

2. The 10 carriers whose true-up obligation is 10% or less than their cash on hand can make their true-up payments immediately and still retain reasonable financial resources.

3. Carriers who do not possess cash 10 times the amount of their true-up debt should pay in 12 equal monthly installments, with interest at the three-month commercial paper rate and subject to penalties for late payments.

4. The stay ordered in D.04-09-063 should be lifted so that the 10 carriers identified in this order pay their true-up debts immediately, and all other carriers pay over 12 months.

5. RCN should be excluded from the list of carriers required to pay immediately, and instead allowed to pay its true-up over 12 months, because of the bankruptcy of its parent company.

6. Credits and debits from the same carrier, or from carriers with common parents, should be determined before the net amount is paid.

7. If carriers have arranged true-up payments regarding DS-1 and DS-3 UNEs, or other UNEs, these payments should proceed according to the terms and conditions of the applicable interconnection agreements.

8. Billing disputes regarding true-up payments should be handled through procedures set forth in interconnection agreements.

9. It is unreasonable to ignore the remand order of the Ninth Circuit regarding the markup and order carriers to pay a markup of 21% when there is uncertainty as to whether this rate will be modified upon remand.

10. It is reasonable to order payment of a lesser markup percentage and finalize true-up payments after markup remand issues are resolved.

11. True-up payments should include a markup of 10% rather than 21% because this is half the current markup, it is similar to the 9% proposed by Verizon, and the markup is unlikely to be lower than this percentage.

12. The Commission should not require payment of a 21% markup, which the Ninth Circuit has found unlawful, because overpayment of the markup could impair competition.

13. When carriers make their true-up payments for the period from May 2002 to September 2004, they should calculate the true-up payments assuming a markup of 10%, pending final determination of the correct markup percentage in A.04-03-013.

14. If the Commission does not modify the markup percentage in A.04-03-013, a further order in that proceeding should direct carriers to pay SBC-CA the remaining true-up balance with a 21% markup.

15. When faced with a remand, the Commission has the discretion to correct a ratemaking error retroactively.

16. The Commission should grant the confidentiality requests related to the individual carriers' true-up debts and SBC-CA's shared and common costs.

## **O R D E R**

### **IT IS ORDERED** that:

1. The stay ordered in Decision 04-09-063 of billing adjustments related to the adoption of permanent unbundled network element (UNE) rates for Pacific Bell Telephone Company d/b/a SBC California (SBC-CA) is lifted and the following carriers shall pay their undisputed true-up obligations within 10 days from the effective date of this order: SBC-CA, AT&T Communications of California, Inc. (AT&T), MCI Inc., Sprint, MPower Communications Corp., Cox Communications Inc., Covad Communications Company, Talk America, XO California, Inc. and Allegiance Telecom of California, Inc. and Z-Tel.

2. All carriers other than those listed in Ordering Paragraph 1 above shall pay their billing adjustments in 12 equal installments, including interest and late payment charges, with the first payment due 30 days from the date of this order.

3. All disputes arising between carriers related to the amount of their billing adjustments shall be handled through the dispute resolution procedures set forth in their applicable interconnection agreements.

4. All billing adjustments shall be calculated assuming a 10% shared and common cost markup, rather than a 21% markup, subject to adjustment upon adoption of a corrected markup percentage in Application 04-03-013.

5. The Assigned Administrative Law Judge (ALJ) shall set an expedited schedule for review of the shared and common cost markup in A.04-03-013.

6. The motions of SBC-CA, PacWest Telecomm, Inc. and AT&T to file information under seal are granted for two years from the date of this ruling.

During that period, the information shall not be made accessible or disclosed to anyone other than the Commission staff except upon execution of an appropriate non-disclosure agreement with SBC-CA, PacWest or AT&T, or on the further order or ruling of the Commission, the Assigned Commissioner, the Assigned ALJ, or the ALJ then designated as Law and Motion Judge.

7. If SBC-CA, PacWest or AT&T believes that further protection of the information filed under seal is needed, they may file a motion stating the justification for further withholding of the information from public inspection, or for such other relief as the Commission rules may then provide. This motion shall be filed no later than one month before the expiration date of today's protective order.

8. Application (A.) 01-02-024, A.02-02-034, and 02-03-002 are closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.