

Decision 02-12-060 December 17, 2002

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)

**ORDER DENYING APPLICATION FOR REHEARING
OF DECISION 02-09-049**

In the fall of 2001, AT&T Communications of California, Inc., MCI WorldCom Network Services, Inc. and MCImetro Access Transmission Services LLC (jointly “Plaintiffs”) filed a suit against us and Pacific Bell Telephone Company in Federal District Court, Northern District California-Oakland, seeking to overturn aspects of D.99-11-050 issued on November 18, 1999 and related Decisions which included both D.98-02-106 relating to one-time non-recurring costs and D.98-12-079 relating to ongoing recurring costs. *AT&T Communications of California Inc. et al., v. Pacific Bell Telephone Company, et al.*, No. COI – 02517 (CW).

Plaintiffs argued that we improperly determined the firm-wide shared and common costs of Pacific Bell (“Pacific”) and unreasonably allocated these costs of Pacific only to unbundled network elements (“UNEs”). In our *Investigation To Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture and Development Of Dominant Carrier Networks* (Rulemaking 93-04-003/Investigation

93-04-002 (the "OANAD proceeding")), we adopted prices for the UNEs that Pacific leases to competitors which use portions of its network. See D.99-11-050 (Cal PUC November 1999). One aspect of the prices adopted in that Order involved a percentage markup of the forward-looking cost of UNEs. In late 1996, the Federal Communications Commission (FCC) issued its "Local Competition Order" which required states to use the TELRIC (a forward-looking cost methodology) to set UNE rates.¹

Applying the TELRIC Methodology, we then adopted a 19 % markup percentage based on a calculation of Pacific's shared and common costs (\$996 million)² divided by the total adjusted TELRIC based direct costs of UNEs (\$4.814 billion plus one time non-recurring costs of \$375 million determined by us in D.98-02-106). See D.99-11-050, mimeo at 72. Thus, each time a UNE is sold by Pacific to a competitor, the price for the UNE includes the 19 percent shared and common costs allocator established in D.99-11-050. Id.

In D.99-11-050, we also made it clear that it would need to address the future status of the prices it was setting by establishing a process for an annual reexamination of the costs. (Id., at 168-169.) We are currently reviewing the costs of several UNEs in our "2001/2002 UNE Reexamination Proceedings", Consolidated in One Proceeding, A.01-02-024.

In response to AT&T's lawsuit, Pacific filed a Cross-Motion alleging that we erred in several respects. In its Cross-Motion, Pacific argued that our decisions resulting from the OANAD Proceeding, supra, were in error, because they (1) rejected Pacific's proposed risk adder, (2) double-counted one time non-recurring costs, (3) failed to set a

¹ Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd 15499 ("Local Competition Order"), modified on reconsideration, 11 FCC Rcd 13042 (1996), vacated in part, *Iowa Utilities Board vs. FCC*, 120 F.3d 753 (8th Cir. 1997), affirmed in part, reversed in part sub nom. *AT&T Corp. vs. Iowa Utilities Board*, 525 U.S. 366 (1999), decision on remand, *Iowa Utilities Board vs. FCC*, 219 F.3d 744 (8th Cir. 2000), affirmed in part, reversed in part sub nom. *Verizon Communications Inc. vs. FCC*, 535 U.S.467 (2000).

² Shared and common costs are defined in Appendix C of D.95-12-016. In that Decision, shared costs are defined as "costs that are attributable to a group of outputs but not specific to anyone within the group, which are avoidable only if all outputs within the group are not provided." Common costs are defined as "costs that are common to all outputs offered by the firm." See Appendix C, at 6.

recurring rate for Operations Support Systems (“OSS”) costs, and (4) erroneously ordered Pacific to provide competitive local exchange carriers (“CLECs”) with combinations of UNEs at cost-based prices.

On August 6, 2002, the U.S. District Court issued its Order in *AT&T v. Pacific Bell* (N.D. Cal., August 6, 2002) denying all of the Plaintiffs’ claims and denying all but one of Pacific’s claims. The Court agreed with Pacific that we had double-counted one-time non-recurring costs of \$375 million (D.98-02-016) when we calculated Pacific’s total adjusted TELRIC-based costs. Specifically, the Court found that we had added the \$375 million of one-time non-recurring costs to the denominator of the common cost markup instead of substituting that amount for the earlier estimated \$583 million of one time nonrecurring costs³ which was still included in Pacific's total adjusted TELRIC-based costs. (See D.99-11-050, mimeo at 72, n.72).

The Court found that Pacific's initial cost studies reflected TELRIC-based UNE costs of \$4.83 billion, and included an estimate of one-time non-recurring costs of \$583 million (as later adjusted by Pacific to \$537.8 million, see footnote 3 below). The Court then found that Pacific's final adjusted TELRIC-based costs totaled \$4.814 billion plus the \$375 million in one-time non-recurring costs (D.98-02-016). Therefore, the final adjusted TELRIC-based costs total \$5.189 billion. However, the Court also found that the \$583 million in one-time non-recurring costs(as later adjusted by Pacific to \$537.8 million, see footnote 3 below) was still included in the final adjusted TELRIC-based costs figure. The Court reached this finding because the Court believed, given the record presented to it, that it was impossible to subtract \$583 million in non-recurring one-time costs (as later adjusted by Pacific to \$537.8 million, see footnote 3 below) from \$4.83 billion to arrive at \$4.814 billion, even considering the other major adjustments made by us to Pacific’s estimated TELRIC-based costs in connection with the OANAD proceedings that led up to D.99-11-050, supra.

³ Pacific in a filing before us on August 28, 2002 noted that the estimated non-recurring costs of \$583 million noted in the Court’s Decision was not correct. The \$583 million number was revised downward to \$537.8 million based on a "labor rate adjustment" of \$45.5 million. See Pacific’s comments, 8/28/02, Addendum, Tab D-5, P.2, line 27 and p. 7, lines 9-11.

Thus, the Court determined that we failed to remove the original \$583 million in one time non-recurring costs (as later adjusted by Pacific to \$537.8 million, see footnote 3) found in the estimated TELRIC-based UNE costs study, while we added the \$375 million in one time non-recurring cost determination found in D.98-02-106 to Pacific's final adjusted TELRIC-based costs figure. As a result, the Court found that we acted in an arbitrary and capricious manner. The Court then ruled that our determination of Pacific's final adjusted TELRIC-based costs for UNEs (the denominator of the common cost markup--\$5.189 billion), as well as all decisions that relied on our mathematical error, must be vacated and remanded, so that the mathematical error could be remedied throughout our Decisions emanating from the OANAD proceeding. (*AT&T v. Pacific Bell*, slip op. at 38.)

On remand, we removed from the denominator of the shared and common costs mark-up, the one-time non-recurring cost figure of \$583 million in one time non-recurring costs (as later adjusted by Pacific to \$537.8 million, see footnote 3 below) that Pacific included in its estimated TELRIC-based costs figure. We then recalculated the shared and common costs allocator from the 19 % markup adopted in D.99-11-050 to a 21 % markup. Next, we found that Pacific was *double-recovering* one-time non-recurring costs since the \$537.8 million in one-time non-recurring costs was included in the estimated TELRIC based costs figure (\$4.83 billion) which were used to develop ongoing recurring costs in D.98-12-079. Based on the same logic that the \$537.8 million in one-time non-recurring costs must be removed from the \$4.814 billion in adjusted TELRIC based costs because of *double counting* of the one-time non-recurring costs, the same one-time non-recurring costs were also included in Pacific's ongoing recurring cost figure established in D.98-12-079. Thus, this decision must be adjusted to remove the *double-recovery*. D.02-09-049 at 22.

On October 11, 2002, Pacific filed an Application for Partial Rehearing of D.02-09-049. Pacific raised four issues. First, Pacific complained that we did not use Pacific's estimated TELRIC-based number (\$4.83 billion) in the setting of ongoing recurring costs in D.98-12-079. Second, Pacific asserted that our decision conflicts with

our own precedent and is contrary to the evidence in the record. Third, Pacific claimed that our decision exceeds the scope of the District Court's Remand Order.

Finally, Pacific complained that was decision conflicts with our rules regarding waiver and finality. AT&T and WorldCom filed a reply to Pacific's Application for Partial Rehearing.

Pacific's major assertion in its Application for Partial Rehearing is that the total estimated TELRIC number generated by Pacific at the early stages of the OANAD proceeding (\$4.83 billion) was not used in setting the ongoing recurring costs in D.98-12-079. This assertion is puzzling. Pacific's total estimated TELRIC-based costs figure of \$4.83 billion is the same number to which we made up-and-down adjustments throughout the OANAD proceeding, supra, to arrive at the final adjusted TELRIC figure of \$5.189 billion. Then, this final number, together with the \$375 million in one time non-recurring costs adopted in D.98-12-079, was the denominator used to set a percentage markup, which Pacific could charge other telephone companies for using portions of Pacific's network. D.99-11-050, mimeo at 72.

Further, Pacific has offered no new or credible evidence to show that its own estimated TELRIC-based figure (\$4.83 billion) was not the basis for its calculations in the setting of ongoing recurring costs in D.98-12-079. In fact, if Pacific had used other numbers as they now claim they did, they would be in violation of the methodology set forth by us in the OANAD proceeding, supra. This methodology was utilized to derive the final adjusted TELRIC-based number that was used as the denominator to set the percentage allocator that competitors pay Pacific for use of their equipment. See OANAD proceeding, supra. Moreover, if we were to accept Pacific's claim, it could be construed as an admission by Pacific that the adopted 21% percentage allocator has no legitimate basis and must be recalculated based on the current TELRIC cost figures set forth by Pacific in recent proceedings. See "*2001/2002 UNE Reexamination Proceedings*", consolidated in one proceeding A.01-02-024.

Finally, Pacific, having raised the alleged error regarding double-counting in Federal District Court and having won the point in that forum, cannot now tell us not to

follow the Federal District Court's Order, which requires us to correct all Decisions that were impacted by this error. See Order And Judgment in *AT&T Communications of California, Inc. v. Pacific Bell Telephone Corporation, supra*. In its Order, the Federal District Court found "[the] CPUC's calculation of Pacific's total direct costs of UNEs is vacated and remanded to correct the double-counting of non-recurring costs.

The relevant CPUC decisions that depend upon the incorrect calculation of Pacific's total correct cost of UNEs are vacated and remanded as noted above." *AT&T vs. Pacific Bell*, Slip op., at 43.

This very clear language from the Federal District Court Order mandates that we look beyond the initial concern raised by Pacific. The Court plainly wants this error corrected in all of our Decisions that emanated from the OANAD proceeding, supra, and that consequently used the estimated TELRIC-based costs figure as a basis for those Decisions. See D.98-12-079. Since the decision at issue here relied upon a cost component vacated by the District Court, this decision also must be corrected or be vacated by operation of law.

Pacific's complaint that AT&T and WorldCom did not raise this issue regarding double recovery prior to the Federal District Court case is irrelevant, given the Court's mandate to us correct all of our Decisions where this error exists. If we failed to correct the error at issue in this case, it would be in violation of the Federal District Court's Order.

Our Decision in this case is properly based on record evidence and applicable law. Pacific's claims of legal error are without merit. Therefore, Pacific's Application for Partial Rehearing is denied.

THEREFORE, IT IS ORDERED that:

1. The rehearing of D. 02-09-049 is denied.

This Order is effective today.

Dated December 17, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

I dissent.

/s/ MICHAEL R. PEEVEY