

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

Application by Pacific Bell Telephone Company  
d/b/a SBC California (U 1001 C) for Arbitration  
of an Interconnection Agreement with MCImetro  
Access Transmission Services LLC (U 5253 C)  
Pursuant to Section 252(b) of the  
Telecommunications Act of 1996.

Application 05-05-027  
(Filed May 20, 2005)

**ADMINISTRATIVE LAW JUDGE'S RULING  
GRANTING SBC CALIFORNIA'S MOTION TO STRIKE**

**I. Background**

On May 20, 2005 Pacific Bell Telephone Company d/b/a SBC California (SBC) filed an application for arbitration of an interconnection agreement with MCImetro Access Transmission Services LLC (MCI) pursuant to Section 252(b) of the Telecommunications Act of 1996. MCI filed its timely response on June 20, 2005. In its response, MCI provided its position on the issues raised by SBC but also included an additional issue of its own-- "Additional Pricing Schedule Issue 51" (Pricing Issue 51).

MCI describes Pricing Issue 51 as follows: "What is the proper, TELRIC [Total Element Long Run Incremental Cost] compliant overhead factor that should be applied to the direct cost of UNEs [Unbundled Network Elements] to ensure that SBC-CA recovers its efficiently-incurred forward-looking overhead costs?"

## **II. SBC's Motion to Strike**

On June 30, 2005 SBC filed a motion to strike MCI's Additional Pricing Schedule Issue No. 51. SBC gives three reasons in support of its motion to strike: (1) The Commission established its UNE rates in generic proceedings, not in individual arbitrations, 2) The Commission has already rejected MCI's reexamination petition on the merits, and 3) MCI never attempted to negotiate the shared and common markup in this arbitration.

### **A. UNE Rates Adopted in Generic Proceedings**

SBC cites the process the Commission used in a generic proceeding<sup>1</sup> to develop the shared and common cost (S&C) markup. This S&C markup accounts for the costs of providing UNEs that are not attributable to any particular UNE itself, *i.e.* general overhead costs. According to SBC many competing carriers - including MCI - presented testimony and legal argument on the S&C markup. The Commission considered the voluminous evidence at length and concluded that the S&C markup should be set at 19%. The Commission's methodology was to divide "the total of shared and common costs for all UNEs...by the total of direct TELRIC costs for all UNEs approved in Decision (D.) 98-02-106 and related compliance filings."

Both SBC and MCI appealed the S&C markup established in D.99-11-050. The federal district court rejected MCI's challenge but agreed with SBC that the 19% was too low and remanded to the Commission for recalculation.<sup>2</sup> As a result, on remand the Commission raised the S&C markup to 21%.

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<sup>1</sup> The Open Access and Network Architecture Development (OANAD) proceeding.

<sup>2</sup> *See AT&T Communications of Cal. v. Pacific Bell Tel. Co.*, 228 F. Supp. 2d 1086, 1101-05 (N.D. Cal. 2002), *aff'd in part and rev'd in part*, 375 F.3d 894 (9<sup>th</sup> Cir. 2004).

In the meantime, MCI appealed the district court's rejection of its challenge to the inclusion of retail costs in the numerator, and the Ninth Circuit sided with MCI and remanded.<sup>3</sup> In response to the Ninth Circuit's remand, the Commission lowered the S&C markup back to 19%. At the same time, the Commission noted that in 2004, MCI (jointly with AT&T) filed a petition for reexamination of the S&C markup. The Commission indicated that it would address consider the merits of MCI's pending petition to reexamine the S&C markup in a separate order.<sup>4</sup>

**B. The Commission has already rejected MCI's reexamination petition on the merits**

The Commission rejected MCI's request to reexamine the S&C markup in D.05-06-008, on June 16, 2005. MCI had first argued that mergers since 1994 had purportedly reduced SBC's overhead costs. Second, MCI contended that this assumption was supported by financial information known as "ARMIS data" that SBC reports to the Federal Communications Commission. Third, MCI claimed that, because the Commission had reviewed direct UNE costs in its 2001/2002 Reexamination, and those costs comprise the denominator of the S&C markup calculation, the Commission must now review the numerator of the markup equation to ensure both components are current.

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<sup>3</sup> See *AT&T*, 375 F.3d at 905-07.

<sup>4</sup> Opinion Establishing Revised Unbundled Network Elements Rates for Pacific Bell Telephone Company DBA SBC California, *Joint Application of AT&T Communications of California, Inc. (U 5002 C) and World Com, Inc. for the Commission to Reexamine Shared and Common Costs and Non-Dedicated Transport in its Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of Decision 99-11-050*, A.01-02-024, D.04-09-063 at 246 (Sept. 23, 2004) ("UNE Relook Order").

SBC cites from the Commission’s decision where the Commission found “that the preliminary evidence provided by Joint Applicants [MCI and AT&T] does not even attempt to show how projections of merger savings and analyses using limited categories of ARMIS data translate into actual declines in shared and common costs.”<sup>5</sup> According to SBC, the major flaw was that MCI’s data focused only on the change in the shared and common costs comprising the numerator and utterly ignored any changes in the direct UNE costs comprising the denominator. The Commission explains:

Joint Applicants merely allege the numerator in the markup calculation has decreased, without showing the relationship between the numerator and denominator. For the markup to be lower, shared and common costs would have to go down more than UNE cost declines. If both have declined by the same amount, the markup percentage would remain unchanged at 19%. Joint Applicants have not attempted to recalculate the markup factor to show that the markup is lower than 19%, nor have they offered any recommendation how the Commission would recalculate the numerator and denominator of the markup given that we have reexamined only some UNE costs, but not all of them.<sup>6</sup>

Moreover, SBC cites various sections of the Commission’s decision to show that the Commission found the analysis that MCI did provide - which was meant to show that the shared and common costs in the numerator had declined substantially - was deeply flawed in five specific ways.

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<sup>5</sup> See D.05-06-008 at 4-5.

<sup>6</sup> *Id* at 5.

First, MCI failed to explain how “ARMIS data for corporate operations and network operations expenses equate to the shared and common costs projected in the Commission’s TELRIC inquiry in the prior OANAD.”<sup>7</sup> Indeed, in D.99-11-050 the Commission had rejected any reliance on ARMIS data because, due to differences in the methods of collection and categorization of ARMIS costs and TELRIC costs, merely plugging ARMIS data into a TELRIC study substantially understates the shared and common cost markup. As the Commission there explained:

We agree with [SBC-CA witness] Mr. Scholl that ARMIS overhead costs cannot be compared easily with shared and common costs determined under the TELRIC methodology: Many of the costs which are shared and common costs in Pacific Bell’s TELRIC analysis are not ‘overhead’ costs in the ARMIS reports, but rather are included in other categories. By basing his recommendation on ARMIS data, Dr. Reardon is both understating his numerator (shared and common costs) and overstating his denominator (TELRICs), resulting in a significantly understated shared and common cost factor.<sup>8</sup>

Second, the Commission found that MCI selectively used only “limited categories of corporate operations expenses and not total expenses” in calculating SBC’s asserted overhead reductions.<sup>9</sup> Thus, even assuming ARMIS data were reliable for calculating shared and common costs, MCI’s analysis failed to use those data properly.

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<sup>7</sup> *Id.*

<sup>8</sup> D.99-11-050 at 69-70.

<sup>9</sup> D.05-06-008 at 5.

Third, the Commission found that MCI's analysis, which focused exclusively on 2002 data, had selectively excluded "more recent 2003 data."<sup>10</sup> As SBC showed, using data from 2003 in MCI's own ARMIS analysis showed "a 15% increase in overhead costs rather than a decrease" - which, all else being equal, would have justified a higher S&C markup, not a lower one."<sup>11</sup>

Fourth, the Commission noted that MCI's method assumed an S&C markup of 9.04% in 1994, which was completely at odds with the Commission's own finding of a 19% S&C markup in D.99-11-050. In the Commission's view, "[t]his alone shows that the proxy method Joint Applicants use to calculate the markup differs drastically from the method used by the Commission in the prior OANAD proceeding, and Joint Applicants offer no explanation to bridge this gap."<sup>12</sup>

Fifth, the commission found that MCI had not shown that any cost savings from mergers "accrue solely to overhead or to California operations, or impact the relationship of overhead costs and total UNE costs."<sup>13</sup>

**C. MCI Never Attempted to Negotiate the Shared and Common Issue in this Arbitration**

SBC states that, at the same time MCI was pressing its reexamination petition before the Commission, it was negotiating a successor interconnection agreement with SBC. It was SBC's understanding that the new agreement, like

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<sup>10</sup> *Id.*

<sup>11</sup> *Id* at 4.

<sup>12</sup> *Id* at 6.

<sup>13</sup> *Id.*

the prior agreement, would incorporate the Commission's UNE rates established in its generic proceedings. SBC asserts that MCI never once attempted to negotiate the S&C markup. In fact, the pricing schedules exchanged by the parties in negotiations contained the rates approved by the Commission.

SBC states that SBC did not list the S&C markup as a disputed issue when it filed its application for arbitration. However, MCI's responsive filing on June 20, 2005--filed just two business days after the Commission rejected MCI's petition to reexamine the S&C markup - seeks to re-litigate the same issue here under "Additional Pricing Schedule Issue 51."

### **III. MCI's Opposition to SBC's Motion to Strike**

On July 12, 2005 MCI filed in opposition to SBC's motion to strike. MCI stresses that it has used every opportunity on appeal from D.99-11-050 and during the annual reviews since 2001 to raise before the Commission the issue of the need to reexamine and revise the common cost markup. Most recently, in its application filed February 2004 in the *2004 UNE Reexamination* MCI again sought such review.

On June 16, 2004, four days prior to the due date for MCI's Response in this arbitration and twenty-one days after the close of the statutory period for negotiations in this arbitration, the Commission issued D.05-06-008, denying review of the shared and common cost markup in the *2004 UNE Reexamination*. According to MCI, the Commission denied review despite representing at least three times in D.05-03-026, issued on March 17, 2005, in the true-up phase of the consolidated *2001-2002 UNE Reexamination*, that it would address prospective revisions of the markup in the *2004 UNE Reexamination*.

MCI rebuts SBC's first argument stating there is no Commission decision in a generic proceeding that finally determines nor pending generic proceeding to consider the issue MCI presents here. MCI states that it diligently sought to have the Commission review and revise the current common cost markup based on new evidence in the generic *2004 UNE Reexamination*, but the Commission denied its request. MCI states that the undeniable fact is that over the past six years the Commission has repeatedly refused to reexamine and update using current information the common cost factor established in D.99-11-050 based on now ten-year-old cost studies and a corporate structure that predates the merger of Pacific Telesis with SBC and the merger of SBC with Ameritech. MCI asserts that while it is perhaps true that the Commission may choose to address the common cost mark-up in a generic proceeding rather than in an individual § 252 arbitration, MCI respectfully submits that the Commission may not refuse both and thus completely avoid its obligation under the Act to ensure that the prices for UNEs comply with the law.

With regard to SBC's second issue, MCI rebuts SBC's claim that the issue of the mark-up was determined on the merits by the Commission in D.05-06-008.<sup>14</sup> According to MCI, D.05-06-008 did not determine the issue on the merits. Instead, in D.05-06-008, the Commission refused to review the issue on the merits based on the preliminary evidence produced in February of 2004 which the Commission found did not meet its procedural threshold of a *prima facie* case that the Commission concluded must be met to warrant a review on the merits in an annual UNE reexamination proceeding.

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<sup>14</sup> Motion at 6.

MCI says that the issue presented by MCI in this arbitration is different from the issue decided by the Commission in the *2004 UNE Reexamination*. In the *2004 UNE Reexamination*, the Commission was applying its threshold *prima facie* case burden of proof on the applicant MCI based on facts presented in February 2004 (before the Commission-approved D.04-09-063 costs were available) and in D.05-06-008 denied MCI's request that the Commission review the prospective common cost markup on the merits and never received or considered the new evidence MCI presents here using D.04-09-063 costs. According to MCI, there was no opportunity to present this evidence in the *2004 UNE Reexamination*, since the application in that proceeding was required to be filed before D.04-09-063 was issued and because the Commission declined to examine this new evidence and denied review of the common cost markup.

In responding to SBC's third issue, MCI asserts there was no reason or opportunity address the issue MCI presents in this arbitration during the underlying negotiations, since at all times during the negotiation the question of whether or not the common cost markup would be reviewed in the *2004 UNE Reexamination* was pending before the Commission in that proceeding. MCI states that the parties were diametrically opposed on that issue in that proceeding, and MCI reasonably believed that review of the common cost markup would occur in that proceeding.

#### **IV. Discussion**

The first issue SBC raised relates to the Commission's policy that UNE rates should be adopted in generic proceedings. The Commission has asserted various times that it intends to address UNE pricing in generic proceedings that are open to all carriers. Resolution ALJ-181 states that rates adopted in the

OANAD docket will be incorporated into individual interconnection agreements.

The Commission policy reads as follows:

Therefore, we order that all agreements arrived at by arbitration include the provision that all arbitrated rates for unbundled elements will be subject to change in order to mirror the rates adopted in OANAD.<sup>15</sup>

The Commission made this determination because it wanted to adopt UNE rates that would apply to *all* carriers, and wanted *all* carriers to have an opportunity to participate in the proceeding to establish those rates. Such is not the case in a two-party arbitration, which under the rules established in Resolution ALJ-181, does not allow the participation of other interested parties.

This is especially true of the shared and common cost mark-up, that affects the price of every UNE. While MCI is correct that the Commission has adopted individual UNE rates in arbitrations, that was done only where no rate for a particular UNE had been adopted in a generic proceeding. The Commission has stated its preference for dealing with UNE pricing issues in the context of generic proceedings, rather than individual arbitrations, and I will honor the Commission's policy.

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<sup>15</sup> Resolution ALJ-181, October 5, 2000, at 3.

With regard to SBC's second issue, MCI asserts that its request, in the context of the *2004 UNE Reexamination*, to reexamine the shared and common cost markup was not resolved on the merits. I disagree. The Commission's discussion in D.05-06-008 shows that the Commission analyzed MCI's preliminary showing and found it to be flawed:

Although direct UNE costs have declined based on the new UNE rates adopted in D.04-09-063, applicants have not successfully presented a *prima facie* case that overhead costs have declined more than the decline in direct UNE costs. As SBC points out, the applicants did not provide any attempted recalculation of the markup, either with the initial OANAD methodology, or a new one. The ARMIS analysis they did present had been examined and discredited by the Commission in D.99-11-050 and is not a sufficient basis on which to open a reexamination.<sup>16</sup>

The Commission lists several other flaws with the data the Joint Applicants presented, including the fact that it is unclear how historical ARMIS data for corporate operations and network operations expenses equate to the shared and common costs projected in the Commission's TELRIC inquiry in the prior OANAD.

MCI's request to reexamine the S&C was denied, based on "preliminary evidence...which the Commission found did not meet its procedural threshold of a *prima facie* case." As SBC states, it is black-letter law that a failure to produce sufficient evidence to make out a *prima facie* case is a loss on the merits, and is no different from a court's entry of summary judgment for failure to produce evidence creating a triable issue of fact.<sup>17</sup> The Commission carefully considered

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<sup>16</sup> D.05-06-008, *mimeo.* at 10.

<sup>17</sup> *See, e.g., Jackson v. Hayakawa*, 605 F.2d 1121, 1125 & n.3 (9<sup>th</sup> Cir. 1979).

all the evidence submitted by MCI and rejected it as unpersuasive and insufficient to require a hearing.

While MCI insists that it has “new information” on the basis of D.04-09-063, the description of Additional Pricing Schedule Issue 51 shows that it is based on ARMIS data:

The proper overhead factor should be calculated by dividing SBC’s ARMIS-reported corporate operations expense, by total revenues less corporate operations expense.<sup>18</sup>

In D.05-06-008, the Joint Applicants were given several reasons for the Commission’s denial of their request for reexamination of the shared and common cost markup, based on flaws to the methodology presented. Joint Applicants were invited to submit a new application at the next appropriate opportunity for reexamination, which, according to D.04-09-063, is no earlier than February 2007. Therefore, MCI has an avenue to revisit this issue in the future.

The third issue raised by SBC relates to MCI’s failure to negotiate the S&C issue as part of this arbitration. MCI attempted to include the reexamination of the shared and common cost markup in this arbitration at the 11<sup>th</sup> hour, after D.05-06-008 was issued. MCI did this even though both SBC and MCI state that the parties did not negotiate that issue in the context of negotiating their new interconnection agreement. Both parties agree that all litigation on the shared and common issue occurred in the context of the *2004 UNE Reexamination* proceeding. The filing of a response to an application for arbitration is not the

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<sup>18</sup> Response of MCImetro to Application by Pacific Bell Telephone Company d/b/a SBC California for Arbitration of an Interconnection Agreement with MCImetro Access Transmission Services LLC Pursuant to Section 252(b) of the Telecommunications Act of 1996, June 2005, at 163.



**CERTIFICATE OF SERVICE**

I certify that I have by mail, and by electronic mail to the parties to which an electronic mail address has been provided, this day served a true copy of the original attached Administrative Law Judge's Ruling Granting SBC California's Motion to Strike on all parties of record in this proceeding or their attorneys of record.

Dated August 18, 2005, at San Francisco, California.

/s/ JANET V. ALVIAR

Janet V. Alviar

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