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Decision 05-06-008 June 16, 2005

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of AT&T Communications of California, Inc. and WorldCom, 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.	Application 04-03-013 (Filed March 12, 2004)

OPINION DENYING REQUEST TO REEXAMINE SHARED AND COMMON COSTS AND SHARED TRANSPORT

In Decision (D.) 99-11-050, the Commission set unbundled network element (UNE) rates for Pacific Bell Telephone Company (Pacific, d/b/a SBC California (SBC)). In that same decision, the Commission established a procedure by which Pacific, or carriers with which Pacific has entered into interconnection agreements, could annually nominate UNEs for reexamination of the adopted rate. (*See* D.99-11-050, *mimeo.* at 271, 272.) When nominating UNEs for review, carriers are required to set forth a summary of the evidence alleged to show that UNE costs have declined by at least 20% from the costs approved in D.98-02-106. (*Id.*)

In this application, AT&T Communications of California, Inc. (AT&T) and WorldCom, Inc. (now MCI) (collectively "Joint Applicants") request reexamination of SBC's shared and common costs and shared transport rates.

Shared and Common Costs

The shared and common cost markup, which allows SBC to recover overhead costs as part of its UNE rates, is currently set at 19%.[1] Thus, each of SBC's UNE rates set by the Commission includes a 19% adder. The markup is calculated by dividing an estimate of SBC's total shared and common costs (the numerator) by an estimate of total direct UNE costs (the denominator).[2] Joint Applicants contend that the current markup is inflated and quite outdated since it is based on 1994 vintage data. They maintain that a number of factors indicate it is virtually certain that SBC's shared and common costs have decreased by 20% or more since the markup was adopted in D.99-11-050.[3]

First, Joint Applicants contend that corporate mergers since 1994 have undoubtedly decreased SBC's overhead costs. According to Joint Applicants, SBC justified its 1997 merger with Pacific Telesis and its 1999 merger with Ameritech based on claims of substantial overhead cost savings. (A.04-03-013, p. 7.) In addition, SBC California has reduced its workforce 19.7% from 1994 to 2002. (Declaration of Thomas L. Brand and Arthur Menko, 2/27/04, p. 11.)

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[1] The markup was set at 19% in D.99-11-050, and later increased to 21% in D.02-09-049. At the time this application was filed, the markup was 21%. In D.05-03-026, the markup was reduced to 19%.

[2] The markup is calculated as follows:

$$\frac{\text{\$901 Million (shared and common costs)}}{\text{\$4.651 Billion (total direct UNE costs)}} = 19.4\%\text{, rounded to 19\%}$$

(*See* D.05-03-026, p. 19, footnote 10.)

[3] In D.02-08-073, the Commission removed the restriction, originally set forth in Ordering Paragraph 12 of D.99-11-050, that the annual cost reexamination proceedings would not consider claims that the markup should be changed.

Second, Joint Applicants claim that projected overhead reductions are confirmed by an examination of SBC's publicly-available ARMIS[4] data relating to corporate operations and network operations expenses, which Joint Applicants allege are the two largest components of the markup. Joint Applicants compare corporate operations expenses to total revenues less corporate operations expense, total access lines, and switched access lines. Joint Applicants also compare network operations expenses to Total Telephone Plant in Service, total access lines, and switched access lines. Joint Applicants claim these analyses show that corporate operations expenses have declined between 20.1% and 45.5% from 1994 to 2002 and network operations expenses have declined between 33.7% and 54.8% over the same time period. (See Brand/Menko Declaration, pps. 11-19.)

Finally, Joint Applicants contend that because the Commission has reexamined SBC's UNE costs in A.01-02-024 and consolidated cases (also known as the "2001/2002 Reexamination"), and UNE costs comprise the denominator of the markup calculation, the Commission must now review the numerator of the markup equation to ensure both components of the markup are current.

SBC opposes Joint Applicants' request to review the shared and common cost markup for several reasons. First, SBC states that Joint Applicants have not offered any calculations to show the effect of the alleged declines in overhead costs on the markup calculation. According to SBC, Joint Applicants take forecasts of merger savings out of context and incorrectly overestimate the extent

[4] ARMIS refers to the FCC's "Automated Reporting Management Information System" that was initiated in 1987 for collecting financial and operational data from the largest carriers and is described further at http://www.fcc.gov/wcb/armis.

to which merger savings relate to overhead and benefit SBC's California operations. In contrast, SBC maintains that merger cost savings have been spread across all SBC corporate entities and affiliates, and affect both direct UNE costs and shared and common costs. Thus, SBC does not agree that merger savings automatically translate into a decline in the shared and common cost markup.

Second, SBC contends that Joint Applicants' analysis using ARMIS data is flawed. The Commission itself noted the difficulty in using ARMIS data to estimate shared and common costs because ARMIS data cannot easily be compared to forward-looking cost estimates in a TELRIC analysis. As a result, ARMIS data can understate shared and common costs. (SBC Protest, 4/15/04, p. 5, citing D.99-11-050 pp. 69-70.) Moreover, SBC contends Joint Applicants' ARMIS analysis is not based on *total* corporate expenses or *total* network operations expenses. When these are reviewed instead, shared and common costs appear to have increased. (SBC Protest, p. 6.)

Finally, SBC contends that if Joint Applicants' allegedly flawed ARMIS analysis is recalculated using data for 2003 rather than 2002, the results show a 15% increase in overhead costs rather than a decrease. According to SBC, in order for the overall shared and common cost markup to have declined by 20%, the numerator in the calculation, i.e. total shared and common costs, would have needed to decline by more than any declines in the denominator, i.e. total direct UNE costs. Joint Applicants have not presented any evidence to show that overhead declines have been greater than declines in direct UNE costs.

Discussion

We agree with SBC that the preliminary evidence provided by Joint Applicants 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. While Joint Applicants show declines in corporate operations expenses when compared to total revenues less corporate operations expenses, this analysis has several shortcomings.

The primary flaw in Joint Applicants' nomination is that while they argue that historical ARMIS data shows certain overhead expense categories have declined, they have not addressed the question whether total overhead expense reductions have exceeded declines in total direct UNE costs. This is the key factor in proving that the shared and common cost markup factor has declined. As can be seen by the markup equation, the markup is based on the relationship between total shared and common costs and total direct UNE costs. 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.

In addition, we agree with the criticisms of SBC 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. SBC validly criticizes Joint Applicants' analysis for using only limited categories of corporate operations expenses and not total expenses and for not using more recent 2003 data. Joint Applicants' analysis assumes a markup factor of 9.04% in 1994, declining to 6.45% in 2002. However, the Commission found in D.99-11-050 that SBC's markup factor was 19% (and later corrected the markup calculation twice, ultimately returning to the current rate of 19%). This 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.

We agree with SBC that while the merger of Pacific Telesis and SBC in 1997 and the merger of SBC and Ameritech in 1999 have no doubt led to cost savings through workforce reductions and other means, Joint Applicants have not shown that these savings accrue solely to overhead or California operations, or impact the relationship of overhead costs and total UNE costs.

Finally, the Commission most recently reviewed the markup percentage in D.05-03-026, where it addressed a remand of the markup calculation from the Ninth Circuit Court of Appeals. In that order, the Commission corrected its calculation and decreased the markup percentage to 19%. (D.05-03-026, p.17-19.) For these reasons, we decline to conduct a proceeding to review the shared and common cost markup at this time.

Shared Transport

SBC offers interconnecting carriers the ability to purchase dedicated transport and shared transport as UNEs. The Commission reviewed SBC's dedicated transport UNE rates in the 2001/2002 Reexamination. Joint Applicants allege that numerous data points converge to show that SBC's shared transport costs have declined by 20% since they were set in 1999 using 1994 data and should also be reviewed.

While Joint Applicants request to review shared transport was pending, the FCC issued its Triennial Review Remand Order (TRRO)[5] in February 2005, finding that incumbent local exchange carriers (ILECs) such as SBC have no obligation to provide competitive local exchange carriers access to the mass market local switching UNE. (TRRO, at para. 5) The FCC's earlier Triennial Review Order (TRO), issued in August 2003, had stated that "unbundled shared transport is tied exclusively to unbundled local circuit switching." (TRO, at para. 534.) The FCC agreed with ILECs that if they are no longer obligated to provide the switching UNE, they should no longer be obligated to unbundle shared transport. (*Id.*)

Given the FCC's findings in the TRO and TRRO regarding the linkage of shared transport and local circuit switching, and the fact that SBC is no longer obligated to provide the local switching UNE, there is no reason for the Commission to pursue review of SBC's shared transport UNE rates. Parties were invited to comment on this conclusion. In response, SBC and MCI agreed that there was no longer a reason to review shared transport UNE rates. Further, SBC noted that the TRRO provides for limited availability of the shared transport UNE for a limited transition period at rates specified by the FCC. (SBC Comments, 5/6/05, p. 2.) Therefore, Joint Applicants request to review shared transport is denied.

Conclusion

For the reasons set forth above, we deny Joint Applicants' application to review the shared and common cost markup and shared transport rates. Joint

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[5] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* cc Docket No. 01-338, Order on Remand, (rel. Feb. 4, 2005.) (TRRO)

Applicants may, if they choose, submit a new application for review of UNEs at the next appropriate opportunity for reexamination, which, according to D.04-09-063, is no earlier than February 2007.

Motion for Confidentiality

SBC requests that certain information contained in its reply to A.04-03-013 be filed under seal. The information pertains to SBC's cost of providing local and tandem switching, and dedicated transport services. SBC contends that competitors in telecommunications markets should not have access to SBC's business-sensitive cost data. SBC has designated this information as confidential and proprietary, and made the information available to parties under nondisclosure agreements. There were no responses to the motion for confidentiality. The Commission has granted similar requests for confidentiality in the past and will do so here.

Comments on Draft Decision

Pursuant to Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Commission's Rules of Practice and Procedure, the draft decision in this matter was mailed to the parties for comments.

Comments were filed by MCI, TURN, Mpower Communications Corp., Navigator Telecommunications, LLC, Telscape Communications, Inc., and XO Communications Services, Inc. (collectively "Joint Commentors"). Reply comments were filed by SBC.

The Joint Commentors contend the draft decision contains factual and legal errors in denying the request to reexamine the shared and common cost markup. They contend the draft legally errs by imposing a higher burden of proof on the applicants than is required. Based on D.99-11-050, applicants need only present a *prima facie* case that the costs in question have declined by at least 20 percent. Instead, Joint Commentors maintain the draft decision holds applicants to an impossible to meet standard by requiring a "convincing showing." They contend it would be impossible to provide a complete recalculation of the markup in the opening filing. Joint Commentors allege the requirement to show a 20 percent change in costs should no longer be required. They note it is undisputed that direct UNE costs, the denominator of the markup equation, have declined, rendering the 19% markup calculation obsolete. Further, they contend the Commission must review the markup to fulfill the remand order by the Ninth Circuit on the same subject because the Commission's earlier "true-up" decision, D.05-03-026, promises an expeditious review of the markup. Joint Commentors maintain the draft decision factually errs by relying on a markup methodology that is now irrelevant, and by dismissing the applicants' ARMIS data.

In response, SBC defends the draft decision as written. According to SBC, the draft decision does not employ an inappropriate burden of proof but applies the correct standard in finding that the initial evidence provided by applicants was flawed and inadequate. SBC notes that applicants' factual allegations were flawed and that they failed to include any alternate calculations of the shared and common cost markup. SBC agrees that direct UNE costs have declined, but the application is fatally deficient in not providing a reasonable analysis of a revised numerator for the markup calculation. The age of the markup percentage alone does not prove it is wrong, and Joint Commentors' attack on the requirement to show a 20% change in costs is an inappropriate and untimely. SBC further contends that the Commission has adequately responded to the Ninth Circuit remand order through its correction of the markup in D.05-03-026, and that the remand order does not require any further prospective review of the markup calculation. Finally, SBC reiterates its earlier argument that applicants' ARMIS analysis was flawed and an insufficient basis on which to open a reexamination of the markup.

We agree with SBC that the draft has not imposed an improper standard in analyzing applicants' request to reexamine the markup. 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. Joint Commentors largely reargue applicants' initial request for review. Moreover, we agree that D.05-03-026 corrected the error in the markup which the Ninth Circuit had found and that a prospective review is not required. There are no changes to the draft in response to comments.

Assignment of Proceeding

Geoffrey Brown is the Assigned Commissioner and Dorothy Duda is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. D.99-11-050 established a procedure for Pacific or carriers with which Pacific has interconnection agreements to annually nominate UNEs for review of Pacific's adopted UNE rates.

2. The current shared and common cost markup of 19% is calculated by dividing total shared and common costs by total direct UNE costs.

3. For the markup to decline, decreases in shared and common costs must exceed decreases in total direct UNE costs.

4. Joint Applicants estimate overhead expenses using limited categories of corporate operations and network operations expenses from 1994 to 2002.

5. The FCC's Triennial Review Order (TRO) and Triennial Review Remand Order (TRRO) together find that SBC has no obligation to provide competitive local exchange carriers access to the mass market local switching UNE or unbundled shared transport.

Conclusions of Law

1. Joint Applicants have not provided preliminary evidence that shows a decline in the shared and common markup because they have not shown that potential declines in total shared and common costs exceed declines in total direct UNE costs.

2. Joint Applicants' request to review shared transport rates should be denied given that the FCC no longer requires unbundling of mass market switching and shared transport.

3. It is not reasonable to review the shared and common cost markup or shared transport costs at this time.

4. Public disclosure of information in SBC's reply comments would place SBC at an unfair business disadvantage.

5. SBC's request to file information under seal should be granted.

O R D E R

IT IS ORDERED that:

1. Application 04-03-013 is denied.

2. SBC's motion to file information under seal is granted for two years from the date of this order. 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, or on the further order or ruling of the Commission, the Assigned Commissioner, the

Assigned Administrative Law Judge (ALJ), or the ALJ then designated as Law and Motion Judge.

3. If SBC believes that further protection of the information filed under seal is needed, it 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.

4. Application 04-03-013 is closed.

This order is effective today.

Dated June 16, 2005, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
SUSAN P. KENNEDY
DIAN M. GRUENEICH
JOHN A. BOHN
Commissioners