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February 19, 1999

K. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

Re: Contested Cost Proceedings to Establish "Permanent Prices" for Interconnection Services and Unbundled Network Elements
Docket No. 97-01262

Dear David:

Enclosed please find the original plus thirteen (13) copies of MCI WorldCom's Response to BellSouth Telecommunication, Inc.'s Petition for Reconsideration and Clarification in the above-referenced docket. Copies have been served on all parties of record.

Very truly yours,

BOULT, CUMMINGS, CONNERS & BERRY, PLC

Jon Hastings

Jon E. Hastings

JEH/sja
Enclosures

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BEFORE THE TENNESSEE REGULATORY AUTHORITY

In re: Petition to Convene a Contested Case Proceeding to Establish Permanent Prices for Interconnection and Unbundled Network Elements

Docket No. 97-01262

RESPONSE OF MCI WORLDCOM TO BELLSOUTH TELECOMMUNICATION, INC.'S PETITION FOR RECONSIDERATION AND CLARIFICATION

INTRODUCTION

MCI Telecommunications Corporation and WorldCom Technologies Inc. (collectively "MCI WorldCom") hereby file their response to the Petition of BellSouth Telecommunications (BellSouth" or "BST") for Reconsideration or Clarification in this matter. This response specifically addresses each of the items BellSouth wishes the Authority to reconsider. Very generally, MCI WorldCom urges the Tennessee Regulatory Authority (the "Authority") to reject BellSouth's Petition, as it does not raise any new evidence or relevant change in the law.

DISCUSSION

A. Fill Factors and Utilization Factors

BellSouth urges the Authority to reconsider its decision that fill and utilization factors should be reasonable and "should acknowledge future technology, demand, cost and engineering as testified to by Dr. Marvin Kahn for ACSI." BellSouth, however is simply rearguing the points it has already made in this case and apparently remains confused about what the various fill factor-related terms represent. BellSouth correctly notes that the FCC requirement is for fill factors to be based on "a reasonable projection of actual total usage." A fill utilization level based on reasonable projection ensures that the spare capacity placed today to serve future demand is applied to that future level of demand. Yes BellSouth continues its efforts to have existing ratepayers pay for costs that are caused by future subscribers -- a clear violation of the principle of cost causation that BellSouth witnesses claim to apply in their studies.

BellSouth's method of developing fill factors is based on a fundamental mistake of juxtaposing current demand and capacity placed to serve future demand, which would allow it to shift 100% of the cost of carrying spare capacity to its customers and competitors and would give it an incentive to inefficiently overdeploy facilities. Use of the fill factors adopted by the Authority in no way implies, as BellSouth claims, that it has imprudently overbuilt in the past, but would take away the incentive for it to imprudently overbuild in the future at competitor's and customer's expense [*See* Wood rebuttal at 79-90 for a complete discussion].

BellSouth's argument that the fill factors adopted by the Authority assume that there will be practically no spare capacity in BellSouth's forward-looking network is simply false and betrays a lack of understanding of basic economics. BellSouth would retain the ability to use its discretion regarding the amount of spare capacity that it should place today in order to serve future customers. It will have the ability to conduct sound financial analysis in order to determine whether total costs are minimized by placing large amounts of capacity at long intervals, or smaller amounts of capacity at shorter intervals. As BellSouth will (hopefully) soon learn, well managed companies operating in a competitive environment are compelled to perform such analysis before making investment decisions. Application of the fill factors adopted by the Authority will permit BellSouth to make this financial analysis with the same opportunities and consequences that a competitive company would face. In direct contrast, the application of the fill factors proposed by BellSouth would prevent this analysis from being performed in a meaningful way -- the application of BellSouth's fill factors to otherwise sound analysis would lead to the nonsensical solution that BST should deploy unlimited network capacity immediately. In summary, the use of the fill factors adopted by the Authority is clearly necessary to protect both competitors and current retail customers, and is apparently necessary to protect BST from itself [*See* Wood Rebuttal at 87-90].

B. Depreciation

BellSouth urges the Authority to reconsider its decision to use the Tennessee-specific depreciation rates established by the TPSC in 1993 because it alleges that these are not forward-looking, having been set in 1993. Moreover, BST alleges that the Authority, by choosing a depreciation rate other than that proposed by BST, violates T.C.A. §65-6-209(I) by directing to BST what depreciation rates to use. The Authority should reject both arguments.

BST is simply incorrect that depreciation lives adopted by the Authority's predecessor in 1993 cannot now serve as forward looking in the current environment. BST states that it is "difficult to fathom" that the TPSC could have considered the increasingly competitive marketplace when setting these lives. BST's ability to "fathom" such a scenario might be enhanced with an improvement in memory: in the 1993 proceeding in Tennessee and in similar proceedings throughout its region during that time frame, BST was arguing that it faced competition for each retail service that it offered. Given BST's arguments of impending competition on all fronts, it is "difficult to fathom" how the TPSC could have set depreciation lives without considering the impact of such competition.

The fact that BST presented "thousands of pages of data" in support of its proposed depreciation lives clearly does not mean that the Authority cannot reach a decision based on what it considers to be the most reliable information available: the results of in-depth investigations by the TPSC and FCC. In this case, BST's definition of the "weight" of the evidence is misguided; its filing thousands of pages of data in no way imparts to the Authority an obligation to place additional weight to the information or to reach a decision that is identical to BST's proposal.

BellSouth's assertion that the use of the depreciation rates adopted by the Authority will constitute "bad policy" is based on a fundamental misunderstanding of how companies operate in competitive markets. BST's thinly veiled threat that it will seek to impose additional costs on retail customers ignores the fact that if those retail customers truly have competitive alternatives, the market will not support the inflated retail price. As BST will (hopefully) soon be forced to learn, companies operating in competitive markets do not have the same assurance of capital recovery as is enjoyed by a company operating pursuant to rate of return regulation. The depreciation rates adopted by the Authority will permit BST to face the same risks and rewards as its competitors, and if effective retail competition develops, retail customers will be protected from BST's attempts to continue to enjoy the protection of rate of return regulation while enjoying the ability to receive unconstrained profits [*See* Wood Rebuttal at 45-56].

BellSouth's argument that in selecting depreciation rates other than those proposed by BellSouth, the Authority violates Tennessee law is entirely wrong. The depreciation rates selected by the Authority will be used to set UNE prices. Selecting depreciation rates is an integral part of setting UNE prices, and setting UNE prices is clearly something the Authority has the authority to do under the Telecommunications Act of 1996. What the Authority is doing in this portion of its Order is requiring BellSouth to set its UNE prices using specific depreciation lives and net salvage values. The Authority notably is <u>not</u> ordering BellSouth to use this same depreciation lives on net salvage values on it balance sheet. BellSouth can use whatever depreciation lives and net salvage value it wants on its balance sheet and its arguments otherwise are specious.

C. <u>Network Maintenance Expense</u>

BellSouth urges the Authority to reconsider its decision to apply a 7% annual reduction to its plant specific expense. BellSouth's argument that the Authority should not require such adjustments to its plant specific expenses is unsupported by fact and based on misleading assertions. Based on the totality of evidence presented, it is certainly reasonable for the Authority to conclude that BST's plant specific expenses need to be reduced over time in order to approximate the level that would be incurred by a competitive provider.

BellSouth argues that the Authority's adjustments are somehow invalid because it relied in part on the testimony of AT&T witness Art Lerma. In making its argument, BST apparently seeks to draw a bright line distinction between "network operations expenses" and "plant specific expenses." BellSouth's attempt to treat these accounting distinctions as having some "real world" substance is misleading, however. A significant portion of the network operations costs discussed by Mr. Lerma are Account 6531 Power and Account 6535 Engineering. In its cost studies, BST applies both power (through its Miscellaneous Common Equipment and Power Factor) and Engineering (through its Engineered, Furnished, and Installed Factor) to specific categories of plant. It is, to borrow a phrase, "difficult to fathom" how a portion of power or engineering expense would trend downward when booked according to one set of accounts, but not do so when booked into a different set of accounts. The conclusions that BellSouth reaches based on review of the cited portions of Mr. Lerma's testimony are both fallacious and disingenuous and should be rejected by the Authority.

D. Switching Issues

BellSouth urges the Authority to reconsider its decision to require BellSouth to calculate switching costs based upon the output of the marginal mode of the SCIS and to reconsider its decision that the "price of the switched port should include all features with no additional charges."

BellSouth's argument regarding the proper use of the SCIS model in order to produce relevant forward looking costs is based on a mere play on words. After arguing that switching costs should not be based on an economic definition of "marginal" costs (and citing the testimony of a number of witnesses to that effect), BST argues that the SCIS model should not be run in "marginal" mode. As BellSouth fully understands, however, selecting the "marginal" mode when running SCIS does not produce "marginal" costs, as economists use the term. Selecting "marginal" rather than "average" mode when running SCIS merely means that the model will not attempt to arbitrarily allocate the so-called "getting started costs" of the switch to individual units of demand. In reality, selecting the "marginal" option when running SCIS produces the "long run average cost of the elements," as described by Dr. Beard (and cited by BST). The results of the model using this option are consistent with both the methodology explicitly adopted by the Authority and the FCC.

BellSouth's argument that the Authority should not require it to recognize the substantial vendor discounts that it receives when purchasing a switch are also flawed. As described above in the discussion on fill factors, BellSouth retains the ability to make a well-informed decision regarding the sizing of a switch. The financial analysis is that same: BellSouth will need to determine whether total costs are minimized by purchasing additional capacity up front or to place incremental additions over time. The Authority's decision regarding switch vendor discounts is fully consistent with its decision regarding fill factors: BellSouth will be able to perform the required financial analysis and face the same opportunities and consequences that a competitive company would face when deploying switching capacity.

The Authority's decision to include vertical feature costs in the cost of a switch line port is both sound and consistent with decisions in other states in the region, such as Georgia and Florida. The Georgia Commission stated: "The Commission affirms that switch vertical features should not be priced separately as individual elements, but should instead be incorporated within the unbundled switch port elements." Before the Georgia Public Service Commission, *Order*

Establishing Cost-Based Rates, Docket No. 7061-U, p. 41, October 21, 1997. The Florida Commission stated: "The AT&T and MCI interconnection agreements with BellSouth reflect our decision that there shall be no additional charge for use of features, functions and capabilities of the switch." Before the Florida Public Service Commission, Final Order on Arbitration, Order No. PSC-98-0604-FOF-TP, Florida PSC Docket Nos. 960757-TP, 960833-TP and 960846-TP, p. 160, April 29, 1998.

E. Physical Collocation

BellSouth urges the Authority to reconsider its decision to adopt the AT&T/MCI collocation model for calculating physical collocation rates. BellSouth argues that the AT&T/MCI collocation is a "fanciful attempt" to artificially reduce the price of collocation. In reality, the use of the costs produced by the AT&T/MCI model will limit BST's ability to engage in "fanciful attempts" to artificially inflate the prices for collocation. The AT&T/MCI collocation model includes the costs necessary to provide space with the characteristics that are essential to the safety and protection of both BST and CLECs, assuming that BST utilizes its available space efficiently. In direct contrast, the BellSouth costs are based on the construction of "collocation condos" that vastly exceed the requirements of either BST or CLECs. In addition, the BellSouth methodology encourages BST to inefficiently utilize the space available within its central offices.

BellSouth's argument that the AT&T/MCI collocation model should not be used because it "is based upon a hypothetical space that does not reflect the specific space, design, or layout of any BellSouth central office in Tennessee" is irrelevant in the context of the calculation of forward looking costs. Perhaps BST has forgotten that its much-touted TELRIC Calculator produces loop costs that are a statewide average, and which represent a hypothetical loop that does not represent the specific location, design, or layout of any BellSouth local loop in Tennessee. If BST is correct that basing prices on the results of the AT&T/MCI collocation model is "contrary to clear congressional intent," it must likewise concede that its TELRIC Calculator is likewise unfit for use.

F. Operational Support System Costs

BellSouth urges the Authority to reconsider its decision that OSS costs should be recovered from all carriers through a recurring rate. BellSouth finds fault with the Authority's conclusion that "all carrier's customers, both ILEC and CLEC, receive the benefit of Operational Support Systems and should bear a portion of those costs," stating that "it is difficult to see how BellSouth's retail customers 'benefit' from" these systems. BellSouth's difficulty in seeing this customer benefit is the result of the monopoly blinders that it apparently still wears. BellSouth's characterization of Tennessee end users as "BellSouth's retail customers" betrays such a view and is the apparent source of BST's "difficulty" to see the world as it will exist in a competitive environment.

Once Tennessee consumers are freed from the shackles of a monopoly provider of local telephone service, they will have the opportunity to receive services from other carriers. These alternatives will likely represent a better value for the consumer, either because they represent the same service at a reduced cost or additional services for a comparable cost. Effective OSS systems will directly benefit those customers who choose to receive service from a provider other than BST. In addition, because effective OSS systems will make it possible for customers to escape the existing monopoly, even those customers who continue to receive service from BST will benefit because BST will have to offer better value in order to compete. In this way, even "BellSouth's retail customers" will benefit from the OSS cost recovery adopted by the Authority, because the existence of a competitive marketplace will inspire BST to make efforts to retain them. Over the longer term (which BST apparently has not been able to discern to date), the existing base of customers will be spread among multiple providers. In order to win new customers that are being served by CLECs, BST will need the same OSS systems that CLECs need today. These new "BellSouth retail customers" will directly benefit from these systems.

G. Nonrecurring Prices

BellSouth urges the Authority to clarify its decision on work activities included in developing nonrecurring prices, despite the fact that the Authority's Order regarding nonrecurring prices is already perfectly clear. As BellSouth recognized in its Petition, the Order states:

> the Authority finds that all work activities associated with fallout should be based upon a 7% fallout rate. Also BST should modify its nonrecurring cost model to reflect only three (3) minutes of work activity per order at the Local Customer Service Center when an order falls out. (p. 33)

First, the word "all" is very clear. Second, the words "modify its nonrecurring cost model to reflect only three (3) minutes of work activity per order at the Local Customer Service C Center when an order falls out" are also very clear.

BellSouth states in its Petition that its proposed nonrecurring cost model assumed an average 3 minutes of work activity at the LCSC when an order falls out and that "this calculation was derived based on the assumption that its takes 15 minutes to resolve a fallout situation which is likely to occur 20% of the time." The Authority has ordered BellSouth to change this calculation so that their nonrecurring cost model is based on the assumption that it takes 3 minutes to resolve a fallout situation which is likely to occur 7% of the time. BellSouth seems to be concerned that this new calculation will change the "average" work time per order that is input into its cost model to be "slightly more than 1 minute." BellSouth is not only confused or feigning confusion, it is having problems with its math. 3 minutes = 180 seconds multiplied by 7% = 12.6 seconds or .21 minutes. Therefore, .21 minutes is the correct "average" work time to be entered into its cost model. This is appropriate because 93% of orders are to be worked electronically and as such 93% of orders have zero (0) manual work time. The Authority's Order is clear already and the Authority's findings are appropriate and no clarification in this regard is warranted.

H. Disconnect Costs

BellSouth argues that it should recover disconnect costs at the time of the installation because "this practice has been followed for years." Applying this logic, it is clear that the Authority must also regulate BST's earnings through rate of return regulation. In this argument, BellSouth is failing to consider that, absent a compelling reason otherwise, cost causation dictates that these costs be recovered when incurred. BellSouth has offered no justification -- either in its original case or in this Petition -- other than the traditional practice followed with retail customers.

BellSouth's arguments related to "soft dial tone" assume that it is unlikely that the "physical facilities necessary to provide basic exchange service are already connected between the customer's premises and the BellSouth central office." The recent decision by the Supreme Court makes it clear that such a connection may indeed exist. The Authority's requirement that these costs be removed will be applicable in many situations and should be applied.

I. Integrated Digital Loop Carrier

BellSouth urges the Authority to reconsider its decision regarding IDLC. BellSouth's arguments throughout this proceeding have been based on its interpretation of the Eighth Circuit's ruling vacating certain FCC rules. The Authority's solution to this issue in that environment was consistent with the objectives of the 1996 Act and with sound public policy. MCI WorldCom believes that, in light of the recent Supreme Court decision, the Authority may now directly order BellSouth to provide IDLC facilities in conjunction with the switch. As requested in its own Petition for Reconsideration, MCI WorldCom would continue to suggest that the Authority request comments from all interested parties regarding the impact of the recent Supreme Court decision on this Interim Order.

CONCLUSION

For the foregoing reasons, the Authority should deny BellSouth's Petition for Reconsideration and Clarification.

Respectfully submitted,

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