BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Determination of Prices, Terms, and Conditions of Certain Unbundled Network Elements: Consideration Upon Remand From the United States District Court.	))))	Case No. TO-2005-0037

SBC MISSOURI'S REPLY CONCERNING PROPOSED PROCEDURAL SCHEDULES

SBC Missouri,[1] opposes the procedural schedules filed by Staff[2] and the CLECs[3] and respectfully requests the Missouri Public Service Commission ("Commission") to adopt the traditional briefing schedule SBC Missouri proposed.

Executive Summary

Staff correctly recognizes that the Commission in this remand is (1) limited to reconsidering only the capital structure element of the cost of capital factor; and (2) must base its reconsideration on cost evidence previously presented to the Commission in the case.[4] Despite these concessions, Staff recommends that another hearing be held. SBC Missouri, however, disagrees that another hearing is either lawful or appropriate. The remand from the United States District Court does not contemplate any additional evidentiary hearings and there is ample evidence in the record from the Commission proceedings below of the appropriate market-based capital structure. This evidence was presented both by SBC Missouri and the CLECs. In its deliberations on reconsideration, the Commission need only apply the proper legal standard to the record evidence.

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[1] Southwestern Bell Telephone, L.P., d/b/a SBC Missouri, will be referred to in this pleading as "SBC Missouri."

[2] Staff of the Missouri Public Service Commission will be referred to in this pleading as "Staff."

[3] NuVox Communications of Missouri, Inc.; XO Missouri, Inc.; Allegiance Telecom of Missouri, Inc.; MCI WorldCom Communications, Inc.; MCImetro Access Transmission Services LLC; AT&T Communications of the Southwest, Inc.; TCG St. Louis; and TCG Kansas City will be referred to in this pleading as "CLECs."

[4] Staff's Motion to Establish Procedural Schedule, filed September 3, 2004 in Case No. TO-2005-0037, at pp. 2-3.

The CLECs, most likely because they wish to free themselves of the market-based capital structure evidence they previously presented to the Commission below, entreat the Commission to completely disregard the United States District Court's mandate both in the scope of the remand proceeding and in the evidence the Commission can consider. The Commission should reject the CLECs' proposal out-of-hand.

Argument

1. Further Hearings are Contrary to the Remand Order and Inappropriate.

In its Motion to Establish Procedural Schedule, Staff proposes the submission of three rounds of testimony (Direct, Rebuttal, and Surrebuttal) and an evidentiary hearing. Staff, however, would limit the proceeding to the capital structure issue and to "the cost information that was the subject of evidence presented in that case."[5] The CLECs also propose three rounds of additional testimony and a hearing.[6]

SBC Missouri opposes these suggestions. Although making the proposal for additional rounds of testimony and a hearing, Staff fails to articulate any basis for such further proceedings. Moreover, Staff's recommendation is directly at odds with its concession that the Commission must act on remand based on the evidence previously submitted. And as outlined specifically below in this Reply, the CLECs' basis for making such a proposal is completely unfounded.

Here, the District Court's mandate does not contemplate any additional hearings. Instead, the Commission is directed to render its decision based on the appropriate legal standard. The record evidence, which was presented during the prior Commission proceeding below, appropriately focused on the correct market-based capital structure.

[5] Staff's Motion to Establish Procedural Schedule, p. 3.

[6] CLECs' Proposed Procedural Schedule and Supporting Suggestions, p. 10.

In addition to the evidence presented by SBC Missouri's cost of capital witness, Dr. William Avera, PhD., the CLEC's own cost of capital witness, Mr. John Hirshleifer, presented his view on what the market-based capital structure would be. Although he improperly attempted to downwardly adjust the market-based capital structure by averaging it with the book-value capital structure, Mr. Hirschleifer presented the individual market-based capital structures for SBC as well as for Verizon, BellSouth, ALLTEL and CenturyTel.[7] He then determined the "value-weighted average" market-based capital structure for the group[8] and portrayed it as providing the "upper bound estimate of the cost of capital for the network element leasing business."[9]

While the Commission, pursuant to the District Court's order, may not consider the "adjustment" performed by Mr. Hirshleifer using book value, the Commission may and should consider the market-based capital structure evidence Mr. Hirshleifer presented below.

As SBC Missouri explained in its Proposed Procedural Schedule and Supporting Suggestions, this remand is not a general remand for further action or proceedings. Rather, it is a specific remand to consider the capital structure and the resulting rates. The District Court did not direct the Commission to conduct further hearings or to gather any additional evidence. As one Missouri Court explained long ago:

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[7] Ex. 29, Hirshleifer Rebuttal, Schedule JH-10. For the Commission's convenience, a copy of Hirschleifer Schedule JH-10 is appended as Attachment 1.

[8] Id.

[9] Id., p. 35. The entire question and answer is as follows:

> **Q. GIVEN YOUR PRECEDING TESTIMONY, WHAT IS THE UPPER BOUNDARY OF THE APPROPRIATE RANGE FOR THE WEIGHTED AVERAGE COST OF CAPITAL FOR SWBT'S PROVISION OF UNES?**
>
> A. As the network element leasing business is less risky than the overall risk of a telephone holding company, estimating a cost of capital using a market value capital structure (which results in a cost of capital estimate for the SBC telephone holding company itself) will provide an upper bound estimate of the cost of capital for the network element leasing business.

> If the Appellate Court remands the case with specific directions to the trial court to enter a specific judgment or to pursue a certain course, the trial court has no discretion but to act accordingly. It is said that the mandate is in the nature of a special power of attorney; and that the trial court, upon its receipt, is without the power to enter any other judgment or to consider and determine any other matter than what is necessarily included in the duty of following the directions given.

State ex rel. Anderson Motor Service Company v. Public Service Commission, 134 S.W.2d 1069, 1078 (Mo. App. Kansas City 1939) (finding these limitations on the power of the court not to obtain because the Circuit Court simply reversed and remanded to the Commission "for further action").

Here, the District Court issued a specific remand with directions to reconsider the capital structure and the resulting rates. But even if the District Court had wished to remand the case to the Commission to supplement the record, the circumstances under which it could have been so are very limited. Under Section 536.140.4 RSMo (2000) of the Missouri Administrative Procedure Act ("MAPA"), a court may remand a case to an administrative agency with directions to reconsider its decision in light of evidence not presented in the initial agency proceeding only where the court finds that evidence could not have been produced in the exercise of reasonable diligence or was improperly excluded at the hearing:

> . . . Wherever the court is not entitled to weigh the evidence and determine the facts for itself, if the court finds that there is competent and material evidence which, in the exercise of reasonable diligence, could not have been produced or was improperly excluded at the hearing before the agency, the court may remand the case to the agency with directions to reconsider the same in light of such evidence.

The Missouri Supreme Court has interpreted Section 536.140.4 to authorize:

> the court to . . . remand the case to the agency with directions to reconsider the facts in light of such evidence only if the court finds either (a) the evidence could not have been produced in the exercise of reasonable diligence, or (b) the evidence was improperly excluded at the hearing before the agency.

Consumer Contact Company v. State Department of Revenue, 592 S.W.2d 782, 787 (Mo. banc 1980); Comfort v. County Council, 822 S.W.2d 460, 462 (Mo. App. E.D. 1991) (no authority

permitting remand of the case for supplementation of the record with omitted ordinances) (emphasis in original).

Here, there is no claim that any evidence relating to market-based capital structure was excluded. And certainly there can be no claim that such evidence could not, with reasonable diligence, have been produced because the CLECs indeed offered such evidence (as did SBC Missouri). Thus, not only did the District Court's order not authorize supplementation of the record on remand, circumstances which might have allowed the court to do so under MAPA did not exist.

2. The CLECs Fundamentally Misconstrue the Purpose of this Proceeding.

In a very transparent and self-serving attempt to limit the practical application of the United States District Court's order, the CLECs claim that any rate changes resulting from this remand proceeding will neither apply to their individual M2A agreements nor result in any monetary true-ups from the rate corrections the Commission must necessarily make in this case:

> Once the Commission makes a decision on remand, presumably the affected rates in the model M2A will change. But there is no provision in the CLEC-specific agreements that would allow the Commission to change those agreements in the course of this proceeding . . . the permanent rates set in Case No. TO-2001-438 remain the effective "permanent" rates in the CLEC-specific interconnection agreements and are not subject to retroactive change or true-up . . . [10]

These claims turn the language in the M2A on its head. The entire premise underlying the need to replace the interim rates in the M2A was that they were to be replaced by permanent rates that were lawful.

In its Interim Order Regarding Missouri Interconnection Agreement, the Commission identified several deficiencies in the M2A that would have caused it to fall short of the requirements of the Section 271(2)(B) "competitive check list." In the pricing area, the

[10] CLECs' Proposed Procedural Schedule and Supporting Suggestions, p. 5.

Commission specifically pointed to the rates the Commission established in Case No. TO-98-115 (the future of which the Commission characterized as "uncertain" due to a recent court decision) and rates for 95 unbundled network elements (identified by Staff as not having been reviewed at all by the Commission for conformance with the FCC's standards). The Commission found that before it could find the M2A compliant, SBC Missouri would have to amend the M2A to make the previously established TO-98-115 rates and those for the 95 UNEs (using Texas rates) interim subject to true-up with permanent prices.[11] SBC Missouri agreed to offer these interim rates and revised the M2A accordingly.

The rates established by the Commission were, of course, required to be consistent with the FCC's local competition order and the TELRIC methodology imposed by that order. In its Order Regarding Recommendation of 271 Application Pursuant to the Telecommunications Act of 1996 and Approving the Missouri Interconnection Agreement (M2A), the Commission made clear its understanding that the replacement permanent rates were not simply to be any old permanent rates, but lawful rates that comply with the Act and applicable FCC rules:

> The fact that the M2A contains interim rates is no barrier to our approval. The FCC has made clear that "the mere presence of interim rates will not generally threaten a section 271 application so long as an interim solution to a particular rate dispute is reasonable under the circumstances, the state commission has demonstrated its commitment to our pricing rules, and provision is made for refunds or true-ups once permanent rates are set." Texas Order ¶ 88 (approving SWBT's Texas application despite interim rates for interconnection). The Commission finds that the M2A reflects a reasonable effort under the circumstances to set interim rates "in accordance with the Act and the FCC's rules." Id. ¶89. [12]

[11] Interim Order Regarding Missouri Interconnection Agreement, Case No. TO-99-227, issued February 13, 2001, pp. 2, 4-6.

[12] Order Regarding Recommendation on 271 Application Pursuant to the Telecommunications Act of 1996 and Approving the Missouri Interconnection Agreement (M2A), Case No. TO-99-227, issued March 15, 2001, at p. 18 (internal footnote cites to other FCC orders omitted, emphasis added).

In following the approach sanctioned by the FCC under which interim rates could be used in support of a Section 271 Application, the Missouri Commission specifically committed to follow the law as set out in the Act and the FCC's rules in setting permanent replacement rates, and to provide for true-ups to the lawfully set rates. The FCC's Memorandum, Opinion and Order granting SBC Missouri's Section 271 application acknowledges that commitment and makes clear that the final permanent rates must be lawful and that the true-up be made to those lawful rates:

> We disagree with commenters who argue that SWBT's interim rates cause it to fail this checklist item . . . the commission has previously held that interim rates may be acceptable as part of a 271 application if: 1) the interim solution to a particular rate dispute is reasonable under the circumstances; 2) the state commission has demonstrated its commitment to our pricing rules; and 3) provision is made for refunds or true-ups once permanent rates are set. SWBT passes the test. The Missouri commission has demonstrated its commitment to TELRIC. All of SWBT's interim rates are subject to refund or true-up once the permanent rates are set. The Missouri commission has scheduled hearings for December 2001 to conclude the setting of permanent rates in Missouri. We find the interim rates in question are reasonable under the circumstances.[13]

The CLECs, however, in arguing that the "interim rates are to be replaced on a one-time basis" and that there will only be "a single true-up,"[14] would have the Commission completely ignore federal law, the FCC's scheme for the replacement of interim rates, the Commission's own previous decisions, as well as violate the clear terms of the M2A interconnection agreement. As the District Court's Order makes clear, the rates the Commission set in Case No. TO-2001-438 were not lawful, due to the Commission's erroneous interpretation of the requirements for determining capital structure under the FCC's TELRIC standard. Accordingly, the District Court

[13] In the Matter of Joint Application by SBC Communications, Inc., Southwestern Bell Telephone Company and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Arkansas and Missouri, CC Docket No. 01-194, Memorandum, Opinion and Order, released November 16, 2001, para. 64 (internal citations omitted, emphasis added).

[14] CLECs' Proposed Procedural Schedule and Supporting Suggestions, p. 4.

remanded the case to the Commission "for reconsideration of the appropriate capital structure and resulting rates."[15]

The District Court did not intend for these rates to be corrected in a vacuum. The Court was fully aware that the purpose of Case No. TO-2001-438 was to establish permanent rates to replace the interim rates in both the model M2A and the individual M2As being used by the CLECs. In remanding this matter to the Commission, the District Court appropriately intended the corrected rates to be used for that same purpose. Certainly nothing in the Act, the FCC's rules, the District Court's Order, the M2A or any Commission Order authorizes rates found to be unlawful by the Federal Court to remain in any individual M2A.

Nor do the terms of the M2A permit such a result. The parties agreed to a true up to the rates established by a lawful commission order, not a true up to a rate that has been declared unlawful and violative of the Act by the United States District Court. The CLECs' proposal that the Commission essentially ignore the decision of the District Court and the terms of the M2A would leave the Commission in clear violation of the District Court's mandate. Such an unlawful proposal should not be given serious consideration.

3. Contractual Change of Law Provisions Have No Application Here.

The CLECs also claim that the M2A contains change of law provisions that "arguably will come into play as a result of Commission action following the Federal Court remand regarding the appropriate capital structure and resulting rates." Specifically pointing to Section 18.4 of the M2A's General Terms and Conditions, the CLECs claim that:

> . . . if any rates are modified by subsequent legal actions, the change shall be effective immediately (not retroactively) consistent with the regulatory action upon written request of a party to the contract. Negotiations and dispute resolution procedures are the means identified for fulfilling such a request. There

[15] Southwestern Bell Telephone, L.P., d/b/a SBC Missouri v. Missouri Public Service Commission, et al., No. 03-04148-CV-C-NKL, slip op. at 12 (D. Mo. June 12, 2004).

> is no provision for a true-up process or any retroactive application of a change in rates pertinent to this proceeding.[16]

Contrary to the CLECs' suggestions, Section 18.4 has no application here because no change in law occurred. The District Court's Order did not change the law. Rather, it simply found that the Commission's August 6, 2002 Report and Order applied the wrong legal standard to the evidence on capital structure and accordingly remanded the case to the Commission "for reconsideration of the appropriate capital structure and resulting rates."[17] Rather than constituting a change in law, the prior proceeding in Case No. TO-2001-438 was designed to implement the provisions of the M2A to establish permanent rates. As determined by the District Court, the Commission failed to lawfully establish those permanent rates and must do so on remand.

By its terms, Section 18.4 has no application to the remand of proceedings the Commission conducted subsequent to the adoption of the M2A for the purpose of establishing permanent rates for those designated as interim in the M2A. Rather, this paragraph is directed at rates in the M2A that resulted from previous arbitrations by the Commission:

> This agreement is entered into as a result of the Missouri Public Service Commission's Order in Case No. TO-99-227, reviewing SWBT's compliance with Section 271 of the federal Telecommunications Act of 1996, and incorporates some of the results of arbitrations by the Commission. In the event that any of the rates, terms and/or conditions herein, or any of the laws or regulations that were the basis or rationale for such rates, terms and/or conditions in the Agreement, are invalidated, modify or stay by any action of any state or federal regulatory or legislative bodies or courts of competent jurisdiction, including but no limited to any decision of the Eighth Circuit relating to any of the costing/pricing rules adopted by the FCC in its First Report and Order . . . the affected provision shall be immediately invalidated, modified, or stayed, consistent with the action of the legislative body, court, or regulatory agency upon the written request of either Party. . . .[18]

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[16] CLECs' Proposed Procedural Schedule and Supporting Suggestions, p. 5.

[17] Southwestern Bell Telephone, L.P., d/b/a SBC Missouri v. Missouri Public Service Commission, et al., No. 03-04148-CV-C-NKL, slip op. at 12 (D. Mo. June 12, 2004).

[18] M2A, Appendix-Pricing UNE, Exhibit 1.

The permanent replacement rates from Case No. TO-2001-438 were not contained in the M2A. Rather, the M2A contains a separate and specific provision (Exhibit 1 to Appendix-Pricing UNE) that set out the mechanism for replacing rates designated in the M2A as interim. Clearly, this specific section of the M2A, and not the general change of law provisions from the General Terms and Conditions section of the M2A, is the governing section that provides the procedure for establishing permanent rates. As determined by the District Court, the Commission failed to lawfully establish those permanent rates and must do so now on remand. The District Court did not purport to effect a change of law.

4. It Would Be Inappropriate to Inject Recent Data into this Proceeding.

Claiming that the evidence in Case No. TO-2001-438 regarding weighted average cost of capital and the cost of equity, cost of debt and target capital structure inputs were "as old as 1999 information," the CLECs' claim that "this old information cannot properly be used by the Commission as it makes its prospective decisions in this remand proceeding."[19] Instead, the CLECs' claim that the Commission must make a prospective decision, determining a forward-looking cost of capital as of the date of the new hearings based on contemporaneous information.[20]

This claim is disingenuous at best. In a transparent attempt to delay the proceeding, and the implementation of lawful rates to which SBC Missouri is entitled, the CLECs suggest that current cost of capital factors be used, without any concern of a mismatch in data periods with the other evidence in the underlying proceeding (e.g., approximately 35 separate cost studies). This proposal is not authorized by the terms of the District Court's mandate, nor would it be consistent with the FCC's TELRIC rules.

[19] CLECs' Proposed Procedural Schedule and Supporting Suggestions, p. 8.

[20] Id.

In the TO-2001-438 case, the CLECs raised concerns about potential mismatches in data periods. They sought to prevent SBC Missouri from using year 2000 data to develop its common cost factor because SBC Missouri's cost studies were based on year 1999 data:

> Issue 72 asks if it is appropriate for SWBT to base its common cost factor on year 2000 data while its cost studies are based on 1999 data. While "newer data is better data" is usually a motto to follow in developing cost studies, it does not fit well in this instance. SWBT experienced a substantial structural change in 2000 from 1999 with respect to a significant portion of their computer assets. (Rhinehart Rebuttal, Exhibit 28, pages 25-26) This change substantially increases the likelihood that there will be mismatches between 1999 and 2000 year data. Joint Sponsors therefore recommend that consistency of source data should be of higher importance than newer data in this instance.[21]

Clearly, any claim that the existing record evidence is insufficient because it is "old" should be given no weight as all of the other data in the case is of the same vintage. For similar reasons, Staff concurs that it would be inappropriate to introduce recent cost of capital data into this reconsideration proceeding:

> Because the M2A has fixed start and end dates, it is Staff's opinion that the Commission should only reconsider the "appropriate capital structure and resulting rates" based on the cost information that was the subject of evidence presented in that case.[22]

Conclusion

The United States District has issued a clear mandate which the Commission must follow. It has no authority to hear additional evidence, and it must make its decision based on the record evidence previously submitted.

[21] Joint Sponsor's Initial Post-Hearing Brief, filed January 25, 2002, in Case No. TO-2001-438 at pp. 44-45.

[22] Staff's Motion to Establish Procedural Schedule, p. 3.

WHEREFORE, SBC Missouri respectfully requests the Commission to adopt the briefing schedule SBC Missouri outlined in its Proposed Procedural Schedule and Supporting Suggestions for handling this remand from the U.S. District Court.

Respectfully submitted,

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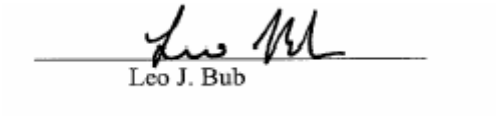
CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing document were served to all parties by e-mail on September 13, 2004.



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