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1 STATE OF MISSOURI
2 PUBLIC SERVICE COMMISSION
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6 TRANSCRIPT OF PROCEEDINGS
7 Oral Argument
8 October 18, 2004
9 Jefferson City, Missouri
10 Volume 2
11

12 In the Matter of the Determination)
13 of Prices, Terms, and Conditions)
14 of Certain Unbundled Network)
15 Elements: Consideration Upon) Case No. TO-2005-0037
16 Remand from the United States)
17 District Court)

18 MORRIS L. WOODRUFF, Presiding,
19 SENIOR REGULATORY LAW JUDGE.
20 CONNIE MURRAY,
21 ROBERT M. CLAYTON III,
22 LINWARD "LIN" APPLING,
23 COMMISSIONERS.
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1 P R O C E E D I N G S

2 JUDGE WOODRUFF: Good morning, everyone.

3 We're here for oral argument today in Case
4 No. TO-2005-0037, which is concerning the determination of
5 prices, terms and conditions of certain unbundled network
6 elements: Consideration upon remand from the United
7 States District Court.

8 We've brought you here today to set oral
9 argument. We'll begin with entries of appearance. For
10 Southwestern Bell?

11 MR. BUB: Thank you, your Honor. Leo Bub
12 for SBC Missouri. Our address is One SBC Center,
13 St. Louis, Missouri 63101.

14 JUDGE WOODRUFF: Okay. For Staff?

15 MR. HAAS: Good morning. William K. Haas
16 appearing on behalf of the Staff of the Public Service
17 Commission. My address is Post Office Box 360,
18 Jefferson City, Missouri 65102.

19 JUDGE WOODRUFF: Okay. I don't see anyone
20 here for Public Counsel. Any of the CLECs represented?
21 Ms. Young?

22 MS. YOUNG: Thank you, Judge. Mary Ann
23 Young with William D. Steinmeier, P.C, P.O. Box 104595,
24 Jefferson City, Missouri, appearing today on behalf of
25 McLeod USA Telecom Services, Inc.

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1 JUDGE WOODRUFF: I don't see any other
2 attorneys in the room. If anyone comes in late, we'll
3 make a notation on the record at that time.

4 What I had planned to do today is allow the
5 parties to give us about a 10-minute opening statement,
6 stating your position on how the Commission should proceed
7 in this case as to whether or not we need to hear
8 additional evidence or whether we can make a decision
9 based on the evidence that's already on the record. After
10 you've each had your chance to make your opening
11 statements, then I'll turn it over to questions from the
12 Commissioners and we'll give you a chance to make a brief
13 closing at that time if you wish.

14 We'll begin with Southwestern Bell. Come
15 up to the podium, please.

16 MR. BUB: Thank you, your Honor. Good
17 morning, Commissioners.

18 In your September 24th Order Scheduling
19 Oral Argument, you asked us to address the question of
20 whether the Commission should accept new evidence
21 regarding SBC's cost capital structure and other aspects
22 of the company's weighted cost of capital.

23 As you know, cost of capital is only one of
24 a myriad of different inputs into the complex financial
25 costing models that generated the rates in this

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1 proceeding. In all, there were well over 30 different
2 cost studies prepared in 2001 for this case. In these
3 studies, in addition to the cost of capital input, you'd
4 find inputs like labor rates for our various employees,
5 you'd find vendor prices for equipment that's directly
6 assigned to the cost object, you'd find values for assets
7 that are not directly assigned to a cost object. Those
8 are things that are known as support assets, things like
9 land, buildings, furniture, office equipment, motor
10 vehicles.

11 You'd also find inflation factors, and in
12 this case the CLECs offered productivity factors. There
13 were maintenance factors, depreciation factors and taxes,
14 and those were all considered in these complex financial
15 models that generated the rates in this proceeding.

16 Much evidence was presented by the parties
17 on these diverse factors, and the Commission was called on
18 to make specific determinations on many of these factors.
19 But here this remand proceeding focuses one component of
20 one factor, and that one component is the capital
21 structure element.

22 As you know, the cost of capital input has
23 three components. The first is the cost of debt element,
24 the second is the cost of equity element, and then the
25 third is the weighting between the two, and that's known

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1 as the capital structure element. But only the
2 Commission's capital structure element determination was
3 appealed. Only that determination was vacated and
4 remanded by the District Court.

5 The District Court's Order specifically
6 states, and this is a quote, the case is remanded to the
7 MPSC for reconsideration of the appropriate capital
8 structure and resulting rates.

9 The question you have now is, what do we do
10 now? Well, let's look at the options that the parties are
11 suggesting that you have. First, you can just go back
12 into your deliberations and render a new capital structure
13 determination. You should note that no party claims that
14 you don't fundamentally have this option. Why? Well,
15 that's what the District Court specifically gave you in
16 its Remand Order.

17 Well settled law is that on remand you only
18 have the authority granted by the reviewing court, and
19 here the District Court found that the Commission applied
20 an incorrect legal standard to the evidence on capital
21 structure. And it confirmed, the court confirmed what the
22 appropriate standard was under the FCC's TELRIC standard,
23 the costing standard the FCC has set out in its orders.

24 Your going back and applying that standard
25 to the evidence in this case is squarely within the

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1 authority granted by the District Court. Here SBC
2 Missouri has suggested a traditional round of briefing to
3 accompany this option. We think it would be helpful to
4 you in your deliberations. For example, it would provide
5 the specific ratio, the capital structure ratio that would
6 be advocated by each party. Briefs could contain each
7 party's rationale for the various capital structures that
8 they propose, and would also provide specific citations to
9 the record.

10 In our view, this approach is consistent
11 with the District Court's Remand Order. But The CLECs and
12 Staff recommend additional hearings to present new
13 evidence. We strongly oppose this and believe it's beyond
14 the authority that has been granted to you by the District
15 Court. The District Court in their Order, they didn't
16 authorize further hearings. They didn't authorize the
17 gathering of additional evidence.

18 You need to contrast that with a recent
19 opinion that was handed down by the Missouri Court of
20 Appeals. That's WD-63075, and this is the Court of
21 Appeals decision that was recently issued in the
22 competitive classification of SBC Missouri. In that
23 particular case, they affirmed part of it and then they
24 remanded part of it, and in their Order they specifically
25 say, in remanding we ask the Commission to reexamine the

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1 competitive status of particular services by applying the
2 effective competition factors to the evidence the
3 Commission has already accumulated.

4 They indicate they reverse the Commission's
5 findings and remand to the Commission -- this is on the
6 last page, on page 23 -- we reverse the Commission's
7 finding and remand for the Commission to analyze the
8 evidence it already has available in order to determine
9 whether effective competition for these services currently
10 exists.

11 Then they say, if the Commission deems it
12 necessary, the Commission may receive additional evidence
13 to determine the issues in question. In this Court of
14 Appeals Order they specifically authorize you to gather
15 additional evidence. That was not the authority that was
16 granted to you in the District Court's Order here in this
17 case.

18 Here what the District Court did was they
19 outlined the correct legal standard and ordered the
20 Commission to reconsideration the appropriate capital
21 structure and the resulting rates. And now that the
22 Commission has the appropriate legal standard, it's bound
23 to apply it to the evidence that's already in the record.

24 The capital structure issue was fully
25 litigated before the Commission, and no party has any

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1 right to present any new evidence that could have or
2 should have been presented in the initial case.

3 Here you'll notice from the Briefs that the
4 CLECs also claim that the Commission not only must
5 reconsider its capital structure element determination,
6 but they must also reconsider its determination on the
7 other two elements of cost of capital, the cost of debt
8 element and the cost of equity element. And you'll also
9 note that this proposal is also opposed by not only SBC
10 Missouri but Staff.

11 This proposal that the CLECs are making
12 here to go beyond and consider these two other elements
13 that weren't vacated, that weren't remanded, is clearly
14 beyond the District Court's mandate. Remember, all that
15 was vacated was the capital structure element. The debt
16 and equity elements were not vacated. They weren't
17 remanded. The District Court simply didn't authorize a
18 second bite at the apple on these two elements.

19 Now, that should be the end of the
20 proposal, but I think we ought to go a little bit further
21 and look at the reasons that were given to support the
22 CLECs' proposal to look at these two extra elements. They
23 say that the cost of debt and the cost of equity along
24 with the capital structure are part of an integrated
25 formula and that they're a closely related input, so then

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1 you have to do them altogether.

2 Let's step back. Again, we talked about
3 all the different inputs that went into these cost models.
4 All of these elements are part of an even larger formula,
5 and these elements are all integrated into a large cost
6 model, and this cost model with all the integrated
7 elements, not just the cost of capital but taxes,
8 inflation, depreciation, those are all used on an
9 integrated basis to produce individual rates.

10 The second reason that they give is that
11 the cost of debt and cost of equity and the capital
12 structure, they're old, and that we somehow need to have
13 contemporary information. But doing so would cause a very
14 serious mismatch with all the other inputs that were in
15 the cost models that weren't appealed.

16 All these different cost models -- all the
17 cost studies, excuse me, they were prepared in early 2001,
18 and they used 1999 or 2000 year data. As we indicated,
19 these studies incorporated things like labor rates and tax
20 rates and inflation rates and equipment prices, and all
21 those things change over time, and it's important when you
22 present these models that you have consistency in data
23 periods.

24 And I believe in our Brief one thing I
25 cited was the CLECs in the case itself criticized us for a

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1 mismatch in data periods on one of the factors that we
2 have produced where we didn't have an exact match of data.
3 I think we were proposing to use 1999 data in with a year
4 2000 factor, and they criticized us for that mismatch.

5 Here the District Court's Order just didn't
6 contemplate redoing these and the other factors. All
7 they -- all the Order contemplated was reconsidering
8 capital structure element.

9 A third reason that the CLECs give for
10 looking at the extra elements is that they say that these
11 rates can only have a prospective effect, so you need to
12 have new data on all the elements to come up with the
13 forward-looking cost of capital.

14 Ordinarily I would agree that rates apply
15 only prospectively. That's the ordinary rule in
16 ratemaking procedures, but that's not quite accurate here.
17 Sure there's going to be some prospective application of
18 these rates. These rates were designed to go into the
19 M2A, and the M2A still has a little bit of life left into
20 it, but it's going to expire soon. It expires in March of
21 2005, this coming March, and there's a provision in there
22 that it can be extended for an additional 130 days, I
23 believe, to allow the parties to negotiate and conduct and
24 perhaps even arbitrate to reach a new replacement
25 agreement. So there is some life left in the M2A. Going

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1 to have some -- these rates will have some prospective
2 application, but it will be very finite, very limited.

3 And where these rates diverge from the
4 normal rule is that they've also to have some retroactive.
5 When you see that in the contract language in the M2A, it
6 calls for a six-month retroactive true-up, and so does the
7 Order -- Missouri Commission's Order approving the M2A.
8 Remember that this M2A and this UNE pricing case, it arose
9 from our Section 271 long distance case. That M2A and
10 that Missouri 271 agreement initially contained interim
11 rates that had not been reviewed for compliance with
12 TELRIC.

13 But we were relying on that 271 agreement
14 with the interim rates, and the Commission approved it and
15 presented it to the FCC with those interim rates, and
16 under the FCC law that's okay under certain conditions.
17 Interim rates in 271 agreements are okay with the FCC if
18 the state commission commits to replacing them with
19 TELRIC-compliant rates and provides for a true-up
20 mechanism.

21 The Missouri Public Service Commission
22 Order approving the M2A with the interim rates contained
23 that commitment. The Commission filed that Order with the
24 FCC to show its commitment to review the rates for
25 compliance with TELRIC and to have a true-up mechanism.

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1 The UNE pricing case underlying --
2 underlies this remand was the Commission's process for
3 fulfilling its commitment to the FCC and to the parties.

4 Now, just because the District Court
5 vacated and remanded one of the Commission's
6 determinations doesn't mean that the resulting remand is
7 not part of the process for replacing the interim rates.
8 It is part of the process. And the process is not
9 complete until the Commission has set appropriate
10 TELRIC-compliant rates.

11 So what the Commission needs to do here is
12 go back, look at the one element that the District Court
13 ordered to be reconsidered, set it, give to the parties.
14 We'll recalculate the rates, and those will be the
15 permanent rates going forward for the M2A.

16 Thank you.

17 JUDGE WOODRUFF: Thank you, Mr. Bub.
18 For Staff?

19 MR. HAAS: May it please the Commission?
20 My name again is William Haas, and I represent the Staff
21 of the Commission in this matter.

22 As Mr. Bub has stated, the final sentence
23 of the Federal Court's Order reads, the case is remanded
24 to the MPSC for reconsideration of the appropriate capital
25 structure and resulting rates. The question before the

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1 Commission is whether the Commission may admit addition
2 evidence on remand. That answer is yes.

3 I would briefly discuss two cases that
4 discuss the question of hearing additional evidence on
5 remand. The first of those cases is State Industries vs.
6 Moreflow Industries. That case is reported at 948 Federal
7 2nd 1573. That case involved an infringement of patents.
8 The case had been tried by the federal trial court. It
9 went up on appeal. The Court of Appeals remanded further
10 reconsideration. The trial court reopened the record,
11 made a new judgment, and the case is now on its second
12 appeal.

13 In that case, the Court of Appeals on the
14 second appeal stated, there is no basis for State
15 Industries' argument that reopening the record to hear new
16 evidence was not permitted by our decision in which we
17 stated that we remand to the District Court to reconsider
18 willfulness and enhanced damages. While we did not
19 explicitly order the court to conduct a new hearing, we
20 certainly did not forbid it.

21 Absent contrary instructions, a remand for
22 reconsideration leaves the precise manner of
23 reconsideration, whether on the existing record or with
24 additional testimony or other evidence, to the sound
25 discretion of the trial court.

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1 The second case that I would like to refer
2 to is United States vs. Bell Petroleum Services. In that
3 case, the government brought an action to recover response
4 costs for its cleanup of a contaminated aquifer. Like the
5 first case, this case had been tried in the District
6 Court, had gone up on appeal, had been remanded for
7 further reconsideration. The District Court on remand
8 determined that the appellate court's earlier opinion
9 precluded consideration of additional evidence. So the
10 trial court refused to hear additional evidence.

11 The case is now back up on appeal again
12 where the Court of Appeals says, where further proceedings
13 are contemplated by an appellate opinion, the District
14 Court retains the discretion to admit additional evidence.
15 Where we remand for further findings but also note that
16 additional proceedings may be involved, our mandate does
17 not tie the lower court's hands to a bedpost, forcing it
18 to stare only at the record before it.

19 The Court of Appeals therefore reversed and
20 remanded to the District Court to exercise its discretion
21 to admit and consideration further evidence.

22 In the present case, the Staff would ask
23 the Commission to exercise its discretion to admit
24 additional evidence on the question of capital structure.
25 The parties, as you have heard, disagree as to the scope

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1 of what that additional evidence would be.

2 The court order remanding this case to the
3 Commission at page 5 notes that there are three elements
4 to determine a cost of capital. Those three are cost of
5 debt, cost of equity and capital structure. However, the
6 court's order directing the Commission to reconsider this
7 case directs it to reconsider capital structure only. It
8 does not direct the Commission to reconsider the cost of
9 debt and the cost of equity. Therefore, it has limited
10 the Commission's reconsideration to the one element.

11 To conclude my comments, again the Staff
12 would request that the Commission take additional evidence
13 related to the capital structure issue only. Thank you.

14 JUDGE WOODRUFF: Thank you, Mr. Haas.
15 Ms. Young?

16 MS. YOUNG: Thank you, Judge. I certainly
17 didn't anticipate being the leadoff for the CLECs this
18 morning in Mr. Lumley's absence. But I just want to make
19 a few brief points on behalf of McLeod USA.

20 First of all, we concur with the Staff that
21 the Commission does have the authority to take additional
22 evidence in this case, and we also believe that they
23 should take additional evidence. I think it's kind of
24 telling that Mr. Bub made a statement to the effect that
25 now the Commission has the appropriate legal standard,

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1 indicating perhaps before we didn't all have that
2 appropriate legal standard before us when we put together
3 our cases to present to the Commission. And now that the
4 parties also have the appropriate legal standard, we think
5 it is incumbent upon the Commission to take additional
6 testimony on the issue that was sent back to them by the
7 Court of Appeals.

8 And finally, we feel very strongly that no
9 retroactive changes are permitted under the terms of the
10 M2A, that we've had the six-month true-up, that any
11 changes now need to be prospective only. Thank you.

12 JUDGE WOODRUFF: Thank you, Ms. Young.
13 Those are all the parties who are here today. Carl Lumley
14 is representing the bulk of the CLECs and he's not here
15 today, and from -- has any of the other parties heard from
16 Mr. Lumley?

17 (No response.)

18 All right. I do want to make one other
19 note. Mr. Mark Comley contacted the Commission on Friday
20 of last week on behalf of Birch Telecom indicating that he
21 would like to be excused from this proceeding today, and
22 he has -- he will be excused. We've not heard anything
23 from Mr. Lumley.

24 So we'll go ahead and turn this over for
25 questions from the Commissioners, if you'd just like to

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1 ask any questions to any -- if you have a specific
2 question for a specific attorney or else just ask a
3 general question to be responded as appropriate.

4 So we'll begin with Commissioner Murray.

5 COMMISSIONER MURRAY: Thank you. I will
6 ask Mr. Haas a question first. I tend to agree with you
7 that we have the discretion, but my question is, why
8 should we exercise that discretion? What would we get out
9 of that in that the court has told us that we should
10 determine capital structure absent a consideration of
11 embedded cost? And we took the Staff's testimony, the
12 Staff's evidence last time and applied an embedded cost
13 analysis to it. What more are we going to get from taking
14 additional evidence?

15 JUDGE WOODRUFF: You can respond from the
16 table if you like.

17 MR. HAAS: As the record now stands, the
18 Commission would have evidence from the CLECs who would be
19 charged with paying these rates, and you would have the
20 evidence from Southwestern Bell who would be collecting
21 these rates, but you would not have heard from the Staff,
22 a neutral party, as to what the appropriate rates would be
23 using the standard which was enunciated by the Federal
24 District Court.

25 COMMISSIONER MURRAY: So you're saying that

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1 the Staff would present different evidence if it had to
2 apply a different legal standard?

3 MR. HAAS: Yes, Commissioner. The Western
4 District Court said that the Staff could not start --
5 could not even use the booked capital structure as a
6 starting point, so yes, we would have to provide
7 additional and different testimony.

8 COMMISSIONER MURRAY: And what would you
9 use as a starting point, then? How would that differ?

10 MR. HAAS: We have not brought our
11 consultant on yet, haven't made that determination.

12 COMMISSIONER MURRAY: Why wouldn't we just
13 take the evidence that is before us that was presented by
14 all of the parties and just make the determination absent
15 any consideration of embedded cost?

16 MR. HAAS: That is certainly an option that
17 the Commission could do in the exercise of its discretion,
18 but once again I would ask that the Staff be given the
19 opportunity to present a third party's opinion on this.

20 COMMISSIONER MURRAY: And I'm trying to
21 understand how you would come up with any different
22 capital structure information knowing that embedded costs
23 could not be applied to your analysis. Wouldn't you have
24 the same numbers that you'd be using, just your analysis
25 would be different and we could take those -- we could

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1 take the numbers that we have and just apply the correct
2 legal analysis to them, it seems to me.

3 MR. HAAS: New testimony from the Staff
4 would have to have a new starting base. As I understand
5 from the previous record, both the Bell witness and the
6 CLEC witness did use something other than the embedded
7 capital structures as their starting points.

8 COMMISSIONER MURRAY: And why is it not
9 appropriate for us to use that evidence?

10 MR. HAAS: Again, that would be
11 appropriate. It's within the Commission's discretion to
12 use -- to use that evidence.

13 COMMISSIONER MURRAY: And is this -- is it
14 my under-- I mean, do I understand you correctly that the
15 Staff doesn't know right now whether you would come up
16 with some kind of different numbers if you used -- if you
17 started at a different point in time or a different -- if
18 you started without using embedded cost?

19 MR. HAAS: We can only assume that, but we,
20 as I mentioned, haven't brought our consultant on yet.

21 COMMISSIONER MURRAY: Ms. Young, I believe
22 you indicated that you thought there should be new
23 evidence taken because all of the parties didn't have --
24 didn't know the appropriate legal standard at the time
25 that we had the hearing; is that correct?

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1 MS. YOUNG: Yes, Judge, in terms --

2 JUDGE WOODRUFF: Ms. Young, you need to use
3 your microphone.

4 MS. YOUNG: The parties did not have the
5 benefit of the Court's guidance at that time. I mean, we
6 had the general legal standard, but not this guidance from
7 the Court of Appeals.

8 COMMISSIONER MURRAY: And how would that
9 guidance, knowing that you don't start with embedded cost,
10 how would that change the numbers that you would come up
11 with?

12 MS. YOUNG: We're essentially the same
13 position as Staff, I believe, to the extent the CLECs
14 would provide additional testimony, the consultant that
15 would be utilized has not, I don't think, been identified
16 and retained.

17 COMMISSIONER MURRAY: Thank you.

18 Mr. Bub, the evidence that was presented
19 previously was presented without -- from SBC and from the
20 CLECs I understand was presented without reference to
21 embedded cost; is that right?

22 MR. BUB: That's exactly right with SBC.
23 With the CLECs, what they did was they had two capital
24 structures that they had evidence on. One was a
25 market-based capital structure, which was very close to

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1 what we had proposed, and then they also had a book value
2 capital structure. What they did is they averaged the
3 two.

4 I think the position that you're in right
5 now is the same position that the FCC was in in the
6 Verizon Virginia arbitration. In that position Staff was
7 not a party, they didn't present any evidence, and they
8 had evidence from the CLECs, from AT&T and WorldCom, and
9 then they had Verizon Virginia. And Verizon Virginia
10 proposed a market value capital structure, and then AT&T
11 WorldCom made a proposal that was nearly identical to what
12 we have.

13 They proposed a, what the FCC described as
14 a weighted average cost of capital formula using book and
15 market average rates. And the FCC rule, and for the
16 reasons they describe above, which was similar to the
17 District Court's Order rejecting book value, we give no
18 weight to the portion of AT&T WorldCom's proposal that is
19 based on incumbent LEC's book value capital structure.
20 And then they go on to make some adjustments to the market
21 value capital structure, and they came out to
22 80 percent/20 percent equity/debt ratio.

23 So you're in a very similar position to
24 what the FCC was where you have two competing proposals,
25 one was straight in line with the FCC's rules, and the

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1 other had two parts, one was in line and the other wasn't.
2 And they disregarded the part that wasn't in line and used
3 the two pieces of evidence, one from Verizon Virginia and
4 the other from the CLECs based on the market value.

5 We have the same information here. The
6 CLECs have market value capital structure evidence that
7 they presented through their witness, Mr. Hershlager.

8 COMMISSIONER MURRAY: So we have market
9 value capital structure in evidence from both the CLECs
10 and from SBC; is that right?

11 MR. BUB: Yes, your Honor, both from
12 companies that will be paying and receiving, the parties
13 in interest.

14 COMMISSIONER MURRAY: And Mr. Haas, why
15 would that market-based capital structure change from that
16 proceeding to this proceeding?

17 MR. HAAS: Commissioner, each witness is
18 going to look at the question differently. Bell's witness
19 and the CLECs' witness did not come up with the same
20 market capital structure. It's possible, if not
21 reasonable, to expect that a third financial analyst would
22 come up with a third market capital structure.

23 COMMISSIONER MURRAY: But at this point we
24 do have two to choose from; is that correct?

25 MR.. HAAS: Yes, that's correct.

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1 JUDGE WOODRUFF: If I can interrupt for a
2 moment. Mr. Lumley has joined us, if you'd like to enter
3 your appearance.

4 MR. LUMLEY: Yes, sir. I apologize. Carl
5 Lumley appearing on behalf of NuVox, XO, Allegiance, MCI
6 WorldCom, MCImetro, AT&T, TCG Kansas City, TCG St. Louis,
7 and Covad.

8 JUDGE WOODRUFF: Just to fill you in on
9 what's happened, we've taken opening statements from the
10 other parties and we've gone to questions from the
11 Commissioners.

12 Commissioner Murray, you can go ahead.

13 COMMISSIONER MURRAY: Mr. Haas, in that
14 there is the six-month true-up period in the M2A, is it
15 not to SBC's further disadvantage to delay this proceeding
16 by taking additional evidence? In other words, doesn't
17 that further delay the point in time at which they would
18 receive rates based on the appropriate capital structure
19 calculation?

20 MR.. HAAS: Whether there will be another
21 true-up is one of the questions that is for the
22 Commission. I would anticipate that being a later
23 question. Part of the question turns on what did the
24 earlier order in the M2A mean when they talked about a
25 true-up following the final rate or a permanent rate, when

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1 does that rate kick in? And that question hasn't been
2 answered yet.

3 COMMISSIONER MURRAY: So if everyone is
4 successful in delaying this, then at most SBC can probably
5 hope for a six-month true-up because the time period for
6 the M2A to run is -- we're within six months of that at
7 this point. Is that -- do you think that's realistic to
8 assume that this proceeding would be delayed long enough
9 that at most SBC would be able to receive the six-month
10 true-up?

11 MR. HAAS: If the Commission makes that
12 decision that there is to be another true-up, yes. I
13 mean, we are looking at the time period of the M2A running
14 out in March.

15 COMMISSIONER MURRAY: And if we decide that
16 there is no true-up, then perhaps even though the rates
17 were inappropriately set because the capital structure was
18 based on an improper legal analysis, then SBC just loses
19 that for the entire period; is that your understanding?

20 MR. HAAS: If you decide, if the Commission
21 decides that any changes are prospective only, then
22 whether the rates go up or down, they would only be in
23 effect for some short period of time.

24 COMMISSIONER MURRAY: How likely is it that
25 a result of a recount -- a reexamination of capital

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1 structure omitting embedded cost would create a rate
2 reduction?

3 MR. HAAS: It depends, I suppose, on
4 whether the Commission decides to use a 1999 capital
5 structure and cost of debt and cost of equity or a 2004
6 capital structure and cost of debt and cost of equity.

7 COMMISSIONER MURRAY: When we're
8 considering a case that was remanded that was decided
9 in -- was the date of this decision?

10 MR. HAAS: It was dated June 17, 2004.

11 COMMISSIONER MURRAY: No. I'm talking
12 about the original proceeding that was remanded.

13 MR. LUMLEY: August 2nd, 2002.

14 COMMISSIONER MURRAY: Thank you. And so
15 the time period that was examined in that proceeding where
16 all of the costs were considered and the rates were set
17 based upon that entire consideration of all of the
18 relevant factors, what time period was that?

19 MR. HAAS: The data was from 1999 and 2000.

20 COMMISSIONER MURRAY: So what would make --
21 what would even arguably allow us to apply cost of capital
22 based on a different time period, or capital structure I
23 mean, based on a different time period?

24 MR. HAAS: That question is probably better
25 answered by Mr. Lumley. The Staff's proposal was that we

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1 would develop a market-based 1999 or 2000 capital
2 structure.

3 COMMISSIONER MURRAY: So it's your position
4 that we would not look at a different time period than was
5 considered for the rest of the case; is that right?

6 MR. HAAS: Yes, that's correct.

7 COMMISSIONER MURRAY: Now, Mr. Lumley, why
8 would you have any basis to argue that we should look at a
9 different time period when looking at only one issue that
10 was remanded out of that entire case?

11 MR. LUMLEY: Well, and that's the problem
12 that the Commission faces is that you made a very complex
13 decision, as you've already indicated, covering a wide
14 range of factors, and even that decision alone was focused
15 on just a subset of rates. It was that specific set of
16 interim rates as opposed to all the rates in the
17 agreement. 19

18 But nonetheless, as you have -- you know,
19 that was a 350-some-odd issue case. It was an extremely
20 complicated case. The appeal that was taken was focused
21 on only a couple of issues, and only one of those now
22 still survives for any consideration. In a normal course
23 of events when the Commission is making a rate-setting
24 decision, whatever your decision may be, it then carries
25 on for some indefinite period of time until someone comes

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1 forward and says, we need to do a rate case, someone files
2 a complaint or a company comes forward and says there's
3 been a change in circumstances and we need a new set of
4 rates.

5 In this particular case, we're dealing with
6 a very unique situation where the Commission pursuant to
7 its role in the 271 process accepted SBC's proposal of a
8 model interconnection agreement that had a specific
9 lifetime to it, and indeed that model agreement, as you've
10 noted, expires next March.

11 Separate and apart from contracts that are
12 based on that agreement, which actually could go another
13 135 days past that pursuant to the renegotiation sections,
14 but certainly the model itself would not be available for
15 adoption after March 5th and one would think practically
16 sometime before that as well.

17 When the appeal was taken, no steps were
18 taken whatsoever for any kind of a stay or anything like
19 that. So when your decision came out and there, as you'll
20 recall, was a fairly complicated process. After your
21 August 2002 decision, it took quite a while for rates to
22 actually be submitted.

23 There was arguments about whether --
24 because your initial decision did not say, here's the
25 final rate. You said, here's our decision on these

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1 issues. And there was a long, drawn-out process
2 interpreting your results into rates.

3 But finally in June of 2003, if I have my
4 date correct, the Commission approved the rates in the
5 model contract. And then after that, those rates were
6 imported into the actual adopted agreements that were in
7 effect, and then certainly down the road other companies
8 have adopted the model agreement with those rates already
9 in it as well.

10 So we have this unusual situation where
11 you're operating with your limited authority to only
12 change rates on a prospective basis, and in an environment
13 where the process has taken quite a long time, and
14 certainly much longer than you would have anticipated, I'm
15 sure, when you were making your decision in the 99-227
16 case that we're going to have these interim rates imported
17 into the model.

18 And it just so happens now that the time is
19 running out. Now, the Federal Court itself emphasized
20 this point in one of its footnotes, I think the first
21 footnote where the court itself said, you know, our
22 decision on review may well be moot by all the changes
23 that are occurring in the time frame involved.

24 And that's -- we feel that's beyond our
25 control. What we do feel is in our control is our legal

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1 rights, and as this Commission noted in the 99-227
2 proceeding, you specifically understood that CLECs could
3 not operate in an environment of unknown rates. They
4 would not be able to make business plans. And that's why
5 specifically in your language you said there would be one
6 six-month true-up.

7 Well, here we are now, you know, years
8 later. We've paid these rates. We've billed our
9 customers based on these rates. And as I said, it just so
10 happens that now there's only about six months left, as
11 you've noted, on the life of the model agreement and
12 roughly the same time period on the actual contract.

13 So we look at the fact that you're limited
14 to a prospective action, and then we say what's the right
15 answer? Well, from our perspective, to have an Order that
16 would pass muster again or pass muster with the federal
17 courts, it would have to be TELRIC compliant. And to say
18 that you could set forward-looking rates in a decision
19 today based on information that's as much as five years
20 old we don't believe would pass scrutiny.

21 I fully understand the artificial
22 constraints that are placed on you by this expiration
23 date, but it's just a matter of how much time is passed
24 throughout this process. We don't feel that that's --
25 that's reason to try and have either an unlawful

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1 retroactive decision or a non-TELRIC-compliant decision
2 that says, okay, we're going to have -- we're going to set
3 new rates today based on extremely old data.

4 But I would say that from our perspective
5 the most important point is that this can only be a
6 prospective decision. It's a -- it's a closer question in
7 terms of the age of the data, but we still firmly believe
8 that a court would look at it and say, you're making your
9 decision today, and under the rules that apply you're
10 supposed to be setting the prospective rate and,
11 therefore, using the old data doesn't make sense.

12 Once you make that decision on capital
13 structure, then everything else kind of hangs from that
14 because the weighted average cost of capital calculation
15 is such an integrated unit. I believe Staff agrees with
16 us on this point, that you shouldn't mix different
17 components.

18 They just have -- they have a different
19 view on what the total set of those components should be,
20 but I think they agree with us that you don't mix and
21 match cost of equity from one period of time and capital
22 structure from another. You're not -- when you're doing a
23 math equation, you're supposed to be plugging in numbers
24 that have a relationship.

25 COMMISSIONER MURRAY: Let me clarify. Is

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1 your position that we ought to be taking new evidence on
2 current cost of debt and equity and coming up with a
3 capital structure based on today versus based on the time
4 period in which this decision was made?

5 MR. LUMLEY: I think I lost you. When you
6 say this, you mean the former decision? I'm sorry.

7 COMMISSIONER MURRAY: Former decision,
8 Commission's decision.

9 MR. LUMLEY: Yes. It's our position that
10 this is an integrated calculation, and that the court
11 referred back to you the issue of capital structure and
12 the issue of appropriate resulting rates. And we do not
13 believe that it would be appropriate to identify a 2004
14 capital structure and plug it into an equation with 1999
15 cost of equity and cost of debt.

16 COMMISSIONER MURRAY: Let me ask you this:
17 Do you think that the language that the Commission used,
18 and I recall that language and I recall our discussions
19 when we put that language in, that there would be a
20 six-month true-up period, do you think that language was
21 meaningless?

22 MR. LUMLEY: No, ma'am. A six-month
23 true-up was implemented.

24 COMMISSIONER MURRAY: Do you think it was
25 meaningless as to any other changes that would be court

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1 ordered?

2 MR. LUMLEY: There was no provision
3 whatsoever for any further true-up based on whether or not
4 any party chose to appeal any aspect of your decision. I
5 wouldn't say that the language was meaningless. I would
6 say the language has no application to the circumstance of
7 some party choosing to appeal that decision.

8 The language was clearly tied to the
9 effective date of your rate order, and that's confirmed by
10 the conduct of the parties, because immediately after you
11 approved the rates the true-up was implemented. If, in
12 fact, the intent had been to await the court process, then
13 there should have been a stay of your rate decision and
14 there should have been no implementation of that true-up.

15 COMMISSIONER MURRAY: Well, I think the --
16 you mentioned earlier that the Commission had stated that
17 CLECs had to have some certainty in terms of the rates
18 they would be paying, and that's why the Commission chose
19 to limit that true-up period to a six-month true-up period
20 rather than saying at any time there was a change in law
21 from a court appeal or an FCC decision or whatever, that
22 we wouldn't true-up further back than six months. And I
23 have trouble seeing why that true-up does not apply here.

24 MR. LUMLEY: Well, it's our understanding
25 of that contract language that it called for a single

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1 true-up and that that true-up has occurred. So --

2 COMMISSIONER MURRAY: You're just basing it
3 on the fact that you think it just was limited to one?

4 MR. LUMLEY: That's correct.

5 COMMISSIONER MURRAY: I may have some
6 further questions, but I'll pass right now. Thank you.

7 JUDGE WOODRUFF: Before we move on to the
8 next Commissioner, I just want to deal with one issue
9 that's come up here. Some of you are standing up to
10 answer questions; some of you aren't. It seems to work
11 better with the microphones if you go ahead and remain
12 seated. We won't consider that to be a sign of
13 disrespect.

14 We'll come over to Commissioner Clayton.

15 COMMISSIONER CLAYTON: Since I've only been
16 in the room recently due to a child that's been up all
17 night, and I walked out without my jacket, so I apologize
18 to all the participants.

19 If Mr. Lumley wants to make his opening
20 statement or if he has any statement that he wants to add,
21 I don't have a problem allowing him to do that and then
22 I'll just have a few questions for the parties. He may
23 not have anything else, but --

24 JUDGE WOODRUFF: Would you like to make an
25 opening statement, Mr. Lumley?

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1 MR. LUMLEY: I would like to touch on a few
2 points, Judge. I did cover some of it in response to
3 Commissioner Murray's question, which I appreciated her
4 giving me that opportunity.

5 Overall, the point that I wanted to make to
6 the Commission this morning is that you need to make a
7 decision where you're trying to go before you decide how
8 to get there, and you need to know how the results of this
9 case will be used and how the appropriate resulting rates,
10 as the court has directed you to establish, are going to
11 apply.

12 And as I indicated in my response to
13 Commissioner Murray's question, we believe that you have
14 no option but to apply those rates on a prospective basis.
15 We don't see any basis in law or in the contract that
16 would allow you to do it retroactively. The model M2A and
17 the M2A-based contracts, as I just indicated, call for a
18 single six-month retroactive true-up, which occurred over
19 a year ago and which was tied to the effective date of
20 your rate-setting order back at that time.

21 And specifically there's no basis for
22 trying to turn that into a second 24-month true-up, which
23 was our understanding of what SBC proposed when we were
24 last here in front of the Judge. My clients certainly do
25 not contractually accept that kind of retroactive change

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1 in their rates.

2 I also wanted to make the point that there
3 is an important distinction between the model M2A, which
4 is still before you in this case, and the numerous
5 M2A-based contracts that are not before you in this case.
6 And specifically, even though I represent 11 different
7 CLECs, that is nowhere near all of the CLECs that have
8 adopted the M2A in this state.

9 To the extent that you change the rates in
10 the model, that will have a direct impact on anyone that
11 adopts the model between now and next March, and certainly
12 at least one company just adopted it in September. So
13 companies are still examining it as a market entry tool,
14 albeit now with a fairly short life to it.

15 But that's the end of this case is your
16 impact on the model. The M2A-based agreements, however,
17 do have change in law provisions, and when this Commission
18 makes a decision in this proceeding that changes the model
19 rates, then those procedures would kick in, and the rates
20 could be imported prospectively into the contracts, but
21 there's procedures for how that happens.

22 We also observe the possibility of
23 prospective application not only outside the confines of
24 this case, but also outside the confines of the M2A-based
25 agreements under their change in law provisions. And we

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1 have significant policy concerns about that.

2 I think the Commission is well aware over
3 the years that it's been very difficult given the time
4 frames imposed by Section 252 for you to tackle these cost
5 and rate issues. We've run into this problem in a number
6 of arbitrations where the Commission just has not felt
7 that it's had adequate time to handle these difficult
8 issues.

9 We have a concern about what you will do
10 with a new weighted average cost of capital figure for
11 Southwestern Bell that you may strike in this case. In
12 particular, if you revisit it using the old data from 1999
13 or some mix of old and new data, we would have very strong
14 concerns about then any long-term application of that
15 number outside the confines of the M2A model and the
16 M2A-based contracts.

17 On the other hand, if you take this
18 opportunity to have an in-depth examination of a
19 forward-looking weighted average cost of capital for SBC,
20 then we could see that figure having prospective
21 application after the expiration of the M2A model and the
22 M2A-based agreements because you would have set a new
23 forward-looking number.

24 Obviously it's an extremely important cost
25 factor that has an impact on virtually every rate on a

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1 long-term basis. Now, in the confines of this discussion,
2 the scope of that impact is only on those rates that were
3 interim at the time you undertook the 438 proceeding, but
4 nonetheless it's an extremely important cost factor.

5 And then just to touch on this again, from
6 our view, because it's a prospective decision, and because
7 you have to comply with TELRIC standards, you should be
8 using forward-looking data. The data should match up so
9 that all the inputs to the weighted average cost of
10 capital calculation are from the same time period.

11 And we believe that all of that dictates
12 the holding of new hearings. And we certainly have a
13 concern about this sort of slice and dice approach where
14 witnesses who testified several years ago with the
15 assumption that all aspects of their testimony would be
16 considered, that suddenly we would just pull out pieces of
17 those testimony and purport to understand what the witness
18 would have said if this part is erased and that part is
19 erased when they were presenting their testimony as a
20 whole.

21 And that's why we certainly agree with
22 Staff that it's not a fair interpretation of prior
23 testimony to try and pick out isolated pieces of it.

24 Finally, very briefly, we don't believe
25 that there are any impediments to this approach. We don't

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1 believe that the Court's mandate was as specific as SBC
2 suggests. The Court said you did this one thing wrong and
3 you need to give us new appropriate resulting rates, and
4 rates is a very broad category that you have to make
5 certain that the end result is correct.

6 We believe it was referred to your
7 discretion in terms of how to proceed, that the Court did
8 not say do this without further hearings, do this without
9 taking new evidence. And because this is a prospective
10 decision, we don't believe that you're bound by any theory
11 of the law of the case, that you can look at this anew.
12 And I appreciate the accommodation.

13 JUDGE WOODRUFF: Thank you. Go ahead.

14 COMMISSIONER CLAYTON: Thank you. I've got
15 a number of questions here that may come off a little
16 jumbled. I've been taking notes as we're flowing along
17 here.

18 I first want to ask Southwestern Bell,
19 since I missed part of your opening statement, if you
20 could answer the question, what is your position on the
21 timing of a new rate that would be established once the
22 capital structure issue is determined? Mr. Lumley's been
23 talking about working forward on a prospective basis. Did
24 you state Bell's position on our power in determining
25 these rates?

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1 MR. BUB: I did, your Honor, and I can run
2 over that one more time.

3 COMMISSIONER CLAYTON: Just briefly, if you
4 would.

5 MR. BUB: We see it having a limited
6 prospective application, because what the interim rates
7 would do, they were in our M2A, and this whole underling
8 UNE pricing decision, the purpose was to place those
9 interim rates in the M2A. Once the M2A expires, so do
10 those rates. So as far as this capital structure
11 determination that you need to make now applying forever
12 into the future, we only see it impacting the rates for
13 the life of the M2A.

14 As Mr. Lumley pointed out and we discussed
15 earlier, the M2A does expire in March of this year. Plus
16 there is a provision for 130, 135-day extension to
17 accommodate negotiations and arbitration for a new
18 agreement. And in that agreement we will be presenting --
19 I'm sure the CLECs will as well -- current cost of capital
20 to apply for the future agreement.

21 COMMISSIONER CLAYTON: Is there any dispute
22 that, any decision that we make, that the rates going
23 backward will not be affected?

24 MR. BUB: Yes.

25 COMMISSIONER CLAYTON: I was confused. Is

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1 there a dispute as to that?

2 MR. BUB: Yes, we do have a dispute.

3 COMMISSIONER CLAYTON: Okay. I think
4 that's what I was trying to ask about. Rather than
5 looking forwarded and the 135 day life and what happens
6 after that, I'm talking about what is your position in
7 going back in affecting rates in the past and how that
8 would be corrected?

9 MR. BUB: Normally with a Commission rate
10 determination, they are prospective only. Here it's
11 different, because not only do we have a contractual
12 provision that calls for a true-up, we also have
13 Commission's order approving the M2A. You have to step
14 back and look at what the M2A was all about. The M2A was
15 the interconnection agreement, the Missouri 271
16 interconnection agreement that set out all the terms under
17 which we would interconnect with our competitors in the
18 context -- and that agreement's presented in the context
19 of our long distance authority case.

20 COMMISSIONER CLAYTON: And what is that
21 time period? Is it six months?

22 MR. BUB: The agreement calls for six-month
23 true-up.

24 COMMISSIONER CLAYTON: And Mr. Lumley said
25 that he -- it's their argument that the true-up has

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1 already occurred. So obviously you would disagree with
2 that. Tell me why.

3 MR. BUB: There has been an initial
4 true-up, and I think you have to look at what the -- this
5 whole thing is a process, and what the -- this goes back
6 to the FCC law in looking at the 271 type agreements with
7 interim rates. And if you look at the Commission's Order
8 approving the M2A, it was its Order issued March 15, 2001.
9 Title is Order Regarding Recommendation on 271 Application
10 Pursuant to the Telecommunications Act of '96 and
11 Approving Missouri Interconnection Agreement M2A.

12 It says, the fact that the M2A contains
13 interim rates is no barrier to our approval. The FCC has
14 made clear that the mere presence of interim rates -- and
15 this is a quote from the FCC Order -- the mere presence of
16 interim rates will not generally threaten the Section 271
17 application so long as an interim solution to a particular
18 rate dispute is reasonable under the circumstances, the
19 state commission has demonstrated its commitment to our
20 pricing rules, and provision is made for refunds or
21 true-up once permanent rates are set. And that's the cite
22 to the Texas order, paragraph 88.

23 And your order has a parenthetical
24 approving SWBT's Texas application despite interim rates
25 for interconnection. The Missouri Commission goes on to

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1 say that the Commission finds that the M2A reflects a
2 reasonable effort under the circumstances to set interim
3 rates in accordance with the Act and the FCC's rules. The
4 interim solution is reasonable because the rates are cost
5 based. This Commission has initiated cost proceedings
6 that will be completed expeditiously in Case No.
7 TO-2001-438, which is the underlying case in our remand
8 proceeding. There's two other case numbers. And SWBT has
9 agreed to abide by the Staff's true-up mechanism.

10 This whole true-up process is part of the
11 process that was outlined in the Order and in the
12 Commission's -- and in our 271 agreement. Just because
13 one part of the Commission's Order in which it set the
14 final rates was reversed doesn't mean that the process is
15 over.

16 What we have right now are rates that have
17 been declared unlawful because the District Court has
18 found that the cost of -- that the capital structure
19 element is noncompliant with TELRIC. So the rates we have
20 in effect right now are not lawful. They've been sent
21 back to further determine the capital structure, and once
22 that capital structure determination is made, then you get
23 back to us, we run it through our cost model and that will
24 produce all the rates.

25 The rates, even though you issued them as

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1 final rates, they didn't become permanent because they
2 were on appeal, and that one element has been reversed.

3 COMMISSIONER CLAYTON: So if there had not
4 been an appeal, then the true-up would be satisfied and
5 the rates would be final?

6 MR. BUB: We'd be done.

7 COMMISSIONER CLAYTON: So your argument,
8 the Order that was referenced, it didn't make any
9 reference to an appeal, did it, or any legal action?

10 MR. BUB: No, it did not.

11 COMMISSIONER CLAYTON: Or a future court
12 action making a finding?

13 MR. BUB: No.

14 COMMISSIONER CLAYTON: Is there anything in
15 the interconnection agreement or any other contract that
16 makes reference to changes in orders by a higher court or
17 something like it?

18 MR. BUB: I want to say change of law
19 provision. It's not really a change of law. This isn't
20 really a change of law. If I somehow wrongly conveyed the
21 impression that the District Court changed the law, that
22 was not the case.

23 COMMISSIONER CLAYTON: And so according to
24 your theory that the rates would remain interim rates
25 until there's a final order issued by this Commission

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1 after all appeals are final, is that what you're saying?

2 MR. BUB: Well, certainly we don't have
3 permanent rates that would trigger --

4 COMMISSIONER CLAYTON: Did I say rates or
5 rules? I may have said rules.

6 MR. BUB: I thought rates.

7 COMMISSIONER CLAYTON: I meant rates.

8 MR. BUB: Certainly we don't have permanent
9 rates until this remand proceeding is completed and you
10 give us the capital structure number and that's run
11 through, then we will have permanent rates.

12 COMMISSIONER CLAYTON: So what would be the
13 time period if we were to -- I suppose we have to change
14 the capital structure, but we issue our Order and let's
15 just assume nobody appeals. Okay? I know that's a great
16 leap of faith, but let's say no one appeals, we have a
17 final Order. What is the time period going back that SBC
18 would -- that the rates would have to be modified looking
19 backward?

20 MR. BUB: Looking backward, our view is
21 that the initial true-up that we did, I believe it was
22 around -- I think we went back to December '02, something
23 in that nature, and the rates we trued up to turned out as
24 a result of this District Court opinion to have been
25 unlawful.

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1 COMMISSIONER CLAYTON: So to --

2 MR. BUB: We believe that the true-up

3 should go back to correct the true-up that --

4 COMMISSIONER CLAYTON: Two years?

5 MR. BUB: Yes.

6 COMMISSIONER CLAYTON: Okay. And that
7 would be whether the rate is increased or decreased
8 depending on the result, it would be subject to refund or
9 there would be an increase?

10 MR. BUB: Yes.

11 COMMISSIONER CLAYTON: How would that be
12 handled in the contract between SBC and CLECs? Does the
13 new rate include a factor that would try to make that up
14 in a six-month period? Would it look beyond that, or is
15 this even a fair question to ask?

16 MR. BUB: That's something that could
17 probably be handled through negotiation with the parties.
18 I know when we did our initial true-up, when we did the
19 calculations we shared them with the CLECs individually,
20 what we thought the true-up amount would be, and where we
21 were owed money, I think we issued credits that would
22 apply over time.

23 And whatever the true-up amount would be
24 now, I think the parties can probably negotiate the actual
25 mechanism.

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1 COMMISSIONER CLAYTON: So that would be
2 subject to negotiation if, absent some settlement, then
3 the commission could have the responsibility of deciding
4 whether it was reflected in rates or whether the parties
5 paid, what, a lump sum amount or periodic payments or got
6 a payment back and had to send in the payments. Okay.
7 Is there any way to assess a value or
8 quantify in a dollar amount the value of this single issue
9 out of a 30-issue case -- and I'll ask this question to
10 all the parties -- with a change to the various positions
11 that are proposed, what that dollar change is or could be?
12 I guess I'll start with you, Leo.
13 MR. BUB: I don't know if anyone's run the
14 numbers specifically. It would really depend on the
15 number you come out with on capital structure. I can tell
16 you that there's certain major drivers in a cost study.
17 One of them's depreciation. To a large extent there's
18 capital structure -- I'm sorry -- the cost of capital
19 itself, but remember we're only dealing with one element.
20 COMMISSIONER CLAYTON: Well, if we make the
21 assumption there are, I think, only two positions left.
22 If one position was tossed out, then we have two positions
23 left. There's no evidence as to what the -- what that
24 dollar amount in change from the current set of rates and
25 the current capital structure would be versus the CLEC

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1 position or versus the SBC position?

2 MR. BUB: I don't think so, because when we
3 actually crunched numbers and produced the rates, there
4 was a lot of variables as you pointed out, and to isolate
5 how one would change, I don't think that could be done
6 without another study.

7 COMMISSIONER CLAYTON: Okay. What is the
8 rate that was actually set after crunching all the
9 numbers?

10 MR. LUMLEY: 10.32 was the weighted average
11 cost of capital.

12 COMMISSIONER CLAYTON: Forgive me. \$10.32?
13 No.

14 MR. LUMLEY: No. 10.32 percent. Sorry.

15 COMMISSIONER CLAYTON: Okay. Mr. Lumley,
16 is it your position that -- does the record as it exists
17 right now have a sufficient amount of evidence to support
18 your position at the hearing on the capital structure
19 issue?

20 MR. LUMLEY: Well, no, because our position
21 is that you need current data, and there would be
22 absolutely no evidence of that.

23 COMMISSIONER CLAYTON: If we were to decide
24 that we're going to use the old data?

25 MR. LUMLEY: Then we would still agree with

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1 Staff that witnesses should be allowed to restate their
2 position in light of the Court's decision, and that we
3 shouldn't arbitrarily try to cut out pieces of someone's
4 prior testimony and purport to try and understand what
5 they would have said had they known something that they
6 didn't know.

7 COMMISSIONER CLAYTON: What would happen --
8 not that cases take a long time to work their way through
9 the process here, but say we were not to issue a decision
10 until right up on the edge of this March 2005 ending
11 point. What happens? Anything?

12 MR. LUMLEY: We believe that it would be a
13 moot decision.

14 COMMISSIONER CLAYTON: Would be moot at
15 that point?

16 MR. BUB: We believe we'd have to true back
17 up.

18 COMMISSIONER CLAYTON: True back up and
19 then you-all would seek to -- okay. Bill? I know you're
20 wanting to get in on this.

21 MR. HAAS: No, your Honor, the Staff hasn't
22 taken a position on that question yet.

23 COMMISSIONER CLAYTON: Okay. Does Staff
24 have a position on the rate looking backward and forward?
25 Does Staff agree with the position of SBC or the position

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1 of the CLECs or does Staff have its own position on the
2 timing of a potential change in rates?

3 MR. HAAS: I'm not sure I followed the
4 question. Sorry.

5 COMMISSIONER CLAYTON: Well, as I
6 understand SBC's position is that if we make a change --
7 if we make a change in the capital structure, let's say
8 that it increases the rate, that SBC believes that that
9 rate should be applied looking back to December 2002,
10 correct?

11 MR. BUB: Yes.

12 COMMISSIONER CLAYTON: So not only we'd be
13 looking at a change in a rate on a prospective basis
14 looking forward, we would have to go back and have a
15 true-up for a two-year period on the change in the rate.
16 Now, if I'm misstating this, somebody correct me.

17 Okay. Mr. Lumley has stated that the
18 timing of the rate, if we were to change it and it would
19 go up, or down I'm assuming, that it would take place on
20 the date of the decision looking forward, that there would
21 only be a change in the rates moving forward. What is the
22 position of Staff?

23 MR. HAAS: The Staff hasn't developed a
24 position on that question yet.

25 COMMISSIONER CLAYTON: To develop a

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1 position on that, there wouldn't be a need for evidence,
2 that would be a legal decision, would it not? Or that's
3 not a factual determination.

4 Okay. Thank you-all very much.

5 JUDGE WOODRUFF: Commissioner Appling?

6 COMMISSIONER APPLING: A couple of
7 questions.

8 Mr. Bub, what is SBC asking the Commission
9 to decide in this case here? I want you to collect your
10 thoughts there for a few minutes while I ask a couple
11 questions to Mr. Haas if you don't mind. Okay?

12 Mr. Haas, following up on a question that
13 Commissioner Clayton asked, do you think that reviewing
14 the capital structure must result in a change of the UNE
15 rates? If we reviewed it again, would that require a
16 change in the UNE rates?

17 MR. HAAS: I think the answer would be yes,
18 because I don't see how the Commission could arrive at the
19 same capital structure as it did in the previous case.

20 COMMISSIONER APPLING: Okay. Everybody's
21 advocating that we have the authority to admit additional
22 evidence. What would be the minimum amount of evidence
23 that we would be allowed to admit?

24 MR. HAAS: The question of how much
25 additional evidence to admit is within the Commission's

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1 discretion, but I guess the minimum would be what was an
2 appropriate market-based capital structure for 1999 or
3 2000.

4 COMMISSIONER APPLING: This is a very
5 complicated case, specifically with the timing, and more
6 specifically is that only two people was here during that,
7 two of the Commissioners was here during the time you
8 first heard it.

9 But last question for you. Do you see any
10 possibility of a settlement in this case?

11 MR. HAAS: That's a better question for the
12 CLECs and Southwestern Bell.

13 COMMISSIONER APPLING: Okay. Thank you.
14 Let's go back to Southwestern Bell. Tell me, what do you
15 want this Commission to decide?

16 MR. BUB: Your Honor, we would like an
17 expeditious capital structure determination. It has taken
18 a long time to get to permanent rates, and frankly, the
19 true-up that we made back in December 2002 we wound up
20 giving back more money than we should have, and the longer
21 this drags out increases the risk that we'll never get an
22 appropriate true-up.

23 So we would first ask that a capital
24 structure determination be made expeditiously. We don't
25 think a hearing's necessary. We think that there's

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1 sufficient evidence in the record now, both from the ones
2 to collect the rates, SBC Missouri, and those that pay it,
3 the CLECs.

4 In the case their witness Mr. Hershlanger
5 introduced -- and this may be plowing over some ground
6 that was discussed earlier -- he introduced two different
7 capital structure figures. One was a book value capital
8 structure, the other was a market-based capital structure.

9 As I indicated before, I think you guys are
10 in the very similar position that the FCC was in the
11 Verizon Virginia decision. There are some differences.
12 Staff wasn't a party there. What the FCC did is they
13 looked at the evidence that was presented by Verizon on
14 the LEC, and they went with the straight market-based
15 capital structure just like we do.

16 The CLECs in that case, I believe it was
17 AT&T and WorldCom, they took a similar approach to the
18 CLECs in this case. They had a market-based and a
19 book-based capital structure, and then they averaged the
20 two. What the FCC did is they said that we can't use book
21 value in determining capital structure, so they
22 disregarded that evidence and based their decision on what
23 the incumbent LEC Verizon had presented on market value
24 capital structure and what the CLECs had provided on
25 market value capital structure and made a determination.

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1 Now, they didn't pick one or the other. I
2 think they made some minor adjustments to make something
3 else -- to square something else, but they did what we're
4 advocating here is using the evidence that's already in
5 the record of market-based capital structure presented by
6 SBC Missouri and the CLECs.

7 On the issue of true-up, we believe that a
8 true-up needs to be made to correct the initial true-up
9 that was made. As far as whether or not you need to make
10 that decision now, I don't know if that one's a critical
11 decision that you need to make now.

12 I think what's critical is to get a
13 determination, and once we have your determination we'd be
14 able to figure out what the rates are, we'll be able to
15 figure out what the impact is. Standing here, I can't
16 tell you. I don't know if Mr. Lumley's clients have done
17 the calculations to determine impact, but standing here I
18 can't tell you how much of an impact.

19 If we see that it's going to be a big
20 number, we may have one set of circumstances; if it's a
21 small one, another. And given the limited time of the
22 M2A, there may be some possibility when we get back
23 together as carriers and maybe we might at that time be
24 able to resolve the true-up mechanism. But at this point,
25 without knowing the actual dollar amount, it's kind of

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1 hard to determine how things will go in the future.

2 I think what's important is to get a new
3 capital structure number in so that we can crank the
4 rates, and then at that point if it's a material number,
5 you know, maybe we do what we want on the true-up, but
6 from our perspective what's important now is to get the
7 new rates.

8 COMMISSIONER APPLING: Mr. Bub, looking
9 into SBC's crystal ball, do you see any possibility of a
10 settlement of this case?

11 MR. BUB: I think it would depend on what
12 the magnitude of the rate change would be, and we're not
13 going to know that until we find out what the capital
14 structure is. Once we get that, we'll put it through our
15 cost models, all 30-something of them, and crank out new
16 rates and then we'll be able to see what the difference
17 is. If it's small, it may not be worth changing all sorts
18 of rate tables because there are business costs involved
19 in implementing a rate change. It may be something we
20 could reach settlement on.

21 COMMISSIONER APPLING: Mr. Lumley, would
22 you like to comment on it?

23 MR. LUMLEY: In terms of the settlement
24 question?

25 COMMISSIONER APPLING: Yes, sir.

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1 MR. LUMLEY: We believe because of the
2 limited time period that we think this Commission can
3 impact in a lawful order that the case certainly should
4 settle. This is a very unique situation where a court has
5 sent something back to you, but it has such a limited life
6 to it that we do believe that the parties should be able
7 to resolve this.

8 However, right now it's complicated by this
9 idea that somehow we're suddenly exposed to a two-month --
10 I mean a two-year retroactive change in all the dollars
11 we've paid.

12 And no, we have not been able to quantify
13 this, and frankly it's extremely difficult because most of
14 these rates have usage components to them, and so every
15 single CLEC has different usage characteristics and uses
16 different UNEs in different ways, and to try to come up
17 with an estimate, I'm sure it's possible if someone
18 retained an expert to run the numbers, but I don't think
19 anybody's done that. So I wish I could tell you that we
20 have.

21 But notwithstanding that, because of the
22 limited amount of time that we believe can be impacted
23 here, we do think that the parties should be able to
24 resolve this by settlement.

25 COMMISSIONER APPLING: Ma'am, any comments?

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1 MS. YOUNG: I think generally I agree with
2 what Mr. Lumley said, and the uncertainty of whether the
3 Commission will determine the rates to be applied
4 retroactively or prospectively is one that would prevent
5 any real settlement discussions at this point, and also
6 the uncertainty of what the extent of the evidence,
7 additional evidence the Commission may permit the parties
8 to provide, those two factors.

9 I mean, essentially we can't engage in
10 negotiations at this point that would be meaningful and
11 likely to result in a settlement.

12 COMMISSIONER APPLING: Thank you very much.

13 JUDGE WOODRUFF: I have a question, then
14 I'll come back to Commissioners for further questions as
15 well. It's to you, Mr. Lumley, and it's follow-up on what
16 Mr. Bub had indicated in discussing the true-up proposal.
17 Correct me if I'm wrong, Mr. Bub, but I understood that
18 SBC's position was the Commission does not need to make a
19 decision on the true-up question at this time, that that
20 would be a decision to follow. Mr. Lumley, do you agree
21 with that?

22 MR. LUMLEY: No. That's the exact opposite
23 message. My message was you need to know where you're
24 going before you decide how to get there. And if you
25 don't do that, if you don't decide, you know, right or

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1 wrong and whether I'm going to agree with you or disagree
2 with you, whether I'm going to appeal your decision or
3 not, if you don't make a decision first what it is you're
4 going to do with your results, I don't see how you decide
5 what's the appropriate procedure for making your decision.
6 JUDGE WOODRUFF: Okay. And your position
7 is that there would be no further true-up?
8 MR. LUMLEY: That's correct.
9 JUDGE WOODRUFF: And Mr. Bub, can you
10 explain to me again what your true-up position is? I
11 understand you're not asking for a new six-month true-up,
12 you're asking the Commission to go back and correct the
13 true-up that was done two years ago?
14 MR. BUB: Yes, your Honor.
15 JUDGE WOODRUFF: So in effect it would be a
16 two year and six month true-up, is that --
17 MR. BUB: Yes, if that's the correct number
18 of months.
19 JUDGE WOODRUFF: I'm just going on
20 approximate numbers.
21 All right. We'll go back to questions
22 from -- any further questions from the Commissioners?
23 Commissioner Murray?
24 COMMISSIONER MURRAY: Thank you. Yes.
25 This true-up issue, I was confused as to what was being

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1 requested here or being proposed. Mr. Bub, how does
2 that -- if we trued this up back to the point in time that
3 we set permanent rates in Case No. 438, how would that
4 differ from any rate case that we would have decided and
5 that went up on appeal without a stay, was remanded back
6 to us to determine a specific issue and we don't go back
7 and retroactively change rates even though a company may
8 have been suffering under rates that were unlawful
9 according to the court because the Commission didn't apply
10 something correctly? How does this differ from a typical
11 rate case where we don't go back and retroactively set
12 rates?

13 MR. BUB: This differs because in the M2A
14 agreement itself we have a retroactive true-up provision.
15 In an order approving the M2A there is, you know, specific
16 language approving a retroactive true-up, and it's all
17 based out of the FCC's law of using and incorporating
18 interim rates into a 271 agreement.

19 What they talked about, and this is in your
20 Order approving the M2A -- this is your Order -- the FCC
21 has made clear that, quote, the mere presence of interim
22 rates will not generally threaten the Section 271
23 application so long as an interim solution to a particular
24 rate dispute is reasonable under the circumstances, the
25 state commission has demonstrated its commitment to our

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1 pricing rules, a provision is made for refund or true-up
2 once permanent rates are set.

3 So we believe this differs from a rate case
4 because there's specific provisions both under the FCC law
5 and the Commission's laws expressed in its Order approving
6 the M2A and our agreement providing for a retroactive
7 application of the rate and true-up.

8 COMMISSIONER MURRAY: At the time permanent
9 rates are set, and we did set permanent rates in 438, did
10 we not?

11 MR. BUB: Yes.

12 COMMISSIONER MURRAY: Just like we set
13 rates in a rate case that may get appealed?

14 MR. BUB: Yes, but there's nothing in the
15 agreement, and this is maybe one point where I disagree
16 with Mr. Lumley as far as setting the date you issued that
17 Order. It would be our view that the rates, because of
18 our appeal they weren't final permanent rates because it
19 turned out they were unlawful because of the capital
20 structure.

21 COMMISSIONER MURRAY: Okay. Let me
22 interrupt you, because in a rate case you could argue the
23 same thing. We decide rates. Somebody appeals. We get
24 the case remanded based on one issue. You could still
25 argue those weren't permanent rates because it was on

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1 appeal, but if you didn't ask for a stay and get a stay,
2 we still don't go back and redo those rates, do we?

3 MR. BUB: Not in a normal rate case because
4 rates under state law apply only prospectively, and in
5 this case we're going not only by the laws expressed in
6 your Order but also under the FCC's Orders that provide
7 for retroactive true-up. So that's the difference.

8 Now, I agree that there is an issue that we
9 have on how long the true-up should be. Now, I agree that
10 we did not ask for a stay. That's a legal question that
11 you're going to have to determine the length of the
12 true-up. But as far as the entitlement to a true-up, that
13 comes from the M2A, the Order approving it and the FCC's
14 decisions concerning the use of interim rates in a 271
15 agreement.

16 Those three things don't exist in a normal
17 rate case, and under state law rates in a normal rate case
18 proceeding are only prospective.

19 COMMISSIONER MURRAY: Okay. Mr. Lumley,
20 are you -- you've indicated something earlier about you
21 have concerns about picking out isolated pieces from the
22 testimony because the parties didn't necessarily know what
23 the witnesses would have said if they had known what the
24 Court was going to say. Is that somewhat accurate?

25 MR. LUMLEY: Yes, ma'am.

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1 COMMISSIONER MURRAY: Are you saying that
2 the CLECs and Staff would have -- witnesses would have
3 come up with different market-based capital structures had
4 they known that those capital -- those market-based
5 capital structures would have been applied?

6 MR. LUMLEY: If I understand your question
7 correctly, not the specific figure, but what SBC's trying
8 to argue is, our witness came forward and said, I've
9 achieved a rate by looking at a high and a low, okay, and
10 achieved a capital structure in between. And what he's
11 now arguing is, because the court threw out the low,
12 therefore you must assume that my witness would have
13 endorsed the high figure, and --

14 COMMISSIONER MURRAY: But the high figure
15 was what your witness said was the market-based capital
16 structure, was it not?

17 MR. LUMLEY: No. He said it -- and I don't
18 have the testimony specifically in front of me, but he did
19 not endorse it as the forward-looking market-based capital
20 structure for SBC. He identified it as a high water mark,
21 he identified a low water mark, and he identified a number
22 in between those as the figure he was endorsing to you.

23 And they're trying to say you have to
24 ignore everything except this one number that he happened
25 to have in his testimony, and we don't think that's a fair

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1 way of interpreting someone's testimony when they don't
2 have the opportunity to explain themselves in light of a
3 change in circumstances.

4 COMMISSIONER MURRAY: When I hear that, it
5 sounds as if you're saying that the calculations of the
6 market-based capital structure would be result-oriented
7 rather than looking for what is a true market-based
8 capital structure.

9 MR. LUMLEY: No. I'm saying that a witness
10 had a particular approach that was an accepted approach
11 across the country, and in a surprise move a single
12 Federal District Court has said you have to put blinders
13 on and you have to ignore a certain piece of evidence.
14 And we don't know what our witness would say under those
15 circumstances.

16 COMMISSIONER MURRAY: But it sounds as if
17 you're saying your witness would say the market-based
18 capital structure is different under those circumstances.
19 Why would it be any different if the witness knew?

20 MR. LUMLEY: I'm not saying that his high
21 water mark would be different. What I'm saying is you
22 can't ignore the fact that he didn't endorse the high
23 water mark to you, and he should be allowed to explain in
24 light of the court's order where he believes the
25 appropriate result is.

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1 COMMISSIONER MURRAY: Did the witnesses
2 state that the high water mark was the market-based
3 capital structure?

4 MR. LUMLEY: I don't believe they described
5 it that way, but I don't have the testimony in front of
6 me. I believe they described their result as the
7 market-based.

8 COMMISSIONER MURRAY: Okay. Staff did not
9 present any market-based capital structure; is that right?

10 MR. HAAS: The Staff -- the Staff presented
11 what it thought was a market-based capital structure, but
12 it used the booked capital structure to achieve that, and
13 the court said you can't use the booked capital structure
14 even as a starting point.

15 COMMISSIONER MURRAY: So it's accurate to
16 say that Staff didn't do a market-based capital structure
17 analysis absent any reference to embedded costs?

18 MR. HAAS: Yes, that's correct.

19 COMMISSIONER MURRAY: And Mr. Lumley, I
20 believe you said that you had a concern about what we
21 would do with a new weighted cost of capital. I'm not
22 sure that I understand that as a valid concern, because in
23 this particular proceeding that was remanded to us, it
24 would apply only to this proceeding as I understand it,
25 and the M2A as long as it's in existence.

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1 MR. LUMLEY: If that's the scope of the
2 Commission's decision, I would agree with you. You would
3 be eliminating our concern. What our concern is is that
4 there's a history here at the Commission of saying in
5 subsequent arbitration proceedings we just looked at a
6 certain rate question recently, and so we're just going to
7 import that decision into this new case. And that's what
8 we're worried about. I'm not saying you will do that.
9 It's an issue that we've identified as a point of concern.

10 I would agree with you that if the
11 Commission definitively said we're only making a decision
12 for the purposes of closing out the M2A and we're not
13 going to rely on it in the future, you would have
14 eliminated that concern for us, I agree.

15 COMMISSIONER MURRAY: And I can see for
16 anything beyond the M2A that it would be outdated data
17 just as all the other data that was used in the M2A would
18 be outdated.

19 MR. LUMLEY: That's part of our concern.

20 COMMISSIONER MURRAY: I think that's all.
21 Thank you, Judge.

22 JUDGE WOODRUFF: Commissioner Clayton?

23 COMMISSIONER CLAYTON: It seems like this
24 whole true-up question is a bigger issue than the actual
25 capital structure issue in terms of dollars, isn't it?

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1 MR. LUMLEY: Yes.

2 MR. BUB: For us it'll depend on what the
3 rates are.

4 COMMISSIONER CLAYTON: Well, still it would
5 be whether we pick -- if we go from 55/45 to 60/40, 65/35,
6 or even 84/16 or whatever Bell's position is, regardless
7 of what that is, in terms of dollars the true-up value is
8 vastly larger than what -- I mean, because you're looking
9 at rates over a six-year period versus rates over -- rates
10 over a two-year period versus six months, correct?

11 MR. LUMLEY: Yes.

12 MR. BUB: Yes. From that perspective, yes.

13 COMMISSIONER CLAYTON: Okay. So that's a
14 huge issue in this case.

15 MR. BUB: And there is the issue of whether
16 it's a six-month or the two-year true-up. Certainly under
17 the language of the M2A it talks about six months, and we
18 did not ask for a true-up. I think there is a legal issue
19 of whether we can go back and correct the true-up. That's
20 our position, at the very least there ought to be a
21 six-month true-up from the setting of permanent rates.

22 COMMISSIONER CLAYTON: So that's an
23 alternative position?

24 MR. BUB: No, no, no,

25 COMMISSIONER CLAYTON: I'm sorry.

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1 MR. BUB: Our view is that the true-up that
2 was made needs to be corrected.

3 COMMISSIONER CLAYTON: So two years looking
4 back and forward while everyone else would -- the rates
5 would only change looking prospectively, correct?

6 Okay. Teaming up the issues that we will
7 have to take upstairs to agenda and go over, the first
8 question is, A, whether or not we take new evidence, and
9 if we say yes to that, it's what amount of evidence and
10 what issues that we're going to determine.

11 No. 2, we actually have to make the
12 determination of what the hypothetical capital structure
13 would be. And then No. 3, we have to decide this issue of
14 retroactivity versus prospective assessments of the rates.

15 MR. BUB: And how long that period would
16 be.

17 COMMISSIONER CLAYTON: Frankly, if we
18 were -- since that's a legal issue, we should be able to
19 decide that without any evidence. That would probably
20 give you-all quite a bit of guidance in resolving this,
21 wouldn't it? Maybe; maybe not.

22 Okay. Mr. Bub, true-up looking backward is
23 looking back the two-year period. Would that be only a
24 true-up with a modification of the capital structure or
25 would that involve a true-up of other issues that have

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1 occurred, other factual issues that have occurred over
2 that two-year period?

3 MR. BUB: Capital structure only.

4 COMMISSIONER CLAYTON: All right. Thank
5 you, Judge.

6 JUDGE WOODRUFF: Commissioner Appling?

7 COMMISSIONER APPLING: No further
8 questions.

9 JUDGE WOODRUFF: All right. I don't have
10 any further questions. I'm going to give the parties a
11 chance to give me about five minutes if they wish to make
12 sort of a closing statement, beginning with SBC.

13 MR. BUB: Thank you, your Honor. At this
14 time I'd just like to emphasize the importance of the
15 Commission issuing an expeditious decision on the capital
16 structure issue. Once we get that, we'll know what the
17 rate impact is, and if it is a very small impact, it may
18 be that business costs in changing rate tables, trying to
19 figure out what the true-up may outweigh the actual cost.

20 We're not going to know that until we get a
21 number. And once we get that number and can determine the
22 impact, at least from our perspective that will help guide
23 us in whether we might be able to work a settlement or
24 resolution with the CLECs in this case.

25 We don't believe a hearing is necessary.

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1 We think you have all the evidence here that you need both
2 to make a determination on what the capital structure
3 should be and how long and whether or not a true-up should
4 occur and how long it should be.

5 We think the only issue that you can
6 consider is the one that was specifically remanded to you
7 from the District Court, and that's the capital structure.
8 I think you'd be going beyond the mandate by considering
9 other elements, cost of debt, cost of equity.

10 There are a whole host of other elements
11 and inputs into these cost studies that also were not
12 appealed. They're not subject to change. They weren't
13 vacated. They weren't remanded. The only thing remanded
14 was the capital structure issue, and that's all that can
15 be redetermined on this remand.

16 JUDGE WOODRUFF: All right. For Staff?

17 MR. HAAS: Thank you. This case was
18 remanded to the Commission for reconsideration of the
19 appropriate capital structure and resulting rates. The
20 Staff would ask the Commission to use its discretion to
21 hear additional testimony on the appropriate capital
22 structure.

23 The question of whether there should be a
24 true-up or not, although related to this case, was not
25 part of the Commission -- pardon me -- part of the Court's

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1 remand, and once the Commission makes this decision on the
2 appropriate capital structure, it may be that at that
3 point one of the parties, one of the CLECs or Southwestern
4 Bell would make their arguments at that time as to whether
5 there should be a true-up.

6 I don't want to make things more difficult
7 than they already are, but there's the possibility that
8 the question of whether there should be a true-up is more
9 than a legal issue where you have a contractual term such
10 as what is a final rate, what is a permanent rate. Where
11 there's ambiguity you may need or want to hear testimony
12 from witnesses who were saying we helped write that, we
13 helped negotiate that, here is what we understood the term
14 to mean.

15 But at the current time we would ask the
16 Commission to hear additional evidence on appropriate
17 capital structure. Thank you.

18 JUDGE WOODRUFF: Ms. Young?

19 MS. YOUNG: I would be happy to defer to
20 Mr. Lumley to go first if that's all right.

21 JUDGE WOODRUFF: All right. Mr. Lumley?

22 MR. LUMLEY: Thank you, Judge.

23 First of all, we disagree that only one
24 issue has been remanded. Two issues were remanded. The
25 first is the capital structure. The second is, what are

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1 the appropriate resulting rates at this time? And you
2 have to wrestle with both of those. And as occurred in
3 the 438 proceeding, once you make a decision on this cost
4 study input, whether you do it solely looking at capital
5 structure or whether you look at the full calculation of
6 weighted average cost of capital, it's going to have to be
7 run through cost studies. Resulting rates are going to
8 have to be presented to you and be approved.

9 So all that's in front of you again. It's
10 just the nature of using these cost studies and trying to
11 get rates to them. You're not pulling single rates out of
12 the air. You're changing very complicated mathematical
13 equations and trying to verify the results, and the
14 results have to be appropriate and that means they have to
15 be TELRIC compliant.

16 Furthermore, Exhibit 1 to appendix pricing
17 UNE of the M2A has the paragraph that discusses the
18 one-time six-month true-up. And we can kind of get lost
19 in labels like interim and permanent. We all know there's
20 no such thing as a totally permanent rate. The point the
21 Commission made was certain rates were interim because
22 they had not been fully examined. They were interim
23 because they were going to be subject to a one-time
24 six-month retroactive true-up.

25 And retroactive price changes are very

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1 unusual, but you have done them on that kind of a basis.
2 You then issued an Order that said permanent rates, and it
3 triggered the one-time six-month interim true-up and that
4 occurred. And that was the end of that, and we're only
5 looking prospectively. And I just can't emphasize enough,
6 I think it's important for you to understand how your
7 results are going to be used so that you can make an
8 appropriate decision how to proceed.

9 As Commissioner Clayton has noted, this
10 true-up issue is the big issue. You could wrestle with
11 capital structure and the accompanying issues and have
12 hearings and make a decision on March the 5th of 2005 and
13 it won't have any impact under our view, but under SBC's
14 view we would still be subject to then a two and a half
15 year true-up, which there's just no legal or contractual
16 basis for.

17 Thank you.

18 JUDGE WOODRUFF: Thank you, Mr. Lumley.
19 Ms. Young, anything to add?

20 MS. YOUNG: Just very briefly. I would
21 generally concur in Mr. Lumley's statements and especially
22 emphasize that we do consider the question of whether the
23 changes will be applied retroactively or prospectively as
24 crucial. We feel that the parties should be given the
25 benefit of the bargain for certainty that was entered into

0082

1 at that time.

2 I'd also like to correct my earlier
3 references in my opening statement to the Court of
4 Appeals. Too long a history of not dealing with the
5 Federal District Court over the years. Those should have
6 been to the Federal District Court.

7 Thank you.

8 JUDGE WOODRUFF: All right. Thank you very
9 much for coming this morning. I will ask the court
10 reporter to expedite the transcript so that we have this
11 by this Friday, which will be October 22nd. And with
12 that, then, we are adjourned. Thank you.

13 WHEREUPON, the oral argument was concluded.

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