

D.P.U. 96-73/74, 96-75, 96-80/81, 96-83, 96-94-Phase 4-A

Consolidated Petitions of New England Telephone and Telegraph Company d/b/a NYNEX, Teleport Communications Group, Inc., Brooks Fiber Communications, AT&T Communications of New England, Inc., MCI Communications Company, and Sprint Communications Company, L.P., pursuant to Section 252(b) of the Telecommunications Act of 1996, for arbitration of interconnection agreements between NYNEX and the aforementioned companies.

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ORDER ON MOTION FOR RECONSIDERATION AND
RECALCULATION OF NYNEX; MOTION FOR RECONSIDERATION AND/OR
CLARIFICATION OF NYNEX; MOTION FOR RECONSIDERATION AND
CLARIFICATION OF MCI; MOTION OF AT&T TO STRIKE PHASE 4 COMPLIANCE
FILING AND FOR ORDER REQUIRING NYNEX TO SUBMIT A COMPLIANCE
FILING COMPLYING WITH PHASE 4 ORDER; AND MOTION FOR
RECALCULATION OF AT&T

I. INTRODUCTION

On December 4, 1996, the Department issued an order in this proceeding which set forth our rulings with regard to the method to be used by New England Telephone and Telegraph Company, d/b/a NYNEX ("NYNEX"), in carrying out total element long-run incremental cost ("TELRIC") studies to determine the prices to be charged by NYNEX to competing local exchange carriers for the use of unbundled network elements. Consolidated Arbitrations, D.P.U. 96-73/74, 96-75, 96-80/81, 96-83, 96-94 (Phase 4) (1996) ("Phase 4 Order"). The method employed by the Department was the one set forth by the Federal Communications Commission ("FCC") in its First Report and Order dated August 8, 1996 ("Local Competition Order").

On December 18, 1996, in conjunction with its compliance filing, NYNEX moved for reconsideration and recalculation with regard to two issues in the Phase 4 Order, the cost of capital and the calculation of certain cost factors. AT&T Communications of New England, Inc. ("AT&T") and MCI Telecommunications Corporation ("MCI") responded to this motion on December 31, 1996. Also on December 31, 1996, AT&T filed a cross-motion on the issue of calculating cost factors, and also filed a motion to strike NYNEX's Phase 4 compliance filing and for an order requiring NYNEX to submit a compliance filing that complies with the

Department's Phase 4 Order. NYNEX responded to AT&T's motions on January 13, 1997.

On December 31, 1996, NYNEX filed another motion for reconsideration and/or clarification with regard to the Department's ruling concerning the access rates the company should pay other exchange carriers for terminating calls to their networks. Statements in opposition to this motion were filed by Teleport Communications Group, Inc. ("TCG"), AT&T, and MCI on January 9, 10, and 13, 1997, respectively.

Also on December 31, 1996, MCI filed a motion for reconsideration and clarification with regard to the Department's findings concerning use of fiber in the feeder portion of the local loop and the manufacturers' discounts in the TELRIC studies. NYNEX responded in opposition to this motion on January 13, 1997.

The Department's standard for review of motions for reconsideration is well established:

A motion for reconsideration should bring to light previously unknown or undisclosed facts that would have a significant impact upon the decision already rendered. It should not attempt to reargue issues considered and decided in the main case. Commonwealth Electric Company, D.P.U. 92-3C-1A at 3-6 (1995); Boston Edison Company, D.P.U. 90-270-A at 3 (1991); Boston Edison Company, D.P.U. 1350-A at 4 (1983)...Alternatively, a motion for reconsideration may be based on the argument that the Department's treatment of an issue was the result of mistake or inadvertence. Massachusetts Electric Company, D.P.U. 90-261-B at 7 (1991); New England Telephone and Telegraph Company, D.P.U. 86-33-J at 2 (1989); Boston Edison Company, D.P.U. 1350-A at 5 (1983).

The Department's standard for review of motions for clarification is also well established:

Clarification of previously issued orders may be granted when an order is silent as to the disposition of a specific issue requiring determination in the order, or when the order contains language that is so ambiguous as to leave doubt as to its meaning. Boston Edison Company, D.P.U. 92-1A-B at 4 (1993); Whitinsville

Water Company, D.P.U. 89-67-A at 1-2 (1989). Clarification does not involve reexamining the record for the purpose of substantively modifying a decision. Boston Edison Company, D.P.U. 90-335-A at 3 (1992), citing Fitchburg Gas & Electric Light Company, D.P.U. 18296/18297, at 2 (1976).

Finally, with respect to motions for recalculation, the Department grants recalculation in instances where an Order contains a computational error or if schedules in the Order are inconsistent with the findings and conclusions contained in the body of the Order. Western Massachusetts Electric Company, D.P.U. 89-255-A at 4 (1990); Essex County Gas Company, D.P.U. 87-59-A at 1-2 (1988).

We will examine the filed motions in light of these standards.

Before turning to the motions for clarification and reconsideration, we first address AT&T's motion to strike the December 17, 1996, compliance filing made by NYNEX. In this order, we resolve a number of concerns raised by the parties, and these conclusions will require a new compliance filing by NYNEX. This order, therefore, renders AT&T's motion moot at this time, and we deny it without prejudice. It is our intention to hold an informal conference on the revised compliance filing to identify outstanding issues. If necessary, a formal hearing will be held to resolve evidentiary questions that might arise with regard to the compliance filing. A schedule for these hearings will be forthcoming from the Department.

II. ISSUES

A. Cost of Capital

1. Positions of the Parties

In its calculation of the cost of common equity, NYNEX employed a single-stage DCF methodology using Institutional Brokers' Estimate System ("IBES") data to determine the rate of growth in dividends. The DCF formula states that the cost of common equity is equal to the expected dividend yield plus the expected growth in dividends per share. NYNEX calculated its cost of equity as 14.8 percent. After an extensive discussion of the relative risks of providing unbundled network elements, the Department agreed with NYNEX that a comparison with a group of industrial companies ("S&P 400") was appropriate. We then focused on the specifics of the method employed by NYNEX and found that a particular aspect of that method, using a single-stage DCF analysis, was problematic. We therefore ordered NYNEX to calculate the cost of equity based upon a three-stage DCF method, such as that advocated by AT&T, but continuing to use the S&P 400 as a comparison group. Phase 4 Order at 38-52.

NYNEX argues that there is no precedent for employing a multi-stage DCF as ordered in this case and cites a number of Department decisions in which multi-stage DCF models were rejected. NYNEX states that, while the Department may change regulatory policies, it should base its changes on new record evidence and it must explain its rationale for changing established precedent. It further states that the use of the method is inconsistent with the bulk of the Department's order, in that its use results in a rate of return of 11.38 percent, which is

below the 11.50 percent rate of return last found reasonable for NYNEX. It suggests that this number was a result of mistake or inadvertence with respect to the impact of the decision.

AT&T argues that NYNEX has failed to demonstrate any basis for reconsideration of the Department's decision regarding the cost of equity capital, noting that the use of a particular method is not inconsistent with Department precedent or internally inconsistent or the result of mistake or inadvertence. AT&T further argues that the extent to which the calculation of NYNEX's cost of equity capital in the TELRIC study is higher or lower than previously allowed rates of return is irrelevant and does not require the Department to revise its decision.

2. Analysis and Findings

NYNEX is correct that the result achieved in this case is not consistent with our overall findings regarding the level of risk associated with the provision of unbundled network elements. The result, that the cost of capital used in the TELRIC model should be below NYNEX's previously allowed rate of return, flies in the face of those findings. In relying on the AT&T three-stage method, we were guided, in part, by Dr. Vander Weide's testimony, in which he stated that the later years in a DCF model get a lower weight (Tr. 8, at 91-93, 157). We expected, based on this testimony, that use of the multi-stage model would produce a minor adjustment to NYNEX's proposed 14.8 percent return on equity, a result which would have been consistent with our findings. Unfortunately, we did not actually ask for the model to be run during the course of the proceeding and only now learn that our interpretation of Dr. Vander Weide's testimony was mistaken, for the use of the multi-stage model produces results that are not reasonable, given our more qualitative

findings concerning the relative risk of providing unbundled network elements. In light of this previously unknown fact about the effect of using the multi-stage approach, we will not require that it be used to determine the cost of equity for the TELRIC study in this case. Instead, as suggested by NYNEX, we must view the record as a whole and thereby reach a judgment as to the appropriate cost of equity in the NYNEX TELRIC study. The witnesses in this proceeding have offered a range of proposed costs of equity capital from 11.0 percent to 14.8 percent, but we have found flaws in all of the methods offered. Fortunately, the witnesses have also offered extensive qualitative discussion as to factors that should be considered in arriving at this figure. In the Phase 4 Order, we devoted a substantial discussion to the level of risk associated with the provision of unbundled network elements. Phase 4 Order at 38-50. We conclude that our findings in the Phase 4 Order with regard to these matters should hold, and we use those findings in reaching our judgment. Viewing the entire record in this proceeding, we find that a 13.5 percent return on equity is reasonable given this level of risk. Accordingly, NYNEX's motion for reconsideration is granted in part.

B. Cost Factors

In the Phase 4 Order, the Department adjusted NYNEX's 1995 expenses to provide an estimate of a reasonable allocation of forward-looking joint and common costs. We found that such an adjustment was necessary to account for likely efficiency improvements in the face of improved technology utilization and competitive forces. We calculated an index of NYNEX's expense level to the ratio of other Bell operating companies and directed NYNEX to apply that ratio (1.22) to its 1995 operating expenses to develop the forward-looking joint and common

costs. Phase 4 Order at 59-61.

NYNEX argues that our calculation was in error, that we inadvertently included a total NYNEX figure, containing both New England Telephone and Telegraph Company ("NET") and New York Telegraph Company ("NYT"), in the fraction. The correct figure, states NYNEX, is 1.11. AT&T argues that the correct figure is actually 1.30, which is based on using the expense level for NYNEX in the numerator of the ratio and deleting the figures for NYNEX, NYT, and NET from the denominator. Alternatively, says AT&T, if the NET figure were to serve as the numerator, the separate NYT figure should be deleted from the denominator, yielding a ratio of 1.16.

The intent of our Phase 4 Order was to compare NET's expenses with those of the other regional operating companies, not to compare total NYNEX expenses with those companies. However, as correctly noted by NYNEX, we inadvertently failed to distinguish between the total NYNEX company and its two major subsidiaries, NET and NYT. (We did so because, in this proceeding, the term "NYNEX" has stood for "NET", and we mistakenly applied that interpretation to the exhibit in question.) To distinguish between the two requires that the numerator of the fraction be the NET figure. The total NYNEX figure should be excluded from the denominator because it includes NET, but the NYT figure should be included in the denominator because it is a separate operation from NET. Thus, the ratio should be calculated as suggested by NYNEX, i.e.,

$385 / [(456 + 399 + 342 + 338 + 319 + 317 + 310 + 296) / 8]$, or 1.11.

NYNEX then goes on to suggest that, had the Department properly calculated the ratio,

it would have not made the forward-looking adjustment to NYNEX's 1995 expenses because it would not have concluded that the company's cost position was inordinately high nor that the adjustment was warranted. On this point, NYNEX is mistaken. We did not make a finding that NYNEX's expenses were inordinately high; neither did we employ such a characterization as a rationale for our use of the ratio. Rather, we suggested that the ratio presents a useful surrogate of the extent to which NYNEX would have to reduce its expenses to be an effective competitor in a TELRIC network environment. It was for this reason that its use was warranted. That has not changed. While we are pleased to know that NET's relative expenses are, in fact, lower than we had calculated, we will nonetheless order that the revised figure be employed in the same manner intended for the original.

Thus, NYNEX's motion is granted in part and denied in part, and AT&T's motion is denied.

C. Terminating Traffic

NYNEX is requesting reconsideration or clarification of the Department's finding that competing carriers' end-office switches be treated as tandem switches for purposes of establishing the rates a local exchange carrier should pay for terminating traffic on those carriers' networks. TCG argues that this finding was in full conformance with the Act, consistent with the Local Competition Order, was based on substantial evidence in the record, and was just, reasonable, adequate and non-discriminatory. AT&T and MCI also argue that NYNEX has failed to demonstrate any basis for reconsideration of Department's finding on this issue.

We find that NYNEX's motion is an attempt to reargue issues considered and decided in the main case. Our decision was based on record evidence and is fully consistent with the Act and the Local Competition Order. Likewise the Order requires no clarification, in that there is no ambiguity in its meaning. Phase 4 Order at 69-70. NYNEX's motion is therefore denied.

D. Fiber in the Feeder

MCI moves for reconsideration of the Department's order with regard to its findings concerning use of fiber in the feeder portion of the network. According to MCI, evidence in the case does not support a cost justification for this use of fiber. MCI requests that, if the Department had intended to rule that it is not necessary for NYNEX to demonstrate that its TELRIC network is the least-cost method of providing today's narrow-band, existing telephone service, then the Department should so state, crystallizing the issues for purposes of appeal.

NYNEX opposes this motion, stating that the Department's findings were supported on the record and fully explained.

We find that MCI's motion is an attempt to reargue issues considered and decided in the main case. Our decision was based on record evidence and is fully consistent with the Act and the Local Competition Order. The rationale used by the Department in reaching its decision is clearly set forth. Phase 4 Order at 15-17. MCI's motion is therefore denied.

E. Manufacturers' Discounts

MCI asks reconsideration of the Department's findings with regard to the appropriate manufacturers' discounts for use in the TELRIC study. The company argues that the order

improperly used the discounts NYNEX currently receives for incremental additions to its current electronic equipment.

NYNEX opposes the motion, stating that the Department's finding were supported on the record.

NYNEX used its current vendor discounts in the TELRIC study, and, as described by NYNEX in its reply to MCI's motion, we found these to be appropriate and supported by the record.¹ We find that MCI's motion is an attempt to reargue issues considered and decided in the main case. MCI's motion is therefore denied.

III. ORDER

After notice, hearing and consideration, it is

FURTHER ORDERED: That the Motion for Reconsideration and Recalculation of New England Telephone and Telegraph Company, d/b/a NYNEX, filed with the Department on December 18, 1996 be and hereby is GRANTED in part and DENIED in part; and it is

FURTHER ORDERED: That the Motion for Reconsideration and/or Clarification of New England Telephone and Telegraph Company, d/b/a NYNEX, filed with the Department on December 31, 1996, be and hereby is DENIED; and it is

FURTHER ORDERED: That the Motion for Reconsideration and Clarification of MCI Telecommunications Corporation, filed with the Department on December 31, 1996, be and hereby is DENIED; and it is

FURTHER ORDERED: That the "Motion to Strike NYNEX's Compliance Filing and

¹ In reviewing the Phase 4 Order, we note that we inadvertently left out a conclusory sentence to that effect, but the implication of our discussion was nonetheless clear to the parties, as is evident from MCI's motion and NYNEX's reply. Phase 4 Order at 37.

For an Order Requiring NYNEX to Submit a Compliance Filing that Complies with the Department's Phase 4 Order" of AT&T Communications of New England, Inc., filed with the Department on December 31, 1996, be and hereby is DENIED without prejudice; and it is

FURTHER ORDERED: That the Motion for Recalculation of AT&T Communications of New England, Inc., filed with the Department on December 31, 1996, be and hereby is DENIED; and it is

FURTHER ORDERED: That the parties comply with all other directives contained herein.

By Order of the Department,

John B. Howe, Chairman

Janet Gail Besser, Commissioner