BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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| In the Matter of the Petition of Communication Options, Inc. for Arbitration of Interconnection Rates, Terms, and Conditions and Related Arrangements with United Telephone Company of Ohio dba Embarq, Pursuant to Section 252(b) of the Telecommunications Act of 1996. | ) | Case No. 08-45-TP-ARB |

ARBITRATION AWARD

The Commission, considering the petition, the evidence of record, posthearing briefs, and otherwise being fully advised, hereby issues its arbitration award.

APPEARANCES:

Brickler & Eckler LLP, by Ms. Sally Bloomfield and Matthew Warnock, 100 S. Third Street, Columbus, Ohio 43215, on behalf of Communication Options, Inc.

Mr. Joseph R. Stewart, 50 West Broad Street, Suite 3600, Columbus, Ohio 43215, on behalf of United Telephone Company of Ohio dba Embarq.

## I. BACKGROUND

Under Section 252(b)(1) of the Telecommunications Act of 1996 (the 1996 Act),[1] if parties are unable to reach an agreement on the terms and conditions for interconnection, a requesting carrier may petition a state commission to arbitrate any issues which remain unresolved, despite voluntary negotiation under Section 252(a) of the 1996 Act.

On August 22, 2007, the Commission adopted carrier-to-carrier rules in Case No. 06-1344-TP-ORD, *In the Matter of the Establishment of Carrier-to-Carrier Rules*.[2] Under Rule 4901:1-7-09(G)(1), Ohio Administrative Code (O.A.C.), an internal arbitration panel is assigned to recommend a resolution of the issues in dispute if the parties cannot reach a voluntary agreement.

1 The 1996 Act is codified at 47 U.S.C. Sec. 151 et. seq.

2 The carrier-to-carrier rules became effective November 30, 2007.

## II. HISTORY OF THE PROCEEDING

Rule 4901:1-7-09(A), O.A.C., specifies that any party to the negotiation of an interconnection agreement may petition for arbitration of open issues between 135 and 160 days after the date on which a local exchange carrier (LEC) receives a request for negotiation. According to the Petition for Arbitration (the petition) filed by Communication Options, Inc. (COI), on December 11, 2006, COI formally requested United Telephone Company of Ohio dba Embarq (Embarq) to commence negotiations for an interconnection agreement (ICA). The parties agreed to extend the 160-day negotiating period to January 16, 2008. COI timely filed a petition on January 16, 2008, to arbitrate the terms and conditions of interconnection with Embarq pursuant to Section 252 of the 1996 Act. In its petition, COI presented fifteen issues for arbitration.

On January 31, 2008, the attorney examiner issued an entry ordering that a prehearing conference be scheduled for February 21, 2008. The prehearing conference was conducted on that date, at which time the parties agreed to continue to negotiate for the purpose of reducing the number of issues in dispute. The parties also agreed to prepare a matrix of resolved and unresolved issues upon completion of the negotiations.

Embarq filed its response to the petition on February 11, 2008. Simultaneously, on the same date, Embarq filed a motion to dismiss the petition and an accompanying memorandum in support. In the motion to dismiss and the memorandum, Embarq argued that COI had not reviewed Embarq's cost studies and, thus, had not negotiated in good faith. COI filed a memorandum contra the motion to dismiss on February 19, 2008, contending that it was not obligated to review Embarq's cost studies and that if Embarq wanted to increase its rates, it must commence a total element long run incremental cost (TELRIC) proceeding. Embarq then filed a reply memorandum to COI's memorandum contra on February 26, 2008, reasserting its arguments from the motion to dismiss and accompanying memorandum.

On February 28, 2008, the attorney examiner issued an entry denying Embarq's motion to dismiss. The attorney examiner stated that Embarq has a duty to provide, to any requesting carrier, access to network elements at reasonable rates, as required by Section 251(c)(3) of the 1996 Act. Therefore, the attorney examiner concluded, if the parties elect not to negotiate or do not succeed on the matter of unbundled network elements (UNEs), the incumbent local exchange carrier (ILEC) must have TELRIC pricing available for the requested UNEs.

Embarq filed an interlocutory appeal on March 4, 2008, contending that denial of its February 11, 2008, motion to dismiss was in error because Section 251(c) of the 1996 Act applies, on both the ILEC and the requesting carrier, the duty to engage in good faith negotiations for rates. COI filed a memorandum contra the interlocutory appeal on

March 10, 2008, arguing that factual issues regarding good faith negotiations are not appropriate for interlocutory appeal. The attorney examiner issued an entry on March 26, 2008, denying certification of the interlocutory appeal because factual issues are not certifiable for interlocutory appeal under Rule 4901-1-15, O.A.C.

On June 9, 2008, the parties filed a joint letter agreeing to waive the time limits on the arbitration award date.

On June 16, 2008, the attorney examiner issued an entry ordering that the parties' arbitration packages be filed and a copy served upon the other party by noon on June 24, 2008. The entry also scheduled a status conference call for June 27, 2008, and set a hearing date of July 1-3, 2008.

On June 24, 2008, the parties filed arbitration packages containing exhibits and the written testimony of respective witnesses, as well as a matrix setting forth the issues to be arbitrated. In addition, also on June 24, 2008, Embarq filed a motion for a protective order regarding certain testimony by witness Christy Londerholm.

On June 27, 2008, the parties participated in a status conference call in preparation for the scheduled July 1-3, 2008, hearing. During the conference call, the parties disagreed on evidentiary issues regarding cost studies that were included within Embarq's prefiled testimony. The attorney examiner then determined that the hearing must be postponed in order to first address the evidentiary issues in contention. As a result, the attorney examiner issued a June 27, 2008, Entry that ordered COI, to the extent it objected to parts of Embarq's prefiled testimony, to file a motion to strike no later than June 30, 2008; Embarq was directed to file a memorandum contra no later than July 2, 2008. As directed, on June 30, 2008, COI filed its motion to strike, and on July 2, 2008, Embarq filed its memorandum contra, as well as an alternative motion to strike the testimony of COI witness August Ankum. On July 15, 2008, the attorney examiner issued an entry denying the motion to strike by both parties, and ordering that supplemental direct testimony must be filed no later than July 25, 2008. The attorney examiner also ordered that a status conference be scheduled for July 31, 2008.

Counsel for COI contacted the attorney examiner on July 23, 2008, indicating that counsel for Embarq had agreed to extend the date for submitting supplemental direct testimony to August 15, 2008. By entry issued on July 30, 2008, the attorney examiner approved the August 15, 2008, deadline for filing supplemental direct testimony, and rescheduled the status conference to August 21, 2008.

On August 13, 2008, COI filed a letter indicating that counsel for Embarq had agreed to further extend the deadline for filing supplemental direct testimony to August 20, 2008. The attorney examiner orally approved this request and changed the date of the status conference call to August 28, 2008.

The arbitration hearing was held on October 28-29, 2008. COI presented the testimony of witnesses Steve Vogelmeier and August Ankum. Embarq presented the testimony of witnesses Edward "Ted" Hart and Christy Londerholm. Ms. Londerholm also adopted and presented the testimony of James M. "Mike" Maples, who could not attend the hearing. Initial briefs were filed by the parties on December 5, 2008. Reply briefs were filed by the parties on December 19, 2008.

III. ISSUES FOR ARBITRATION

**Issues 1, 8, 9, 11, and 12** all pertain to the conditioning of DS1 Loops and the charges associated with the conditioning of these loops. In general, it is understood that loops may be conditioned to the extent necessary to provision advanced services. Embarq argues that it should be able to charge COI when conditioning of a loop is necessary. Embarq also contends that its charge for conditioning is not included in the price of Embarq's DS1 loop, but is a separate charge. COI believes that Embarq's DS1 loop prices include the cost of loop conditioning and that no additional charge is reasonable. In greater detail, Issues 1, 8, 9, 11, and 12, the ICA language proposed by each party, and further assertions of the parties are as follows:

**Issue 1: What is the appropriate definition of a DS1 Loop?**

Embarq's proposed language, with additional words proposed by COI in italics, reads as follows:

> Sec. 1.42 "DS1 Loop" is a digital Local Loop having total digital signal speed of 1.544 megabytes per second. DS1 Loops include, but are not limited to, two-wire and four-wire Copper Loops capable of, *because of included line conditioning,* providing high-bit rate digital subscriber line services, including T1 services.

**Issue 8: What terms and conditions should govern the availability of DS1 Loops?**

Embarq's proposed language, with additional words proposed by COI in italics, reads as follows:

> Sec. 45.6.1 Subject to the cap in Section 45.6.2, Embarq will provide CLEC nondiscriminatory access to a DS1 Loop on an unbundled basis to any building not served by a Wire Center with at least 60,000 Business Lines and at least four Fiber-based Collocators. Once a Wire Center exceeds both of these thresholds, no future DS1 Loop unbundling will be required in that wire center. DS1 Loops include, but are no limited to, two-wire and four-wire Copper Loops capable of, *because of included line*

*conditioning,* providing high-bit digital subscriber line services, including T1 services. The Wire Centers that meet these requirements as of the date of this Agreement are listed in Exhibit A.

**Issue 9: Can Embarq charge for conditioning of a DS1 Loop?**

Embarq's proposed language, with additional words proposed by COI in italics, reads as follows:

Sec. 48.6.3 *Other than for DS1 Loops,* if Embarq undertakes Conditioning activity for a particular loop to provide the successful installation of advanced services, CLEC will pay applicable conditioning charges as set forth in Table One pursuant to Section 54.3 of this Agreement.

**Issue 11: What is the definition of a conditioned loop?**

COI proposes deleting the word "excessive" from the following language proposed by Embarq:

Sec. 54.3.1 Conditioned loops are loops in which ~~excessive~~ bridge taps, load coils, low-pass filters, range extenders, and similar devices have been removed to enable the delivery of high-speed switched wireline telecommunications capability, including DSL. Embarq will condition loops at CLEC's request and will assess charges for loop conditioning in accordance with the prices listed in Table One. Embarq recommends that CLEC utilize the Loop Make Up process in Section 48 prior to submitting orders for loops intended for advanced services.

**Issue 12: Can ILECs charge CLECs for Loop Make-Up Information?**

COI proposes an additional contract section, for which Embarq offers no alternative language. COI's proposal states:

Sec. 54.3.2 *If CLEC orders Loop Make-Up Information for DS1 Loops prior to placing an order and conditioning is necessary to implement, loop conditioning charges will not apply. This waiver is exclusively on DS1 Loops.*

COI asserts that in each of the prior ICAs the language regarding "DS1 loops" was interpreted by Embarq in a manner that did not require the conditioning of DS1 loops and/or the collection of loop conditioning charges (COI Initial Brief at 2). According to COI, Embarq unilaterally changed its interpretation in September 2007 and initiated separate line conditioning charges for DS-1 loops (*Id.* citing Tr. Vol. I at 67). COI further asserts that the cost of loop conditioning is currently included in the installation and monthly recurring charges associated with DS1 loops (*Id.* at 3 citing Tr. Vol. I at 95). COI also contends that it cannot verify when line conditioning is necessary and/or when the associated charges are warranted (*Id.* at 3 citing Tr. Vol. I at 70). In addition, COI contends that Embarq does more line conditioning than is necessary by removing all bridge taps, even though the technology currently used by Embarq allows some bridge taps to be left in place without prohibiting the provisioning of advanced services (*Id.* at 5 citing Tr. Vol. I at 69). Lastly, COI is not contesting Embarq's ability to be compensated for line conditioning pursuant to orders set forth by the Federal Communications Commission (FCC) (*Id.* at 3 citing Tr. Vol. I at 95).

Embarq asserts that COI's definition of DS1 loops is inconsistent with the definition adopted by the FCC (Embarq Ex. 2 at 6). Embarq contends that by adding the phrase "because of included line conditioning" to the definition of DS1 loop, COI is indirectly seeking to address the issue of whether Embarq can charge COI for any line conditioning that Embarq must perform in order to provision a DS1 unbundled loop (*Id.* at 7). The definition of DS1 loop is included in Sections 1.42 and 45.6.1 (Issues 1 and 8) of the interconnection agreement and, according to Embarq, its definition is the same as the definition adopted by the FCC. Embarq argues that its definition should be incorporated into the ICA resulting from this proceeding. In response to COI's assertion that in September 2007 Embarq changed its policy for separately assessing line conditioning charges, Embarq states that it was simply a mistake on Embarq's part that the charges were not previously collected. Embarq also claims that its mistake in prior years is irrelevant to this issue. (Embarq Reply Brief citing Tr. Vol. 1 at 106-107).

Embarq also contends that when COI proposes adding the words "Other than for DS1 Loops" to Sec. 48.6.3 of the ICA (Issue 9), COI seeks to deny Embarq its ability to charge for line conditioning when it provisions a DS1 loop for COI (Embarq Ex. 2 at 10). Embarq explains that line conditioning includes removing from a copper loop (or subloop) any device, such as bridge taps, load coils, low pass filters and range extenders, that can diminish the capacity of the loop (Embarq Initial Brief at 7). In addition, Embarq points out that the FCC decided that ILECs are legally permitted to charge competitive local exchange carriers (CLECs) for line conditioning (*Id.*). Lastly, Embarq avers that it is appropriate to charge separately for line conditioning because not all DS1 loops require conditioning to provide advanced services. Embarq states that if a loop is short, with limited bridge taps and without any load coils or similar devices connected, it is possible to provision a DS1 loop without conditioning. As such, Embarq disagrees with COI that the phrase "Other than for DS1 Loops" should be incorporated into the ICA.

Embarq asserts that the definitions proposed by each party for "conditioned loops" are identical, except that COI proposes to delete the word "excessive" from the definition (Embarq Initial Brief at 8)(Issue 11). Embarq contends that COI's proposal is incorrect, because it is unnecessary to remove all bridge taps from a loop to enable the loop to provide services such as xDSL (*Id.*). Embarq supports this contention by referencing the

*Telecordia Notes on the Network* and to a standard promulgated by the American National Standards Institute (*Id.* at 8 citing Embarq Ex. 2 at 18-19). Embarq further asserts that its definition is consistent with the manner in which Embarq conditions its own loops. Finally, Embarq avers that its proposed definition is consistent with the FCC's definition of line conditioning and with other FCC orders (*Id.* at 8 citing Embarq Ex. 2 at 20-21). As such, Embarq disagrees with COI's proposal to remove the word "excessive" from Embarq's proposed ICA language.

Lastly, Embarq asserts that loop make up information is provided as part of the pre-ordering function, is a subset of the Operation and Support Systems unbundled network element, and is subject to the TELRIC pricing methodology as required by the FCC (*Id.* at 9 citing Embarq Ex. 2 at 24). Embarq avers that the FCC has not required ILECs to provide access to unbundled network elements for free (*Id.* at 9 citing Embarq Ex. 2 at 24). Embarq requests that COI's proposed language for Section 54.3.2 of the ICA (Issue 12) be rejected (*Id.*). Embarq has not proposed any alternative language.

**ISSUES 1, 8, 9, 11, and 12 ARBITRATION AWARD**

The Commission agrees with Embarq that it has already been clearly established by the FCC that ILECs may be required to incur costs in removing impairments on loops to enable CLECs to use the loop to provide advanced services (Embarq Ex. 2 at 12-13 citing *In the Matter of Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Radio Service Providers*, CC Docket No. 96-98 and CC Docket 95-185, First Report and Order, Released August 8, 1996, "Local Competition First Report and Order," ¶382). The FCC has further established that ILECs "shall recover the costs of line conditioning from the requesting telecommunications carrier" (*Id.* at 13 citing Title 47 C.F.R. §51.319(a)(1)(B)). While it appears that COI does not dispute the right of Embarq to charge COI for line conditioning, there is no evidence to support COI's claim that loop conditioning, a non-recurring cost element, is recovered in the monthly recurring and installation costs of DS1 loops. According to Embarq's testimony in this proceeding, it does not include any non-recurring costs in the cost of a DS1 loop (Embarq Exhibit 3 at 33-34). As such, COI's proposed language in support of that claim is not necessary. The Commission also agrees with Embarq that a mistake in billing in previous years is not relevant and does not prove that line conditioning costs are currently included in Embarq's DS1 loop rates. Thus, Embarq's proposed language, without the modifications proposed by COI, should be adopted for Issues 1, 8, and 9.

Regarding COI's belief that Embarq does more line conditioning than necessary, and thus COI's proposal to delete the word "excessive" from Sec. 54.3.1 (Issue 11), the Commission observes that deletion of "excessive" will have the opposite result from what COI seeks. Deleting "excessive" from Sec. 54.3.1 would require Embarq to remove all bridge taps from the loop. Both Embarq and COI appear to be in agreement that not all bridge taps need to be removed. Indeed, the Commission takes notice that COI's Initial Brief recommends that Section 54.3.1 include the word "excessive," a recommendation that is identical to Embarq's (COI Initial Brief at 7). Therefore, Embarq's proposed Sec. 54.3.1 language, without COI's modification, is appropriate and should be included in the ICA.

Finally, as to COI's concern that it cannot verify when line conditioning is necessary and/or when the associated charges are necessary, the Commission observes that COI's proposed language in Issue 12 does not address Embarq's verification process. Rather, COI's language is simply another attempt to prohibit Embarq from charging for line conditioning separately from DS1 Loop rates. The Commission has already resolved Issue 12 in its discussion of Issues 1, 8, 9, and 11, and, therefore, rejects COI's proposed language in Section 54.3.2. While we are not ruling on Embarq's current verification process, the Commission notes Embarq's claim that the issue should become moot once COI implements its own test equipment on Embarq circuits, as planned by COI (Embarq Reply Brief at 5 citing Tr. Vol. I at 111).

**Issue 2: What is the appropriate number of days for COI to review its bill and submit payments for services under the agreement and what amount of time should elapse before Embarq enforces certain collection procedures and limits COI's access into Embarq's systems?**

Embarq proposes that the following language be incorporated into the ICA:

> 7.2.3 If an invoice is not paid within forty-five (45) days after the bill date, Embarq may cancel any pending orders.
>
> 7.2.4 If the account remains delinquent sixty (60) days after the bill date, Embarq will terminate all services under this agreement.

Embarq asserts that its proposed language is reasonable, inasmuch as it provides COI with one and one-half months to pay undisputed amounts. To the extent that there is a dispute, Embarq will suspend the collection process and extend the payment interval while the dispute is investigated (Embarq Initial Brief at 10 citing Embarq Ex. 1 at 5). Embarq explains that it is necessary to limit the number of days for payment of undisputed amounts because extending the payment period allows charges to continue to accrue, thus increasing the credit risk to the wholesale provider. Embarq also highlights the fact that, unlike tangible goods, provided telecommunications services cannot be recovered and do not have any future value. In support of its position, Embarq alleges that COI has a history of late payments, has paid fewer than one of five invoices by the due date, and has paid approximately one of every five invoices fifty or more days after the invoice date (*Id.* at 11 citing Embarq Ex. 1 at 10).

Embarq believes that it provides COI with billing information promptly after the billing date. For example, according to Embarq, for the first six moths of 2008, the average time for the delivery of the compact disc containing billing information was 7.6 days from the bill cycle date (*Id.* at 11 citing Embarq Ex. 1 at 7). Embarq also asserts that the forty-five day period is reasonable, because COI has chosen not to receive the bills via the most expedient method. Specifically, Embarq notes that it offers an electronic billing format that provides a CLEC customer with the bill data within four days after the invoice date. In response to COI's claim that it requires a great deal of time to review its bills, Embarq believes that, on a monthly basis, each invoice is significantly the same because of the repetition of recurring charges (*Id.* at 11 citing Embarq Ex. 1 at 8).

COI advocates that the suspension/termination language contained in the existing ICA be incorporated into the new ICA. COI's proposed language reads as follows:

> 7.2.3 If an undisputed invoice is not paid within sixty (60) after the bill date, Embarq may suspend processing new orders and cancel any pending orders.
>
> 7.2.4 If the account remains delinquent ninety (90) days after the bill date, Embarq will terminate all services under this Agreement.

COI avers that, while the payment period is a set amount of time calculated from the invoice date, it is always at least several days or more before the bill is actually transmitted to the customer. As a result, COI contends that the payment time period has never been the full amount of time specified on COI's invoice or bill (COI Initial Brief at 7). Specifically, COI asserts that its regular experience has been that Embarq's invoices are received about sixteen days after the actual invoice date (*Id.* citing Tr. Vol. II at 239). Therefore, COI believes that it is deprived of a significant number of days in the suspension and/or termination calculation (*Id.*). COI believes that it is more appropriate to tie the suspension or termination interval to the date of receipt of the invoice (*Id.* at 8).

In support of its position that Embarq's proposed language should be rejected, COI explains that each month Embarq sends approximately ten voluminous bills varying in length from fifty to 1,600 pages. Therefore, COI states, each month it must review approximately 1,000-5,000 items consisting of charges and credits. COI represents that Embarq's bills are difficult to decipher and require considerable additional work (i.e., nearly 126 man hours) for COI personnel to verify the c harges on the bill (*Id.* at 9 citing Tr. Vol. I, 10-14; Tr. Vol. II, 204; COI Ex. 1 at 13-14). As additional support for its position that Embarq's shortened time frames should be rejected, COI points out that, since 2000, it has received nearly $2 million in credits as a result of Embarq's billing mistakes (*Id.* at 11 citing Tr. Vol. I at 53).

COI notes that over the past ten years, the companies have had four different ICAs that have all incorporated suspension and termination provisions of sixty and ninety days, respectively. COI highlights the fact that these provisions only apply to the disputed portions of the bill. The company also submits that the company has paid, and will continue to pay, the undisputed portions of the bill within the initial sixty-day period. Additionally, COI asserts that Embarq has never invoked the suspension/termination provisions in its current ICA (*Id.* at 11-12 citing COI Ex. 1 at 3-4; Tr. Vol. II at 271). Further, COI represents that it makes regular weekly payments in the amount of approximately $100,000 regardless of whether any charges are disputed (*Id.* at 8 citing Tr. Vol. I at 85; Tr. Vol. II, 220; COI Ex.1 at 3).

Finally, COI asserts that Embarq has failed to provide a substantial reason as to why the current suspension/termination provisions need to be revised. Specifically, COI rejects Embarq's contention that the disputed changes are necessary in order to establish uniform contracts (*Id.* at 12 citing COI Ex. 1 at 4).

**ISSUE 2 ARBITRATION AWARD**

A review of the record reflects that the use of File Transfer Protocol (FTP) can reduce the applicable interval between the bill date printed on a bill and the time upon which it is received by COI from the current average fifteen-day time frame to five days or less (Tr. Vol. I at 60-61, 81-82). COI explains that in order to utilize the FTP, it must be capable of reading the transmitted bills in the BOS-45 billing format (*Id.* at 40-42, 64). COI states that it is currently engaged in the process of testing for electronic billing utilizing FTP and is committed to utilizing FTP upon successful completion of testing, which it suggested should likely occur within one month of the hearing (*Id.* at 82, 92). COI acknowledges that, assuming the FTP testing is successful, it is willing to accept the suspension/termination language incorporated in Embarq's proposed ICA (*Id.* at 92). Further, COI states that it is developing a program that will lessen the time that it takes to verify Embarq's bills (*Id.* at 16). Therefore, the Commission determines that Embarq's proposed language in 7.2.3 and 7.2.4 should be adopted. The Commission directs Embarq to assist COI with the timely resolution of any implementation or utilization difficulties COI may encounter with electronic billing. Within thirty days of this Award, the parties are directed to notify the Commission in this docket as to whether COI's testing for electronic billing utilizing FTP has been successful and whether COI is utilizing electronic billing at that time.

**Issue 7: Is it reasonable for Embarq to require a security deposit from COI for services and interconnection to be provided under this agreement?**

Embarq proposes the following language regarding security deposits:

Sec. 37.4 Security deposits shall be in an amount equal to two (2) months' estimated billings as calculated by Embarq, or twice the most recent month's invoices from Embarq for existing accounts. All security deposits will be subject to a minimum deposit level of $10,000.

Sec. 37.9 Any security deposit may be held during the continuance of the service as security for the payment of any and all amounts accruing for the service. No interest will accrue or be paid on deposits.

(Joint Matrix of Disputed Issues, submitted with COI Arbitration Package, June 24, 2008.)

Embarq states that it has included comparable security deposit language in its ICAs since 2002 and began doing so because of financial problems that the CLEC industry has experienced since 2001, some of which resulted in financial losses to Embarq (Embarq Exhibit 1 at 12; Tr. Vol. II at 295-296). Embarq asserts that it is often the largest or one of the largest creditors when a CLEC files for bankruptcy, and adds that when COI filed for bankruptcy in 2000, there was an unsecured amount of $685,000 owed to Embarq's predecessor and former parent Sprint. According to Embarq, part of the $685,000 was paid out over a five year plan, but the remaining loss to Embarq was $616,500 (Embarq Exhibit 1 at 12).

Regarding the appropriate amount for a security deposit, Embarq states that COI is typically billed approximately $400,000 per month. Embarq witness "Ted" Hart (Mr. Hart) contends that "given COI's propensity for late-paying undisputed amounts, oftentimes stretching past the day 50 invoice aging mark, COI creates a situation where it could be ten days or less from owing Embarq for three months' worth of billings" (*Id.* at 13). Thus, Mr. Hart asserts, if the ninetieth day after the initial invoice date is, as COI recommends, set as the deadline for Embarq's disconnection of service for nonpayment (see Issue 2), Embarq will be only two days away from being owed for four months of billing by COI. Mr. Hart observes that if Embarq were indeed owed such an amount, the debt would be twice the amount that Embarq proposes for a security deposit (*Id.*). Embarq realizes that it can be difficult and complex for COI to validate Embarq's bills for accuracy, resulting in some delay in payment, but believes that after conducting business with Embarq for ten years and being in business for seventeen years, COI should have made "substantial electronic manual mitigation efforts" to prevent unpaid bills stretching to more than forty-five days (Tr. Vol. II at 280-281). With the foregoing in mind, Embarq argues that its proposed security deposit of two months' worth of invoices is reasonable (Embarq Ex. 1 at 13).

While conceding that COI has made weekly payments to Embarq during and after COI's bankruptcy (Tr. Vol. II at 220) and established credit with Embarq (*Id.* at 254), Embarq believes that such payments do not mitigate any risk to Embarq (*Id.* at 222).

Embarq explains that its proposed language does not arise out of questions about COI's ability to pay, but rather to make "more enforceable" and "more certain" that Embarq will have a security deposit when it is needed (*Id.* at 278-279). Embarq favors a nonrefundable security deposit even if COI has shown a history of prompt payment, because the deposit provides Embarq, as an unsecured creditor, "some basis for collecting on the investment devoted to enabling the CLEC's business" (Embarq Ex. 1 at 13-14). While aware that some contracts require the return of a security deposit and that Commission policy requires the return of a residential security deposit under certain circumstances (Tr. Vol. II at 254), Embarq considers its relationship to COI be different, because COI could owe Embarq for three months' billing at $400,000 per month, while the amount that a residential customer might owe after three months would be of "another magnitude" and a "completely different . . . size" (*Id.* at 261-262). According to Mr. Hart, although the parties have not discussed the possibility of a reduction in the security deposit after a probationary period of time, Embarq would be entirely opposed to such a policy (*Id.* at 295).

Embarq finds it reasonable to hold a security deposit and not pay interest, because the purpose of the deposit is to limit Embarq's financial exposure to COI and not be COI's financing source. Embarq suggests that COI utilize a letter of credit from a financial institution as a deposit, thereby keeping its cash and earning interest (Embarq Ex. 1 at 14; Tr. Vol. II at 247).

Embarq opposes making a reciprocal security deposit to COI because of COI's different credit profile than Embarq (Tr. Vol. II at 250, 265). In explanation, Embarq states that it has been in business for over 100 years in its earliest form and publicly traded since the 1950s or 1960s, and is a company with much greater and deeper financial resources than what it knows about COI. Thus, concludes Embarq, the risks associated with conducting business with Embarq, compared to COI, differ (*Id.* at 259).

Regarding COI's allegation that Embarq was late in paying its bills for three or four months, Mr. Hart asserted that Embarq generally pays its bills within the thirty day time frame allowed, and that on the occasion referred to by COI, Embarq filed a dispute which resulted in a settlement agreement (*Id.* at 282). When asked whether Embarq had not even filed the dispute until several months had elapsed, Mr. Hart was uncertain (*Id.* at 287).

COI contends that Embarq's proposed security deposit language is unreasonable and should be replaced with language in the currently effective ICA, which reads as follows:

> Sec. 36.1 Sprint reserves the right to secure the account with a suitable form of security deposit, unless satisfactory credit has already been established through twelve (12) consecutive months of current payments for carrier services to Sprint and all ILEC affiliates of Sprint.

> Sec. 36.8 . . . Cash or cash equivalent security deposits will be returned to CLEC when CLEC has made current payments for carrier services to Sprint and all Sprint affiliates for twelve (12) consecutive months.

(COI Ex. 1 at 5).

COI presents several arguments against Embarq's proposed language.

First, COI argues, it has never paid a security deposit to Embarq during a relationship of nearly two decades (COI Initial Brief at 14 citing Tr. Vol. I at 89 and Tr. Vol. II at 241), even after COI's emergence from bankruptcy (Tr. Vol. I at 89), and Embarq currently holds no security deposit from COI (COI Initial Brief at 14 citing Tr. Vol. II at 241). Furthermore, adds COI, no other telecommunications entity that it contracts with has required a security deposit (*Id.* at 14 citing Tr. Vol. I at 105). COI argues that the purpose of a security deposit is to assure that a vendor is not at risk from customers having poor payment records, and that if a customer fails to pay, the vendor is paid from the deposit until the vendor terminates the contract (COI Ex. 1 at 5, 7). Indeed, contends COI, even Embarq witness Mr. Hart stated that a security deposit provides a backstop for potential losses (COI Initial Brief at 13 citing Tr. Vol. II at 253.) However, argues COI, there is no need for it to make such a deposit, even in the form of a letter of credit, because it has paid its bills in timely manner every week (COI Ex. 1 at 3; Tr. Vol. I at 85, 91) and has proven its financial responsibility for ten years (COI Ex. 1 at 6). COI asserts that it has never had any of its accounts suspended or terminated because of late payments (COI Initial Brief at 17 citing Tr. Vol. II at 242 and Tr. Vol. I at 89).

Regarding its filing for Chapter 11 reorganization in August 2000, COI explains that it had disagreed with Embarq over the billing of unbundled network elements platform (UNE-P), and that, while COI had argued that UNE-P could not be billed, Embarq contended that such billing was proper (Tr. Vol. 1 at 29). COI adds that the Chapter 11 reorganization resulted in weekly payments of approximately $100,000 to Embarq (COI Exhibit 1 at 3; COI Initial Brief at 16 citing Tr. Vol. I at 89, COI Ex. 1 at 3, and Tr. Vol. I at 19). Finally, while disagreeing that originally in the bankruptcy proceeding it had owed Embarq approximately $680,000, COI states that the bankruptcy reorganization resulted in a settlement, under which COI paid Embarq the "undisputed amount" at issue (Tr. Vol. 1 at 31), including $68,000 over a five-year period (*Id.* at 29-31, 45). COI also contends that from 2000 to present, Embarq has credited $2,000,000 to COI (*Id.* at 53) to compensate for improper billing by Embarq (COI Initial Brief at 20 citing Tr. Vol. I at 44).

COI considers it ironic that Embarq seeks a security deposit, because COI has made full and timely payments (COI Initial Brief at 13), while Embarq has been late in paying COI (Tr. Vol. I at 52-53). Specifically, argues COI, in May 2007 Embarq withheld payment of bills for four months but did not issue a dispute of any type (COI Ex. I at 7; COI Initial Brief at 20 citing Tr. Vol. I at 87). COI asserts that after it contacted Embarq several times regarding the nonpayment, Embarq sent a claim for the total amount of the four monthly invoices rather than for the disputed amount only (COI Initial Brief at 20 citing Tr. Vol. I at 90; COI Ex. 1 at 7).

Second, COI objects to the amount of the security deposit that Embarq proposes. In COI's opinion, an $800,000 deposit is substantial, and Embarq has indicated that it would require the security deposit when the ICA becomes effective, rather than after a triggering event such as numerous payment defaults, even though COI pays its bills weekly and has not had its accounts suspended or terminated for late payments (COI Initial Brief at 16-17 citing COI Ex. 1 at 3, 5-6 and citing Tr. Vol. II at 241, Tr. Vol. I at 89).

Third, COI disagrees with Embarq's proposal that a security deposit be retained for the entire term of the ICA, rather than until COI has proven that the security deposit is no longer necessary, as is mandated by the currently effective ICA language (*Id.* at 17 citing Tr. Vol. II at 254 and COI Ex. 1 at 5). COI adds that while Chapter 4901:1-17, O.A.C, which is titled "Establishment of Credit," applies to residential customer billing, its provisions are similar to the currently effective ICA language. Under Rule 4901:1-17-06, O.A.C., adds COI, a deposit must be returned if a customer (a) has made payment for twelve consecutive months without being terminated, (b) there are no more than two times during the twelve months that bills were not paid timely, and (c) the customer is not delinquent when the deposit is to be returned (*Id.* at 17). COI urges the Commission to consider the provisions of Chapter 4901:1-17, O.A.C., when examining the language proposed by Embarq (COI Ex. 1 at 6-7). Indeed, notes COI, even Embarq witness Mr. Hart stated that the regulatory framework for telecommunications often allows a security deposit to be returned to a customer after a certain length of time (COI Initial Brief at 17 citing Tr. Vol. II at 254), while he also acknowledged that COI has already established its credit with Embarq (*Id.* at 17-18 citing Tr. Vol. II at 254).

Fourth, observes COI, under Embarq's proposed language no interest would be paid on a security deposit (*Id.* at 18 citing Tr. Vol. II at 254 and COI Ex. 1 at 5, 6), even though COI has a satisfactory record of payment (*Id.* at 18 citing COI Ex. 1 at 5). In contrast, asserts COI, Rule 4901:1-17-05, O.A.C., requires that a minimum interest rate of three percent must be paid if the deposit of a residential customer is held 180 days or longer (*Id.* at 18). Given that Embarq's proposal would require COI to make a security deposit of $800,000 for the period of the ICA, and if Rule 4901:1-17-05, O.A.C., were applicable, COI calculates that it would earn a total of $36,000 over the term of the ICA (*Id.*).

Finally, argues COI, if the Commission decides that Embarq is entitled to a security deposit from COI, there should be a reciprocal deposit to COI. COI contends that although it has proposed reciprocity, Embarq refused to discuss the matter (*Id.* citing COI

Ex. 1 at 7). COI adds that only during the arbitration hearing did Embarq even raise the possibility of a security deposit offset (*Id.* citing Tr. Vol. II at 256).

COI asserts that while it receives reciprocal compensation payments from Embarq (*Id.* at 19 citing COI Ex. 1 at 7), Embarq has not always paid bills in timely manner (*Id.* at 19), and given COI's limited finances relative to Embarq (*Id.* citing Tr. Vol. II at 251), the risk associated with Embarq not paying COI is greater than the risk associated with COI not paying Embarq (*Id.* citing Tr. Vol. I at 26). COI contends that it has no leverage and must pay its Embarq bills monthly or face a letter of suspension, but if Embarq does not pay COI, COI's only recourse is at the Commission (*Id.* citing Tr. Vol. I at 27). In addition, asserts COI, while Embarq is a large, publicly traded company that has existed for some time, such conditions do not always indicate financial stability (*Id.* citing Tr. Vol. II at 267-270). In sum, contends COI, a reciprocal security deposit would compensate for Embarq's "inability to work within the terms of the contract," i.e, Embarq's objecting to all charges on certain bills, despite the currently effective ICA allowing only disputed charges to remain unpaid (*Id.* at 19-20 citing Tr. Vol. I at 88-90).

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The Commission recognizes COI's contentions that it has proven its creditworthiness to Embarq (COI Ex. 1 at 6; COI Initial Brief at 17-18 citing Tr. Vol. II at 254) and that Embarq has, to date, not required a security deposit from COI, even after COI's bankruptcy (COI Initial Brief at 17-18 citing Tr. Vol. II at 254). Furthermore, it is significant that COI has never had its accounts terminated or suspended by Embarq because of lack of payment, and that COI continues to provide weekly payments to Embarq in the amount of $100,000 since emerging from bankruptcy nearly five years ago (COI Exhibit 1 at 3, Tr. Vol. II at 241-242, Tr. Vol. I at 89). In addition, as pointed out previously, Embarq explains that its proposed language does not arise out of questions about COI's ability to pay, but rather to make "more enforceable" and "more certain" that Embarq has a security deposit when needed (Tr. Vol. II at 278-279). While the Commission understands Embarq's arguments regarding the recent financial difficulties encountered by CLECs, we also find that Embarq's proposed language requiring security deposits, particularly from a CLEC with an established account, is one-sided, could possibly create a barrier to competition, and is unreasonable. Given that both parties agree that COI is billed approximately $400,000 per month by Embarq, it would appear to create an undue hardship on COI to provide Embarq with two months of billing ($800,000) as a cash deposit for the term of the contract while Embarq pays no interest. Further, the Commission notes Mr. Hart's observation that when COI recently owed Embarq $850,000, such a sum would comprise a large portion of COI's liabilities on a balance sheet, because COI is "a small CLEC with the asset base of a small CLEC," while debts owed by Embarq to COI would be a much smaller proportion of Embarq's outstanding liabilities (Tr. Vol. II at 259-260). Under this same rationale, the Commission finds that a large cash deposit, as requested by Embarq's proposed language, would be a significant liability for a small

CLEC that could not use the money to meet other financial obligations. Embarq's suggestion that COI could, alternatively, provide an irrevocable letter of credit as a deposit would involve costs for COI and could prove infeasible for COI in current financial markets.

The Commission agrees with COI that the primary purpose behind a deposit is to establish initial creditworthiness with an unknown entity. A security deposit should not and cannot be used to shield a company from all financial risk to the detriment of its competitor. The fact that COI has filed bankruptcy in the past is not at all indicative of its financial future. In fact, COI's unique regular weekly payments to Embarq that were established as a result of COI's bankruptcy and continue today, almost five years later, show good faith by COI in paying what is owed to Embarq. Finally, the Commission observes that COI cannot operate without Embarq's services and that, as a result of the Commission's award for Issue 2, Embarq may terminate services to COI under Embarq's proposal of 60 days, rather than 90 days as COI recommends. Thus, the Commission's Issue 2 award should also serve to reduce Embarq's exposure to risk from COI.

While the Commission further observes Embarq's contention that there is comparable security deposit language in its ICAs with other CLECs (Embarq Ex. 1 at 12; Tr. Vol. II at 295-296) the Commission is not convinced that this is a sufficient reason to adopt Embarq's proposed language here, given the Commission's concerns with the unilateral nature of Embarq's language. For example, Embarq's existing security deposit language that is currently utilized with other CLECs, and as proposed for this ICA, begins with Sec. 37.1 as follows: "Embarq reserves the right to secure the account with a suitable security deposit in the form and amounts set forth herein." Section 37.3 continues "*If* a security deposit is required on a new account, CLEC will remit such security deposit prior to inauguration of service. *If* a security deposit is requested for an existing account, payment of the security deposit will be made prior to acceptance by Embarq of additional orders for service." (emphasis added.) While Embarq testified that such contract language has been in existence with other CLECs since 2002, it did not provide information as to whether these deposits were actually collected from these CLECs. In fact, Mr. Hart's direct testimony indicates that Embarq "attempts" to collect security deposits from interconnected carriers (Embarq Exhibit 1 at 12). The permissive nature of Embarq's contract language would allow it to collect a deposit if and when it believes one is necessary and could lead to discriminatory behavior.

Regarding reciprocity of security deposits, the Commission, for the same reasons stated above in response to Embarq's proposal, believes that it is not appropriate to require Embarq to provide COI with a security deposit. Embarq's creditworthiness has been established, and COI has dispute resolution and other means by which it can obtain payment from Embarq. Indeed, COI also is in control of a network that Embarq must connect with in order to complete its customer calls to COI customers. Thus, the Commission concludes that Embarq's proposed security deposit language is unreasonable, as is COI's proposal to require reciprocity, and should be replaced with language in the expired but currently effective ICA, which reads as follows, with the simple substitution of the word "Embarq" for "Sprint":

> Sec. 36.1 Embarq reserves the right to secure the account with a suitable form of security deposit, unless satisfactory credit has already been established through twelve (12) consecutive months of current payments for carrier services to Embarq and all ILEC affiliates of Embarq.
>
> Sec. 36.8 . . . Cash or cash equivalent security deposits will be returned to CLEC when CLEC has made current payments for carrier services to Embarq and all Embarq affiliates for twelve (12) consecutive months.

**Issue 10: What is the maximum number of DS1 dedicated transport circuits that a CLEC can lease on a single route?**

Embarq proposes that the following language be incorporated into the interconnection agreement resulting from this proceeding:

> Sec. 50.2.2 CLEC may obtain a maximum of ten unbundled DS1 dedicated transport circuits on each route where DS1 dedicated transport is available on an unbundled basis.

Embarq contends that this dispute is over the number of unbundled DS1 dedicated transport circuits COI may obtain on a single route (Embarq Ex. 2 at 15). Embarq alleges that its proposed language accurately reflects the limit of ten DS1 circuits included in the FCC Triennial Review Remand Order (TRRO), which states that the limit or the "cap" is a "maximum" of ten unbundled DS1 dedicated transport circuits (*Id.* at 15 citing Title 47 C.F.R. §51.319(e)(2)(ii)(B)). Additionally, Embarq asserts that its proposed language mirrors the FCC regulation (*Id.* at 15).

Embarq continues its argument by stating that this Commission has agreed with the FCC's regulation addressing this same issue in an earlier arbitration proceeding involving SBC Ohio (SBC) and several CLECs (*Id.* at 16-17 citing Case No. 05-887-TP-UNC, *In the Matter of the Establishment of Terms and Conditions of an Interconnection Agreement Amendment Pursuant to the Federal Communication Commission's Triennial Review Order and its Order on Remand* (05-887)(Arbitration Award, November 9, 2005, at 55). Embarq urges the Commission to follow the FCC's regulation and the Commission's own precedent by limiting COI to a maximum of ten DS1 dedicated circuits on a single route (Embarq Initial Brief at 10).

Furthermore, Embarq recommends that the Commission not modify federal law in a conflicting manner, since the aggrieved party could petition the FCC for a declaratory ruling as discussed in the Triennial Review Order ¶¶191-196 (Embarq Ex. 2 at 17). Embarq states that BellSouth petitioned the FCC when several state commissions ordered it to provide services contradictory to federal law, resulting in the FCC overturning the state decisions [*Id.* at 17 citing *In the Matter of BellSouth Telecommunications, Inc. Request for Declaratory Ruling that State Commissions May Not Regulate Broadband Internet Access Services by Requiring Bellsouth to Provide Wholesale or Retail Broadband Services to Competitive LEC UNE Voice Customers,* WC Docket No. 03-251, Memorandum Opinion and Order and Notice of Inquiry, released March 25, 2005 *(BellSouth)*].

COI argues that Embarq's proposed language be modified by deleting the word "ten" and inserting "twenty (20)" as follows:

> Sec. 50.2.2 CLEC may obtain a maximum of ~~ten~~ *twenty (20)* unbundled DS1 dedicated transport circuits on each route where DS1 dedicated transport is available on an unbundled basis.
>
> (Emphasis added.)

COI asserts that Embarq's proposed language prohibits COI from ordering more than ten DS1 transport circuits at a time when the next level of service would be a DS3 transport circuit, which has the capacity of twenty-eight DS1 transport circuits (COI Ex. 1 at 8). COI states the FCC established a cap of ten DS1s, based upon the evidence before it and upon its assumption that ten DS1s was the price breakpoint after which the purchase of a DS3 would be more economical (COI Initial Brief at 32 citing TRRO at ¶ 181). COI points out that the FCC's evidence was based upon 2004 cost ratios of various telecommunications providers comparing DS1s to DS3s, thus establishing the price breakpoint of ten DS1s (*Id.* at 32 citing TRRO at footnote 490). COI claims the evidence in this arbitration is not pertinent to that presented in the TRRO by the various telecommunications providers more than four years ago (*Id.*). Moreover, COI explains that the economic basis for the FCC's decision in the TRRO cannot occur in this case, because Embarq's cost ratio is more than two times the highest ratio cited in the TRRO (*Id.* at 32 citing COI Ex. 1 at 9).

As an example, COI states that if it needs to order eleven DS1s, Embarq's proposed language forces it to order the significantly more expensive DS3 transport circuit which has a price equivalent of twenty-four DS1 circuits (COI Ex. 1 at 8). This requirement compels COI to take on the capacity of thirteen additional DS1s that it does not need at a much higher cost than eleven DS1s (*Id.*). Furthermore, COI alleges that Embarq is manipulating the terms of the TRRO and its price breaks by substantially increasing its price of a DS3 and then arguing that the FCC cap of ten DS1s should prevail (COI Initial Brief at 32).

In response to Embarq's argument that the Commission should follow its precedent set in 05-887 concerning this issue, COI alleges that the Commission did not in the 05-887 Arbitration Award adopt the mandatory cap of ten on the number of DS1s, but only recognized the FCC ruling. Instead, asserts COI, what the Commission adopted was:

> . . . the FCC's *reasoning*, as the arbitration award agreed "with the FCC's reasoning and the record that for an efficient carrier who aggregates sufficient traffic on DS1 facilities, *which the FCC record reveals is approximately* 10 DS1 Transport facilities, that carrier should have generated enough revenue to be economically capable of deploying a DS3 facility or lease a DS3 facility from an alternative supplier."
>
> (*Id.* at 32 citing 05-887, Arbitration Award at 55. Emphasis added by COI.)

Due to the disparity of economics when Embarq is involved and the fact that the FCC recommended the cap based on evidence that does not hold true for this case, COI urges the Commission to modify the FCC's cap to fit the high ratio that exists because of Embarq's high DS3 prices (*Id.*).

## ISSUE 10 ARBITRATION AWARD

The Commission determines that Embarq's proposed language regarding DS1 dedicated transport caps mirrors the FCC rule, adopted in the TRRO, 47 C.F.R. §51.319(e)(2)(ii)(B), and that the Commission is not compelled by COI's arguments, as discussed below, to modify FCC regulations on this issue.

Embarq is accurate that the Commission has previously adopted the FCC caps in the 05-887 Arbitration Award. In 05-887, the Commission adopted SBC's proposed interconnection language, which included a cap of 10 DS1 dedicated transport circuits. Although COI is correct that the FCC rule was not adopted verbatim, the Commission concurred with SBC's proposal, based on the FCC's rationale and record, by incorporating SBC's proposed language, which contains the same language proposed by Embarq in its ICA with COI.

Moreover, this issue was addressed again in the 05-887 Entry on Rehearing at Finding 23, in which this Commission further explained its adoption of SBC's proposed language. In denying rehearing for this issue, the Commission quoted portions of FCC rule 47 C.F.R. §51.319(e)(2)(ii)(B) stating:

> ...the FCC imposed a ten circuit unbundled DS1 dedicated transport circuit cap "...on each route *where DS1 dedicated transport is available on an unbundled basis.*" The plain meaning of the rule clearly states that the cap applies on routes where DS1 unbundled dedicated transport is available. The rule does not address the DS3 dedicated transport facilities or the exclusion of the cap on those DS3 dedicated transport routes that are impaired. The FCC rule applies to *any* route that the DS1 dedicated transport facility is available on an unbundled basis. This means that any routes where *both wire centers are not Tier 1,* the ten circuit DS1 dedicated transport circuit cap applies, regardless of the availability of DS3 dedicated transport facilities. (Emphasis added.)

Next, the Commission does not agree with COI that the evidence the FCC used to determine the DS1 transport cap is the same evidence that COI points to in its Initial Brief at 32 citing TRRO Order at footnote 490. The evidence cited by COI pertains to DS1 loops and not DS1 transport as cited in the TRRO Order ¶181, which cites footnote 490. The FCC set the DS1 dedicated transport cap using the evidence found in the TRRO Order ¶128 at footnote 358, in which submitted data revealed the DS1 to DS3 price breakpoint to average at ten. The evidence before the FCC represents an average of the data submitted by CLECs and is not indicative of all DS1 to DS3 pricing in each individual state as noted by the FCC's comments within footnote 358. Therefore, we find that the FCC's determination that it is efficient for a carrier to aggregate traffic at approximately ten DS1s to be based on an average of the data before the FCC. We further recognize that each state's DS1 to DS3 dedicated transport average pricing may be exactly at ten DS1s, or below or above 10 DS1s. However, the FCC found that its DS1 dedicated transport cap is a representation of all the evidence before it and is not subject to state specific adjustments. This determination is further supported by the FCC actions in overturning the states' decisions in *BellSouth,* as noted by Embarq (Embarq Ex. 2 at 17).

The Commission notes that COI is not required to obtain DS1 dedicated transport from Embarq when other fiber-based providers exist in a wire center. In this regard, the Commission highlights COI witness Steve Vogelmeier's admission at hearing, "I'm going to find some other way to get there. They lose the revenue..." (Tr. Vol. I at 75). We interpret this as confirmation from COI that it has choices for fiber-based providers, other than Embarq, in those wire centers in which COI seeks DS1 dedicated transport.

In conclusion, the Commission determines that Embarq's proposed language for Section 50.2.2 should be adopted into the ICA.

**Issue 15: Whether the charges for DS1 Loops, 4-Wire Digital Loops (With No Electronics) and 4-Wire X-DSL Capable Loops Are Just?**

Issue 15 asks the Commission to resolve the parties' pricing dispute for certain UNE loops. The parties submitted proposed rates and are requesting that the Commission set interim rates until such time as Embarq files an application seeking Commission approval of permanent rates based on TELRIC. The parties seek interim rates for the following UNEs:

- 4-wire Digital Loops (with no electronics),
- 4-wire xDSL-Capable Loops, and
- DS1 Loops and ISDN PRI Loops.

COI asserts that Embarq's pricing of its 4-wire Digital Loops (with no electronics), 4-wire xDSL-Capable Loops, and DS1 Loops is unreasonable because the prices are not TELRIC-approved rates and Embarq's TELRIC study model is not a Commission-approved TELRIC study (Tr. Vol. I at 46-48). Furthermore, COI declares that Embarq does not have Commission-approved TELRIC rates in Ohio (COI Initial Brief at 22 citing Tr. Vol. I at 46). Therefore, COI is seeking interim rates for the UNEs noted above.

To support its request, COI cites Rule 4901:1-7-18, O.A.C., which COI argues allows the Commission to set interim rates prior to the establishment of permanent TELRIC rates (*Id.* at 22). COI explains that Rule 4901:1-7-18(B), O.A.C., states that the Commission shall set interim rates when it does not have sufficient time to review the cost information submitted by an ILEC or when it appears there may be significant concerns by the Commission regarding the cost studies (*Id.* at 22-23). COI argues that since Embarq does not currently have Commission-approved permanent TELRIC rates, and because COI's witness Dr. August Ankum (Dr. Ankum) has significant concerns with Embarq's proposed Cost Study, the focus of this case must be on setting interim rates, as set forth in Rule 4901:1-7-18, O.A.C. (*Id.* at 23).

According to COI, Embarq misleadingly states that COI had the opportunity to review Embarq's original price list and cost study months before the arbitration but chose not to do so because COI had refused to sign a nondisclosure agreement (COI Reply Brief at 5). COI contends that the starting point of its pricing proposal, as set forth in Dr. Ankum's direct testimony, was entirely based upon Embarq's initial cost study provided to COI in support of Embarq's September 2006 Price List and which violated TELRIC principles while overstating costs (*Id.* at 7 citing COI Exhibit 2 at 7). Further, COI argues, upon the filing of the direct testimony of Embarq witness Christy Londerholm (Ms. Londerholm), it became apparent that Embarq had changed the basis of its proposal from the earlier September 2006 Price List/Cost Study to the New Cost Study, which COI had not previously received. COI claims that this change caused it to incur additional costs for the preparation and filing of Dr. Ankum's supplemental testimony (*Id.* at 7, 8). COI adds that only portions of the New Cost Study were accessible to COI and its consultants due to some "invisible" programming (COI Initial Brief at 27 at 8 citing Tr. Vol. I at 126-128), and because of the timing under which the New Cost Study was submitted, COI had insufficient time for review, which severely handicapped its audit of the information (*Id.* at 27).

The rates proposed by Embarq, COI explains, are for services that have been priced the same in the last three ICAs. COI avers that this is a logical outcome because of Embarq over-recovering its costs and also because new technology is making these services more profitable to Embarq (COI Initial Brief at 23). Moreover, COI contends, Embarq's proposed rates are considerably higher than the rates in its current ICA, which is inconsistent with telecommunications cost developments (COI Exhibit 3A at 5, Table 2). COI believes it has established the unreasonableness of Embarq's proposed rates by comparing Embarq's rates with the rates of AT&T approved by other Midwestern state utility commissions (COI Exhibit 2A at 8, Table 3). COI argues that the basis of its comparison with other state utility commissions' rates evolves from the large degree of similarity in the geographic characteristics between the Midwestern states, and thus, it is with these geographic characteristics that state commissions have, in accordance with FCC's TELRIC requirements, approved de-averaged rates for zones (*Id.* at 8-9). Therefore, COI continues, it has established a range of reasonableness which indicates that Embarq's proposed rates are outside that range (*Id.*).

COI further suggests that Embarq is proposing considerably higher rates than the rates Embarq currently agrees to in ICAs with other CLECs (COI Initial Brief at 25). To COI, this is irrational, because no rational business enterprise would sell products systematically below cost. Therefore, argues COI, no ILEC with leverage in ICA negotiations would voluntarily agree to rates below cost (*Id.* at 26). COI uses this reasoning to assert that Embarq's ICA with Cincinnati Bell Extended Territories (CBET) invalidates its New Cost Study and demonstrates that Embarq significantly overestimates cost (*Id.*). Further, COI claims, because of the leverage in ICA negotiations that Embarq retains as an ILEC, as well as the absence of Commission-approved rates or cost methodology for Embarq, the ICA rates observed by Embarq should be considered the upper limit of its actual costs (*Id.*).

With respect to the specific inputs and assumptions within the New Cost Study, COI observes problems with fill factors, cost of capital, depreciation rates, and other inconsistencies (COI Exhibit 2A at 19-24). Regarding the fill factors, COI argues that Embarq's New Cost Study uses actual fill factors for copper feeder cable and builds two lines to each housing unit for distribution cable. To demonstrate that Embarq's fill factors are unreasonable, COI compares Embarq's fill factors to Commission-approved fill factors in the most recent SBC Phase I UNE case (*Id.* at 20). COI argues that the New Cost Study's copper cable fill factors are significantly lower than the fill factors approved by the

Commission for SBC, which suggests that the New Cost Study generates a significantly higher copper investment and cost than expected in a TELRIC study (*Id.*).

As for the cost of capital, COI comments that the New Cost Study incorporates a value slightly higher than the approved cost of capital for SBC. COI takes issue with the calculation by claiming that there appears to be an error, the nature of which COI is unable to determine (*Id.* at 21).

Regarding depreciation rates, COI contends that the New Cost Study uses depreciation lives that are generally shorter than the depreciation lives approved in the SBC UNE case or used by the FCC, resulting in the New Cost Study overstating the loop rates produced by the model (*Id.* at 22).

COI concludes that Embarq's New Cost Study produces grossly inflated cost estimates and therefore recommends adopting COI's counter-proposal rates. According to COI, its proposed rates were developed using generally accepted Telephone Plant Indices and other price indices, as well as information from Embarq's own New Cost Study. In COI's opinion, its proposed rates make upwards adjustments to its existing rates in the current ICA with Embarq, represent a more reasonable proposal than Embarq's, and should be adopted by the Commission (*Id.* at 30). COI attests that the result of these adjustments produces the following COI's counter-proposal rates:

| UNE Loops | COI's Proposed price |
|---|---|
| **4-Wire xDSL – Capable Loop** | |
| **4-Wire Digital Loop (with no electronics)** | |
| Band 1 | **$49.57** |
| Band 2 | **$49.53** |
| Band 3 | **$81.15** |
| Band 4 | **$157.88** |
| **DS1 Loop and ISDN PRI Loop** | |
| Band 1 | **$69.05** |
| Band 2 | **$68.46** |
| Band 3 | **$107.27** |
| Band 4 | **$156.41** |

Embarq urges the Commission to set Embarq's interim rates based upon the best evidence available in this proceeding, which is the testimony and cost study presented by its witness Ms. Londerholm (Embarq Initial Brief at 2). Embarq's proposed rates are:

| Network Element | Embarq's Proposed price |
|---|---|
| DS1 Loop | |
| Band 1 | $120.79 |
| Band 2 | $245.68 |
| Band 3 | $514.72 |
| | |
| 4-Wire Loop | |
| Band 1 | $70.40 |
| Band 2 | $109.59 |
| Band 3 | $170.98 |

Embarq claims the fact that it has not previously conducted a TELRIC case is irrelevant, because it never claimed that it had Commission-approved TELRIC rates (Embarq Reply Brief at 6). Furthermore, Embarq states, the pertinent question is what interim rates the Commission should set in this proceeding (*Id.* at 6).

Moreover, claims Embarq, Ms. Londerholm, who is a cost study expert intimately involved with cost models since their development in 2002, sponsored a TELRIC-compliant cost study (*Id.* at 2). Embarq argues that the TELRIC pricing of the UNEs are subject to this issue and that the New Cost Study, including its inputs and methodology, comply with the FCC and the Commission's costing standards (*Id.* at 2-3).

Ms. Londerholm describes the generic approach used by Embarq to perform its TELRIC study, which included determining the forward-looking installed cost, developing capital and expense cost, and calculating a reasonable contribution to common costs (Embarq Exhibit 3A at 7-10). Additionally, Ms. Londerholm explains how DS1 capable loops are provisioned, the issues that significantly affect UNE loop costs, and Embarq's wire center loop modeling process, while also providing a detailed definition of the local loop (Embarq Exhibit 3A at 10-23). Ms. Londerholm claims that Embarq's loop modeling methodology complies with the FCC's TELRIC cost methodology and that Embarq developed its forward-looking investment to get a forward-looking installed cost for the least cost efficient loop network (Embarq Exhibit 3A at 23-37). Lastly, Ms. Londerholm argues that Embarq developed three rate bands for DS1 UNE loops based upon the 1996 Act, as well as this Commission's ruling of allowing ILECs to establish different rate elements for these elements in at least three defined geographic areas within the state reflecting geographic cost differences (Embarq Exhibit 3A at 37-38).

Embarq requests that the Commission ignore COI's complaints regarding insufficient time or an inability to review the Embarq Cost Study. In Embarq's opinion, COI refused the opportunity for a timely review of the Cost Study and failed to advise Embarq of problems in running the study (Embarq Initial Brief at 5). Further, argues Embarq, despite COI's claim of "invisible" programming and its alleged inability to review the Cost Study, neither COI nor its consultants made any effort to talk with Embarq's costing expert about COI's concerns regarding the Cost Study (Embarq Reply Brief at 12).

Embarq contends that COI incorrectly claims that Embarq's rates are unreasonable because of COI's belief that Embarq's prior rates over-recovered costs, while technology improvements have created reduced-cost economies (Embarq Exhibit 3 at 42). Embarq asserts that concepts of "over-recovery" and "more profitable" have no place in the FCC's TELRIC costing methodology and that COI is wrong with respect to how costs have behaved in the last 6-8 years (*Id.*). Further, Embarq claims, COI's "suspicion" that Embarq's prior rates are too high is not supported by any credible evidence, nor did COI sponsor a cost study or other relevant analysis of the relationship between prior rates and the underlying costs (Embarq Reply Brief at 7). Embarq points out that Ms. Londerholm's testimony and the TELRIC cost study, which uses forward-looking costs, contradict any COI claim that new technology has produced lower costs (*Id.* at 8 citing Embarq Exhibit 3A at 23). In addition, observes Embarq, COI's allegation of new technology producing lower costs is not supported by any citation on record (*Id.* at 7). According to Ms. Londerholm, and as shown in Table 2 of her testimony, over the past five years Embarq has seen dramatic cost increases in certain inputs, so consequently Embarq's proposed rates are higher than those contained in earlier ICAs (Embarq Exhibit 3A at 24). Moreover, Embarq claims, the main reason that the earlier rates are irrelevant, and the details of which Ms. Londerholm had previously explained to COI, is that the earlier rates were based upon a cost study that contained a significant error, i.e., failing to correctly allocate the cost of circuit equipment to DS1 loops (Embarq Reply Brief at 8 citing Tr. Vol. II at 369-370). Specifically, Ms. Londerholm explains, longer distanced customers are served using fiber optics with a digital loop carrier that has electronic equipment associated with it, and the electronic equipment's costs are shared between DS1 loops and voice grade loops (Tr. Vol. II at 404- 405). The expired ICA, according to Ms. Londerholm, failed to properly allocate the cost of the electronics between the DS1 loops and the voice grade loops, thus resulting in a cost for DS1 loops that was too low (*Id.*).

Embarq disagrees with COI that Embarq's rates are unreasonable when compared to AT&T's TELRIC-approved rates in Ohio and other Midwestern states. According to Embarq, the record contains no evidence to make such a comparison; specifically, the record does not indicate when AT&T's rates were set, what principles the other state commissions applied to AT&T's cost studies, how different AT&T is from Embarq and how the AT&T and Embarq cost studies compare (Embarq Reply Brief at 9-10). Additionally, Embarq claims, cross-examination of Dr. Ankum proves that AT&T's rates are not comparable, because he admitted that he had no access to AT&T's proprietary studies (*Id.* at 10 citing Tr. Vol. I at 122) and did not know explicitly how AT&T's average loop length in its band 3 compared to the average loop length in Embarq's rate band 1 (*Id.* at 121). Further, observes Embarq, Dr. Ankum admitted that AT&T has greater scale economies than Embarq, resulting in lower AT&T costs even in rural areas (*Id.* at 125).

Embarq believes that the rates agreed to in other ICAs show the reasonableness of its rates, because COI's current ICA with Verizon has a DS1 loop price that is reasonably comparable to the Embarq-proposed DS1 loop price (Embarq Exhibit 3 at 47). Further, Embarq declares, the ICA that Embarq recently negotiated with CBET demonstrates the statewide average cost for a DS1 loop to be reasonable, when compared to Embarq's statewide-average DS1 prices that result from the updated inputs of the New Cost Study sponsored in this proceeding (Embarq Initial Brief at 5). Embarq points to Table 10 in COI's Initial Brief to show the reasonableness of its rates, in that the table suggests that Embarq's new rates are, on average, lower than the rates contained in the current ICA with Granite (Embarq Reply Brief at 10). Embarq conveys that it does not know how COI calculated the averages for the various rate bands, but in comparison to the Granite ICA and using Embarq's recent New Cost Study rates, the Granite ICA has higher average rates for both 4-wire and DS1 loops (*Id.*). Therefore, Embarq explains, since the process of negotiation affects the rates agreed to, negotiated rates do not disprove the validity of rates generated by Embarq's New Cost Study (*Id.* at 11).

In conclusion, Embarq insists its proposed rates should be adopted by the Commission as interim rates because (1) the goal in setting rates for an ICA is to adopt TELRIC rates and (2) Embarq's proposed rates are TELRIC-compliant, as derived from a TELRIC cost study, while COI's proposed rates are not (*Id.* at 14).

**ISSUE 15 ARBITRATION AWARD**

The Commission has evaluated the information presented by both parties related to Embarq's TELRIC study, with respect to the proposed pricing and provisioning of unbundled 4-wire loops and DS1 loops. Specifically, we evaluated both parties' arguments and rationale for setting the specific proposed interim rates. In accordance with Rule 4901:1-7-18, O.A.C. (Rule 18), the Commission may set interim rates while arbitrating disputes, "...when it does not have sufficient time to review the cost information provided by an incumbent local exchange carrier or when it appears that, there may be significant concerns with the cost studies from the Commission's cursory review." As such, we agree with COI that both criteria articulated in Rule 18 apply in this arbitration, as further discussed in this Award. Accordingly, the focus of the Award is to establish interim rates for unbundled 4-wire loops and DS1 loops that are based on the best information available about Embarq's forward-looking economic costs, and subject to a true-up pursuant to Rule 4901:1-7-17(3), O.A.C.

We start by evaluating Embarq's proposed interim rates for unbundled 4-wire loops and DS1 loops, which Embarq claims are based on its proposed TELRIC study model using the 2008 inputs. Based on the Commission's general review of Embarq's TELRIC study model and issues raised by COI regarding certain model inputs, we are not convinced that the TELRIC study is representative of the forward-looking economic cost to justify awarding Embarq with interim rates equal to the costs produced by its proposed TELRIC study. We reach this conclusion because of significant concerns we have with Embarq's TELRIC study model, which is further discussed below.

Our concerns with Embarq's TELRIC study begin with its use of fill factors. Pursuant to Rule 4901:1-7-19(B)(9), O.A.C., in developing the forward-looking economic cost of UNEs, the investment shall be adjusted to reflect reasonably accurate fill factors, which are defined as the proportion of a facility that will be filled with network usage during the study period. In setting TELRIC-based rates in prior TELRIC proceedings, this Commission has disallowed the use of actual fill factors in a TELRIC study, as it is inconsistent with TELRIC principals and requirements.

According to Embarq's "Loop Input Definitions" for "Density Cable Sizing Factor Table":

> Cable sizing factors are developed separately for feeder, distribution, and fiber cables. Feeder fill factors are developed from company specific data by wire center. Feeder fill factors are calculated by taking feeder pairs in service and dividing by feeder pairs available for each wire center. The inputs into LM (loop module) represent actual fill in Embarq's network. LM contains calculations that adjust the fill factors upward (increased cable utilization) so that the modeled cable utilization in LM is equivalent to the utilization seen in reality.
>
> (COI Exhibit 8 at 16.)

In explaining this, Ms. Londerholm testifies that the copper feeder coming from the Embarq central office is the only element to use actual utilization, and then the model does a "sizing routine" using the 1996 actual fill for the copper feeder which results in an upward adjustment to the fill factor. It is this adjustment that the model uses for developing the network costs (Confidential Tr. Vol. II at 379-381). Although Ms. Londerholm states that only copper feeder uses actual fill factors, the model starts with an actual fill factor but adjusts it along the process to develop an "adjusted fill factor" that is used to develop the cost results. Embarq provides no explanation for how such an adjustment takes place, what criteria was used to make the adjustment, or whether the "adjusted fill factor" represents a reasonable fill factor for TELRIC purposes. Similarly, none of the other fill factors for other network facilities used in the cost study was evaluated for that purpose. Based on our experience, fill factors used in similar cost models have had a considerable impact on the final cost results of the models. Therefore, absent Embarq's support for the reasonableness of various fill factors used in the cost study model, we are not assured that it represents appropriate forward-looking fill factors.

Our next concern with Embarq's New Cost Study model is that the economic lives used in the New Cost Study model are lower than those previously approved by this Commission. Economic lives are used to calculate depreciation rates. As Ms. Londerholm testified, "Embarq has developed forward-looking economic lives for all UNE asset categories and utilized these lives in its UNE cost studies" (Embarq Exhibit 3 at 37). We find no basis within Embarq's testimony to support the use of lower economic lives than this Commission has previously determined in other TELRIC proceedings, as argued by COI (COI Exhibit 2A at 21-23).

An additional area of concern is Embarq's cost of capital calculation. Because of the absence of Embarq's support for the reasonableness of various components of the proposed cost of capital, we are not assured that it represents a forward-looking cost of capital reflecting the risks of a competitive market. For example, COI's witness Dr. Ankum takes notice of what appears to be an error in deriving the cost of capital, in the New Cost Study in Ms. Londerholm's testimony (Embarq Exhibit 3A at 17). We note that Ms. Londerholm's testimony provided a correction to the cost of equity component of the cost of capital that was originally provided in her direct testimony, explaining that it was a simple mathematical error and does not change any of the inputs or results of the New Cost Study (Tr. Vol. II at 343). However, while this may be so, the cost of capital value in the model cannot be traced to its source, nor can any of its components. Without the explicit ability to verify the cost of capital value, its components' values, and how said cost flows through the New Cost Study, we cannot evaluate the impact of such error on the costs produced by the model. We are not convinced that this mathematical error for the cost of capital does not change any of the inputs or results of the cost model.

Next, we address COI's counter-proposal interim rates. Based on our review of the record, we find that COI's counter-proposed interim rates do not represent reasonable rates for unbundled 4-wire loops and DS1 loops. We reach this conclusion because of concerns that we have with the assumptions used to derive COI's rates, specifically, the starting point used by Dr. Ankum in establishing COI's counter-proposed interim rates. Dr. Ankum begins his process with the current ICA rates (Embarq Exhibit 2A at 38). First, the current ICA rates in the existing agreement between COI and Embarq are negotiated rates and are not necessarily TELRIC-based rates as acknowledged by COI (*Id.* at 40). Second, it is obvious that the four-band rates for both unbundled 4-wire loops and DS1 loops in the existing ICA between the parties, with the identical rates for band-1 and band-2, are not reflective of cost-based deaveraging as required by Rule 4901:1-7-17(B)(2)(d), O.A.C. We also note that while COI objected to Embarq's restructuring of the four rate bands in its existing ICA into only three rate bands in Embarq's proposed rates, COI's counter-proposal for interim rates reflect effectively three rate bands, as it includes four bands with almost identical rates for band-1 and band-2 (Tr. Volume II at 394-395). Additionally, the record reflects that Embarq underestimated DS-1 rates reflected in the current ICA by not including the appropriate allocation of circuit equipment costs to DS-1 circuits (Tr. Vol. II at 373-374 and 408-410). COI acknowledged that it is aware of that error (Tr. Vol. I at 33-34). Accordingly, any adjustment to the existing ICA rates to develop an interim rate for the new ICA would perpetuate the problems and errors outlined here, and provide unreasonable interim rates that are not cost-based.

Pursuant to Rule 4901:1-7-17(A)(3), O.A.C., and based on the best information available on this record, the Commission finds that the rates in the current Commission-approved ICA between Embarq and CBET filed in Case No. 07-1275-TP-NAG, *In the Matter of the Application of United Telephone Company of Ohio dba Embarq for Approval of a Negotiated Agreement with Cincinnati Bell Extended Territories, LLC,* for unbundled 4-wire Digital loops (with no electronics), 4-wire xDSL-capable loops, and DS1 and ISDN PRI loops (CBET's rates) shall be adopted as the interim rates in this ICA subject to a true-up. We find that these CBET rates are more reasonable as interim rates for the purpose of this proceeding and address several of the issues and objections raised by both COI and Embarq regarding the other party's proposal. We find that the CBET rates reflect: 1) recent investments and expenses that are close to what would be used in a TELRIC proceeding; 2) DS-1 rates that have a reasonable allocation of circuit equipment; 3) five rate bands that depict cost-based deaveraging; and 4) 4-wire loops and DS-1 loops served from a given wire center would belong to the same rate band. The interim rates to be included in the parties' ICA are as follows:

| UNE Loops | Arbitration Award Interim Rates |
|---|---|
| **4-Wire xDSL – Capable Loop**<br>**4-Wire Digital Loop (with no electronics)** | |
| Band 1 | **$69.74** |
| Band 2 | **$73.13** |
| Band 3 | **$96.36** |
| Band 4 | **$110.70** |
| Band 5 | **$182.40** |
| | |
| **DS1 Service and ISDN PRI Loop** | |
| Band 1 | **$76.66** |
| Band 2 | **$111.58** |
| Band 3 | **$184.39** |
| Band 4 | **$276.49** |
| Band 5 | **$509.60** |

It is, therefore,

ORDERED, That COI and Embarq incorporate the directives set forth in this Arbitration Award within their final interconnection agreement. It is, further,

ORDERED, That, within 30 days of this Arbitration Award, COI and Embarq shall docket their entire interconnection agreement for review by the Commission, in accordance with the Rule 4901:1-7-09, O.A.C. If the parties are unable to agree upon an entire interconnection agreement within this time frame, each party shall file for the Commission to review its version of the language that should be used in a Commission-approved interconnection agreement. It is, further,

ORDERED, That within ten days of the filing of the interconnection agreement, any party or other interested persons may file written comments supporting or opposing the proposed interconnection agreement language and that any party or other interested persons may file responses to comments within five days thereafter. It is, further,

ORDERED, That nothing in this Arbitration Award shall be binding upon this Commission in any subsequent investigation or proceeding involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That this Arbitration Award does not constitute state action for the purpose of antitrust laws. It is not our intent to insulate any party to a contract from the provisions of any state or federal law that prohibits restraint of trade. It is, further,

ORDERED, That this docket shall remain open until further order of the Commission. It is, further, ORDERED, That a copy of this Arbitration Award be served upon COI, Embarq, their respective counsel, and all interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Paul A. Centolella

Ronda Hartman Fergus

Valerie A. Lemmie

Cheryl L. Roberto

JA/JL/RR/MG:ct

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Reneé J. Jenkins
Secretary