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April 11, 2001

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
445 Twelfth Street, SW - Room TWB-204
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

REDACTED VERSION

Re: *Ex Parte* - CC Docket No. 01-9
Application by Verizon New England, Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), and Verizon Global Networks Inc., for Authorization to Provide In-Region InterLATA Services in Massachusetts

Dear Ms. Salas:

On April 4, 2001, Mr. Edward Young, Verizon's Senior Vice President of Federal Government Relations, submitted an *ex parte* to Chairman Powell in this proceeding ("Young letter") in which Verizon claimed (at 1) that the rates for "unbundled network elements in Massachusetts comply fully with the Act". AT&T explains again below that Verizon's switching rates are not TELRIC compliant and that Verizon's Supplemental Massachusetts 271 Application must therefore be denied.

The arguments presented in Verizon's April 4th *ex parte* are neither new, accurate, nor persuasive. They were merely repackaged from Verizon's prior submissions and summarized into a single document. Per the Young letter, Verizon's story goes as follows:

1. The current New York UNE rates are not based on alleged misrepresentations by Verizon as to the level of switch discounts Bell Atlantic (Verizon's predecessor) received in New York. Rather, the New York rates are based on a New York Public Service Commission (NYPSC) analysis that is immune to any factual misrepresentations that Bell Atlantic may have made on this issue.

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2. Because the NYPSC determined these rates to be TELRIC in 1997, this Commission approved Bell Atlantic's Section 271 application in 1999, and the D.C. Circuit did not reverse the Commission's findings, these rates must be TELRIC for Massachusetts in 2001 - and the NYPSC's current re-examination of the validity of these rates may be ignored.

Each of these assertions is false.

Verizon is simply dissembling when it argues that the understated switch discounts to which Verizon's witnesses testified did not affect the NYPSC's analysis. Indeed, Verizon's material misrepresentations about its vendor switching discounts did infect the NYPSC approved 1997 rates. The NYPSC's recognition of these misrepresentations led directly to the current New York UNE cost case, and switching is one of the most significant issues in that New York proceeding.

In its UNE Pricing Order, the NYPSC stated that its analysis "... did not take account, however, of the atypically large discounts received by New York Telephone from its vendors after 1994 in connection with a major switch replacement program."[1] The reason for this exclusion is that the NYPSC did *in fact* rely on Verizon's misrepresentation that it would not receive these large discounts in the future. Indeed, AT&T's and WorldCom's demonstration that Verizon continues to receive these discounts -- and would continue to receive them in the future -- was an important reason why the NYPSC determined to revisit these prices in its current (and near-completed) UNE rate proceeding.[2]

Verizon does not (and cannot) deny that Bell Atlantic was well aware that its actual TELRIC costs for switching were much less than it misrepresented to the NYPSC. In 1996, Bell Atlantic filed a declaration with the New Jersey Board of Public Utilities, stating that ... "For example, if Bell Atlantic, or for that matter, AT&T . . . were to install a new Lucent 5ESS switch in New York City, with analog line interfaces, designed to provide 60,000 lines, the total costs of the

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[1] Opinion No. 97-2, Opinion and Order Setting Rates for the First Group of Network Elements, Issued and Released April 1, 1997.

[2] For example at the December 8, 2000 hearing in the current New York UNE case (Tr. 5030-31), Administrative Law Judge Linsider noted with regard to the subject of vendor discounts for switching that:

> "The other piece, the other way, though in which the experience in the last case is important here is with respect to the overriding and extreme importance of this very difficult issue which bedeviled the Commission in the last case, was responsible for, at least in part for the institution of this case."

hardware and software could be as low as $55 to $60 per line."[3] These $55 to $60 per line switches were the very ones that were excluded from the NYPSC's analysis. Had these type of costs been included, the implied per line investments would have been substantially below the $192 level that the NYPSC derived, relying as it did on Verizon's misrepresented discount levels.

Critically, as a result of the NYPSC's findings that Verizon had materially misrepresented its vendor switching discounts, the NYPSC ordered that UNE switching rates remain *temporary* and subject to refund pending the outcome of a complete re-examination of the New York UNE rates.[4] Therefore, the rates established in New York in 1997 simply were not reflective of the forward-looking costs Verizon would pay for switches, in direct violation of TELRIC. The NYPSC rates were supposed to reflect forward-looking costs as of 1996, but do not. However, the true-up that will occur following the conclusion of the current New York rate case can cure that problem. In contrast, the fixed rates Verizon filed in Massachusetts in October 2000 cannot.[5]

In sum, Verizon argues, on the one hand, that the Massachusetts rates are TELRIC because they are at the same level as the previously "approved" New York rates. On the other hand, Verizon steadfastly resists any notion that the Massachusetts rates need to stay in parallel with the New York rates when they are lowered. Verizon cannot have it both ways. This is especially true since both Verizon and AT&T agree that switching costs in both states are quite similar.[6]

With regard to Verizon's claim that its current switching rates "produce an effective discount of 48 percent for the average residential customer in

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[3] Declaration of Nancy Sayer, In the Matter of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, Application for Consent to Transfer of Control, Tracking No. 90205, 960221, at 5.

[4] NYPSC September 30, 1998 Order at 12.

[5] The current interim switching usage rates for New York, which were set in 1997, also cannot be TELRIC in 2001 for another reason. Local usage volumes have steadily and significantly increased since 1996 (the year for which data were provided in New York), and the rates at issue are usage sensitive. As a result, at the same time that the numerator used to develop the switching usage rates should be *decreased* for the reasons stated above, the denominator used to calculate those same rates for 2001 should be *increased* to account for the significant additional usage. Together, these two changes should lead to a very substantial decrease in the New York switching usage rates (and the "ported" Massachusetts rates) for the year 2001. See the Attachment to this letter for analysis details.

[6] March 21, 2001 *ex parte* letter from Charles Griffin in this proceeding (at 2) and LaCouture/Ruesterholz Supplementary Declaration ¶ 180 (citing the "common corporate heritage," the "common set of engineering practices," and the similar mix of switch types in the two States).

Massachusetts,"[7] AT&T demonstrated that the margin available to a UNE-P CLEC attempting to serve the broad residential market in Massachusetts is insufficient to support competition.[8] Indeed, the marketplace itself has refuted Verizon's analysis. If in fact the margins were at the level Verizon suggests, CLECs would be flocking to provide residential UNE-P based service in Massachusetts. But Verizon itself provides data proving that residential UNE-P entry has been trivial.[9]

Finally, Verizon's claims about the extent of local competition in Massachusetts[10] leave out many critical facts, the most important of which is that cable-based competition for residential customers is available in less than half of the state.[11]

In sum, the record in this proceeding shows that: (1) the UNE rates Verizon filed on October 13, 2000 are not TELRIC compliant, (2) even when the USF Synthesis Model is used as a measure of absolute or relative cost comparisons between states (as the FCC used it in its Kansas/Oklahoma 271 Order), the October 13[th] filed rates are unreasonable and grossly inflated,[12] and (3) the filed rates are so excessive that they ensure that the Massachusetts local exchange service market is not now open to statewide residential competition, much less "irreversibly" open to competition. Accordingly, Verizon's Section 271 application must be rejected.

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[7] Young letter at 2, citing Verizon's November 21, 2000 *ex parte* in CC Docket No. 00-176.

[8] Declaration of Michael Lieberman, dated November 30, 2000 in CC Docket No. 00-176 (at 10 – 11). It is more than a little ironic that one of the principal reasons for Verizon's reputed 48% discount is because Verizon chose to grossly understate the number of its overpriced switching minutes that it assumed a residential customer would use.

[9] The Young *ex parte* letter is silent on the matter of UNE-P. However, as AT&T noted in its Reply Comments (at 15-16), Verizon's own February 15 *ex parte* stated that there were only 9,200 residential lines served through UNE-P as of the end of December 2000.

[10] Edward Young *ex parte* letter (at 1).

[11] AT&T's October 16, 2000 Comments in CC Docket No. 00-176 (at 12).

March 27, 2001 *ex parte* letter from Charles Griffin in this proceeding (at 2).

In accordance with Section 1.1206(a)(1) of the Commission's rules, two copies of this Notice are being submitted to the Secretary of the Commission for inclusion in the public record for the above-captioned proceeding.

Sincerely,

Charles Griffin

Attachment

cc: Commissioner H. Furchtgott-Roth
Commissioner S. Ness
Commissioner G. Tristani
K. Dixon
J. Goldstein
B. Tramont
S. Whitesell
D. Attwood
M. Carey
K. Farroba
S. Pie
J. Veach

ATTACHMENT

This attachment provides some of the technical reasons why Verizon's fabulous description of events in New York is inaccurate - and certainly provides no serious justification for accepting 1997 New York switching rates as TELRIC in Massachusetts for the year 2001 and onward.

1. TELRIC switch prices are significantly lower than the current NY prices

- *1997 New York switch prices did rely on understated vendor discounts*

  As indicated in the accompanying letter, the NYPSC's 1997 analysis did rely on Verizon's misstatement that it had not recently received and would not receive substantial vendor discounts on its switch purchases. Furthermore, because the magnitude of this Verizon misstatement was so large, it is likely that 1997 switch prices in New York were set at levels that are *double* what they would have been had Verizon's witnesses not made these false statements to the NYPSC.

- *Verizon's April 5, 2001 ex parte letter confirms this fact*

  Verizon's *ex parte* letter states that in the current New York UNE proceeding, Verizon is proposing switch investments of $195 per line, which, it notes, approximate the $192 figure adopted by the NYPSC in 1997. However, the Verizon testimony attached to its *ex parte* also points out that its proposed $195 cost is based *solely* on the cost of adding *growth* lines to its existing switches.[1] Anyone who has compared prices charged in the service department at the back of an auto dealership with those charged for a complete vehicle in the showroom at the front understands the absurdity of this assumption - and its financial implications.

  Thus, the fact that Verizon's current proposed switch investment is $195 per line (based only on growth lines) matches to the 1997 number of $192 simply confirms that $192 number (which was based on Verizon's misstated discounts) is grossly overstated. The dollar effect of this overstatement can easily be seen by examining Attachment D to Verizon's *ex parte* - which shows significantly lower prices for "initial" switch purchases in the first row of the sheet - compared with prices for adding growth equipment shown in subsequent rows.[2]

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[1] This is a clear violation of the TELRIC principle that switches should be costed as if they were purchased new to serve all current demand. Instead, Verizon would have us calculate its costs based on a price list for individual spare, replacement or add-on parts.

[2] In what has become an unfortunate trend, Verizon's Attachment C does not show this same well-established relationship between the prices for initial switch purchases compared to growth equipment purchases because Verizon/Lucent used the wrong contract when computing the initial switch prices. *See* AT&T's NYPSC brief on pages 87-104.

If the prices in the first row of Attachment D for the different geographic zones are divided by the total lines for the respective zones, then the average material investment per line would decrease substantially from $195. For example, the Manhattan Zone 1 Initial switch price from Attachment D is *** Start Confidential*** XXX.***End Confidential*** Dividing this by 61,000 lines per switch in this zone (from page 1 of Attachment B) would generate a material price per line of ***Start Confidential *** XXX.[3] ***End Confidential*** This figure is 60% *less* than the growth-only based figure of ***Start Confidential *** XXX ***End Confidential*** shown by Verizon on page 1, Attachment B for Zone 1A.

2. **Even if the 1997 New York rates were accurate in 1997, they overstate greatly 2001 costs**

- *Switch prices have been declining steadily*

Even if the switch investments developed by the NYPSC in 1997 were correct, they no longer reflect such investment cost in 2001 - the year in which Verizon seeks approval for its Massachusetts rates.

In 1998, Pacific Bell's witness, Dr. Jerry Hausman stated that per-line switching investments had declined significantly over the previous five years at an annual rate of 8% per year.[4] Peter Huber and Evan Leo, authors of the self-titled "UNE Fact Report" submitted by USTA to the Commission in 1999 stated that, "Costs have been driven down rapidly by advances in digital technology. On a per-line basis, prices have declined 60 percent from 1986 to 1996 and were projected to fall another 12 percent by 2000."[5] And BellSouth in a Florida UNE cost proceeding stated that, "In general, switching costs have declined in the time span between the two studies" [1997 and 2000] and "The studies reflect a general overall decline in BellSouth's switching prices over the last several years."[6]

Thus, even if the NYPSC analysis had determined the correct investment cost for switching in 1997, this cost in 2001 should be anywhere from 12% to 30% lower.

- *Switch usage has increased steadily*

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[3] Note how consistent this figure is to the $55 to $60 figures that Bell Atlantic witness Nancy Sayer was telling the New Jersey Bureau of Public Utilities back in 1996.

[4] Testimony of Jerry Hausman for Pacific Bell, April 8, 1998 at page 8. In addition, Dr. Hausman has stated that the mid 1990s price for switching does not exceed $75 per line.

[5] USTA Comments Pursuant to 2nd FNRPM Released 4/16/99 re: Implementing Local Competition. Docket 96-98. Table #3: UNE Fact Report, Submitted by USTA Prepared for Ameritech, Bell Atlantic, BellSouth, GTE and US West, May 26, 1999, at I-28.

[6] Direct Testimony of Joseph H. Page before the Florida Public Service Commission, Docket No. 990649-TP, May 1, 21000, pages 10-11, page 30.

In addition to declines in the investment cost of switching over the last four years, there have been substantial increases in minute usage per line over this time frame. Because the usage-based switching prices charged in New York and Massachusetts are designed to recover substantial amounts of fixed costs (e.g., processor costs), the cost of minute of usage declines substantially as minutes of use per line grows. Therefore, any price developed in 1997 for switching based on 1997 usage volumes will be too high today. Because Commission statistics show that over the last four years, switching usage per line has grown between 20% and 25%, usage increases alone should drive major reductions in 2001 switching prices.

- *Technology has improved since the mid-1990*

  The 1997 switching rates in New York also do not account for the switch port cost savings now available through use of Next Generation Digital Loop Carrier (NGDLC) GR303-compliant technology - because switches purchased in 1993/1994 did not include such NGDLC ports. Because these line ports are much less expensive than analog lines that would have made up the bulk of the line termination equipment in older switches;[7] and because both New York and Massachusetts have both specified that 100% of all loops should be "costed" as if they employed fiber feeder (which NGDLC is intended to serve); the TELRIC of switching in 2001 is much lower than it may have been in 1997.

[7] For example, BellSouth states, "The introduction of GR303 based line terminating equipment has significantly lowered line port and usage costs." *Id*, page 11. Verizon has also recognized the advantages of GR303 digital loop carrier, stating, "Engineering studies have demonstrated that the cost per line of multiplexing in an NGDLC RT [remote terminal], plus the cost of a digital port at the circuit switch, is always less than an analog voice termination option at the switch." *See* Panel Testimony of Bell Atlantic-New York on Revised Costs and Rates for Unbundled Network Elements and Related Wholesale Services, Case 98-C-1357, Revised February 24, 2000, pages 130-131.