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July 11, 2001

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Magalie Roman Salas
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: Application by Verizon Pennsylvania, Inc. et al to Provide In-Region, InterLATA Services in Pennsylvania
CC Docket No. 01-138

Dear Ms. Salas:

Enclosed for filing please find the Comments of AT&T Corp. ("AT&T") in connection with the above referenced matter. Pursuant to the Public Notice issued June 21, 2001, AT&T is submitting the original and four (4) copies of its comments and supporting exhibits in redacted form.

AT&T is also submitting under seal the portions of supporting exhibits that contain material designated as confidential pursuant to the Protective Order in this matter. These pages bear a legend indicating that they are confidential.

Please let me know if any additional information is required. Thank you.

Very truly yours,

Peter M. Andros

Peter M. Andros
Legal Assistant

Encl.

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Application by Verizon Pennsylvania Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in Pennsylvania	)	**CC Docket No. 01-138**

COMMENTS OF AT&T CORP. IN OPPOSITION TO VERIZON PENNSYLVANIA'S SECTION 271 APPLICATION FOR PENNSYLVANIA

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July 11, 2001

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APPENDIX TO COMMENTS OF AT&T CORP. IN OPPOSITION TO VERIZON's SECTION 271 APPLICATION FOR PENNSYLVANIA

CC Docket No. 01-138

EX.	DECLARANT	SUBJECT(S) COVERED
A	Michael R. Baranowski	Evaluation of Verizon's UNE Rates and TELRIC.
B	Michael J. Nolan	Verizon's failure to make DSL available for resale as required by Section 251(c)(4) of the 1996 Act; Verizon's offering of DSL at retail to end-users.
C	Mason Fawzi and Robert Kirchberger	Nondiscriminatory access to OSS; the KPMG report on Verizon's OSS; unreasonably low flow-through rates for CLEC orders; failure of Verizon to provide timely billing completion notices; failure of Verizon to provide adequate electronic bills.
D	Joseph Bloss and E. Christopher Nurse	Analysis of the Pennsylvania Performance Assurance Plan/Performance Measurements

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COMMENTS OF AT&T CORP.
IN OPPOSITION TO VERIZON PENNSYLVANIA'S
SECTION 271 APPLICATION FOR PENNSYLVANIA

Pursuant to the Commission's Public Notice, AT&T Corp. ("AT&T") respectfully submits these comments in opposition to the application of Verizon Pennsylvania Inc., *et al.* ("Verizon") for authorization to provide in-region, interLATA services in the former Bell Atlantic territory in Pennsylvania.

INTRODUCTION AND SUMMARY

The Pennsylvania Public Utility Commission ("Pennsylvania PUC" or "PaPUC") has done much to compel Verizon to comply with its market-opening obligations under the Telecommunications Act and to create conditions in which meaningful local competition can take root and flourish. As a result, some competitors have begun to provide local service in Pennsylvania. These are positive developments for which the Pennsylvania PUC, particularly in light of Verizon's tenacious resistance to opening its markets, should be commended. This progress, however, cannot obscure the fact that two commissioners of the PaPUC, relying on a detailed evidentiary analysis prepared by the PUC staff, voted to oppose the instant application because of Verizon's failures, reflected in its own performance data, to comply with critical checklist obligations. And even the bare majority of the Pennsylvania PUC that voted, in the face of this strong dissent, to support the instant application found as recently as June 6, 2001, that Verizon had not complied with all the obligations of the Act,[1] and only supported Verizon's application based on Verizon's acceptance of conditions which do not, in fact, remedy the identified deficiencies.

Verizon is here seeking long-distance authorization before it has fully implemented the competitive checklist. In a number of areas that are crucial to securing the future of local competition in Pennsylvania, Verizon has yet to demonstrate the level of nondiscriminatory performance that the Act requires. This is not a matter of seeking perfection. There is no question that Verizon is capable of providing better performance. It has proven that ability in other states. Its decision to seek authorization in Pennsylvania before demonstrating a comparable level of performance here is therefore unwarranted. The timing of long-distance relief must be determined not by a BOC's internal business planning, but by demonstrated and full implementation of the BOC's checklist obligations.

That is particularly true where, as in Pennsylvania, the inroads on the BOC's monopoly that competitors have made are quite modest, and the remaining checklist deficiencies, though relatively few in number, are competitively quite significant. For example, even ignoring the growth in Verizon's own number of residential lines served over the last 18 months, while including CLECs' growth during that same period, CLECs have been able to capture only 4 percent of the residential market using unbundled network elements, and only 2 percent of the

[1] PaPUC Secretarial Letter, PaPUC Docket No. M-00001435, June 6, 2001, at 1 ("[T]he Commission finds, based on the record developed in this proceeding, that Verizon has demonstrated its compliance in most respects").

market using their own facilities. While this is a start, it is not evidence that Verizon has lost its local monopoly over the residential market, or that local competition is irreversibly established. The sharply-divided ruling of the Pennsylvania PUC as to whether to endorse Verizon's application at this time, which included pointed dissents from Commissioners Brownell and Fitzpatrick, underscores the point. As Commissioner Brownell put it, "full compliance . . . is clearly lacking," and the competitive gains to date are "not sustainable absent a guarantee of full open access."[2]

The limited local competition to date in Pennsylvania reflects the uncertainty, unreliability, and poor performance that Verizon has yet to eliminate and, in many instances, has chosen deliberately to foster and perpetuate. In several competitively critical areas, Verizon has yet to demonstrate a commitment to providing CLECs with the support that the Act and meaningful local competition require. Verizon has not only refused to set cost-based UNE prices in Pennsylvania, but has used Pennsylvania as a test case to litigate whether it even has such an obligation. Similarly, Verizon has refused to establish a performance remedies plan equal to that in New York, and insists on reserving the right to challenge the Pennsylvania PUC's very authority to impose *any* remedies plan. As dissenting Commissioner Fitzpatrick observed, Verizon has yet to provide in Pennsylvania the reliable electronic billing for UNE-P in Pennsylvania that Verizon provides in New York and Massachusetts, and that SBC provided in each of the states where it received long-distance authorization.[3] Verizon's promises of future improvement are entitled to no weight, particularly because, as Commissioner Brownell put it, it

[2] Dissenting Statement of Comm'r Brownell at 3, 4.

[3] Dissenting Statement of Comm'r Fitzpatrick at 2.

is "difficult to have confidence in a company which has apparently misled this Commission on the record."[4]

Accordingly, this Commission should insist, as Commissioner Fitzpatrick urged, that Verizon finish the task of fully implementing the competitive checklist "*before* it enters the long distance market."[5] These comments identify several of the most competitively significant steps that Verizon must be required to take.

Part I describes Verizon's complete failure to establish cost-based UNE rates in Pennsylvania. Verizon's application is facially deficient with respect to this crucial issue: Verizon provides no affidavits, cost studies, or other evidence to support its assertion that UNE-rates in Pennsylvania are cost-based. It could not be otherwise. Had Verizon provided this Commission with the full pricing record in Pennsylvania, it would have had to disclose its repeated concessions that the Pennsylvania rates – which are the product of negotiations rather than of the application of TELRIC methodology – are not cost-based, lack any evidentiary or factual support, and are arbitrary and capricious. Similarly, Verizon would have had to admit that it has chosen to contest and litigate at every turn its obligation to provide UNEs at rates set in accordance with this Commission's TELRIC methodology. This application is therefore unique among 271 applications submitted to this Commission to date; it is the only one in which the applicant concedes that its UNE rates both lack evidentiary support and do not comport with TELRIC.

[4] Dissenting Statement of Comm'r Brownell at 3.

[5] Dissenting Statement of Comm'r Fitzpatrick at 1 (emphasis in original).

None of Verizon's rationales for defending its UNE rates has merit. Verizon points, for example, to the Pennsylvania Commission's explanation that the negotiated rates are close to the rates that application of Verizon's cost studies would have generated. This explanation only compounds the problem, however, because it is beyond dispute that Verizon's cost studies were not prepared in accordance with TELRIC methodology. Indeed, a federal district court already has held that the costing approach proposed by Verizon and adopted by the PaPUC failed to comply with the Commission's TELRIC standards, and that those cost studies, in addition to the many other flaws discussed below, are based on the costs of reproducing Verizon's existing network rather than on the forward-looking costs of an efficient network. No more fundamental departure from TELRIC methodology is conceivable. Thus, to the extent Verizon's UNE rates reflect Verizon's cost studies, that is simply another reason why they must be rejected.

Similarly, Verizon cannot salvage its UNE rates by claiming that those rates have promoted competitive entry. Verizon has greatly overstated the degree to which competitors have been able to use UNEs to enter the residential market. Indeed, AT&T has determined that its potential margins for UNE-based state-wide entry in Pennsylvania are far too small to be profitable, and therefore has chosen to not provide such services in Pennsylvania. In all events, the critical issue under the competitive checklist is not whether competitive entry is viable in Pennsylvania (which it is not), but whether Verizon's proposed Pennsylvania UNE rates comply with TELRIC principles, a showing that Verizon has failed to make.

Part II explains Verizon's deliberate effort to stifle whatever remaining hope there may be of DSL competition in Pennsylvania by imposing unlawful restrictions on the resale of DSL. Specifically, Verizon refuses to provide DSL at wholesale rates when a CLEC, and not

Verizon, is providing the customer's voice service. Verizon will thus resell voice, and will resell DSL, but it will not resell both to allow a CLEC to provide both voice and DSL to a single customer. This absurd and highly anticompetitive restriction is plainly unlawful, as Commissioner Brownell expressly noted in her dissenting statement.

Once again, Verizon has offered no legitimate defense of its anticompetitive policy. Its principal claim is that, notwithstanding Verizon's direct marketing of DSL to retail customers, it actually provides DSL through a line-sharing arrangement with its DSL affiliate, Verizon Advanced Data, Inc. ("VADI"). It therefore claims that it need only make line-sharing available to other competitors, and that this entitles Verizon to withhold resale of DSL when Verizon is not the voice provider. The manipulation of corporate affiliates to avoid checklist obligations, however, was flatly rejected by the United States Court of Appeals for the D.C. Circuit in the *ASCENT* decision. *Association of Communications Enterprises* v. *FCC,* 235 F.3d 662 (D.C. Cir. 2001) ("*ASCENT*"). *ASCENT* makes clear that Verizon cannot evade its resale obligations by pointing to the formalism of a separate DSL affiliate; the reality is that Verizon is providing DSL at retail, and the law therefore requires that Verizon provide DSL to CLECs at an appropriate avoided-cost discount regardless of whether a CLEC or Verizon is providing the customer's voice service. Indeed, Verizon's reliance on this argument is all the more remarkable given its simultaneous effort to dissolve VADI – a fact about which Verizon "apparently misled" the Pennsylvania Commission.[6]

Part III explains why Verizon also has not met its obligation to provide CLECs with nondiscriminatory access to its operations support systems. Indeed, Verizon's OSS

[6] Dissenting Statement of Comm'r Brownell at 3.

performance is substantially below the levels it has previously shown (in New York and Massachusetts) that it can attain, and well below the levels and quality of service that Verizon's own retail operations enjoy in Pennsylvania – a point underscored by both Commissioners who dissented from the Consultative Report of the PaPUC. In these circumstances, where its performance falls well short of what the record shows Verizon is capable of attaining and what it provides itself, Verizon cannot possibly be deemed to have "fully implemented" the competitive checklist.

For example, despite substantial third-party testing of Verizon's OSS, a very high rate of CLEC orders in Pennsylvania falls out for manual processing, with its inherent risks of errors and delay. Indeed, flow-through rates in Pennsylvania are far lower than those in New York today. In the case of UNE-P and UNE orders, the most recent flow-through rates reported by Verizon at the time it filed its Section 271 application for Pennsylvania are even lower than the flow-through rates that Verizon achieved in New York when Verizon submitted its 271 application for that state in 1999. Unfortunately, continuing to subject CLECs to manual order processing is not the only competitively significant OSS issue. Verizon also fails to provide CLECs with the timely billing completion notices that they need to ensure that customers are billed accurately – an issue this Commission has previously and correctly acknowledged to be of substantial competitive significance. And critically, Verizon also has failed to demonstrate in Pennsylvania that it is able to provide CLECs with timely, accurate, and complete electronic bills. Without such billing support (and hence the ability to validate Verizon's charges), even if all other factors permitted entry, CLECs simply could not efficiently and successfully provide service to large numbers of residential customers.

Part IV explains that there is no sound basis for Verizon's assertion that it is subject to "a comprehensive, self-executing performance assurance mechanism that provides . . . incentives to provide the best wholesale performance possible." Verizon Br. at 84. In this case, Verizon has refused to make an unequivocal commitment to establish *any* remedy plan, much less an adequate plan. The Pennsylvania Performance Assurance Plan ("PaPAP") on which Verizon relies is wholly insufficient to deter anticompetitive conduct. The PaPAP omits key metrics that are important to any showing of nondiscriminatory conduct. Additionally, as pointed out by Commissioner Brownell,[7] Verizon's improper implementation of measures within the plan renders its performance data unreliable, and its performance results are otherwise unverifiable. Ensuring the completeness and reliability of performance measures and results before Section 271 entry is critical not only to measuring checklist compliance, but to establishing an appropriate point of departure against which to assess backsliding.

Even assuming, *arguendo,* that Verizon's performance measures and results could be deemed complete and reliable – and they most assuredly are not – the PaPAP still is incapable of deterring backsliding because the penalties it establishes are paltry compared to the benefits of noncompliance. Recognizing this, Verizon would appear to have this Commission believe that it will voluntarily adopt any new measurements that may be imported into the PaPAP from New York. Verizon's pattern of conduct to date, however, belies this suggestion. As a predicate matter, Verizon has taken the position that the PaPUC lacks authority to implement *any* performance standards and remedies. Even after the PaPUC conditioned approval of Verizon's 271 application on, *inter alia,* the withdrawal of Verizon's state court challenge to the existing PaPAP, Verizon only discontinued that appeal – effectively leaving it free to raise its

[7] Dissenting Statement of Comm'r Brownell at 2.

fundamental challenge to the state commission's authority to apply remedies for discriminatory wholesale performance in response to any further PaPUC action concerning the PAP.

Moreover, any suggestion that Verizon is willing to import the New York remedies plan into Pennsylvania is thoroughly contradicted by Verizon's actions. In prior state proceedings, Verizon has strongly opposed the adoption of the New York PAP in Pennsylvania. And in a pleading filed with the PaPUC just last week, Verizon made it clear that it continues to reject the New York plan as a model for use in Pennsylvania. Under these circumstances, there is no basis for finding that Verizon is currently subject to an enforcement plan with "a self-executing mechanism that does not leave the door open unreasonably to litigation and appeal." *New York 271 Order* ¶ 433.

Finally, Part V sets forth the reasons why approval of Verizon's application would not serve the public interest. Section 271 makes clear, and this Commission has acknowledged, that even where (unlike here) a BOC has fully implemented each of its checklist obligations, interLATA authorization is not in the public interest if other relevant factors demonstrate either that its local markets are not open to competition or that they will not remain open to competition. As the dissenting statements of two Pennsylvania Commissioners attest, it is premature to conclude even that the Pennsylvania local market is fully open to competition, let alone that it will assuredly remain so. Competitors serve only a tiny fraction of the residential lines in the former Bell Atlantic territory of Pennsylvania, and many of the competitors to which Verizon points either have not yet entered the market in any significant way, are exiting or reducing their presence in the market, or are in extreme financial distress. None has yet made investments in the Pennsylvania market and established a record of success sufficient to provide assurance that the vigorous local competition promised by the Act will ever occur, let alone flourish indefinitely. As the independent analyses of the failure of local residential competition to develop in Texas make clear, Pennsylvania consumers will pay a high price – a lack choice of providers in local service and higher long distance prices – if long distance authorization is prematurely approved.

For all of these reasons, then, this Commission should not lower the bar for Verizon in Pennsylvania. Verizon has elsewhere demonstrated that it is capable of providing CLECs with far better performance (and performance that more nearly approximates what it enjoys), with a commitment to participating in proceedings designed to set TELRIC-compliant UNE rates, and with far greater certainty (complete performance measurements, enforceable and meaningful remedies) than it has yet been willing to offer in Pennsylvania. There is no reason to accept less here. Indeed, the checklist's "full implementation" requirement precludes any such acceptance. Accordingly, the Commission should deny Verizon's application for Pennsylvania.[8]

I. VERIZON HAS NOT EVEN SERIOUSLY ATTEMPTED TO MEET ITS CHECKLIST ITEM TWO BURDEN OF DEMONSTRATING THAT ITS UNE RATES ARE COST- BASED.

Verizon has the burden of showing that its Pennsylvania UNE rates – which were the product of an arbitrary negotiated settlement, rather than any serious attempt to apply the

[8] Verizon claims that "even AT&T's own chairman has been forced to concede that 'Pennsylvania is just doing a wonderful job to open up the local telephone market to competition.'" Br. at 12. Verizon has quoted AT&T's chairman completely out of context and, in a patently misleading fashion. Contrary to the implication in Verizon's brief, the statement had nothing to do with the proceedings that the PaPUC conducted this year to examine Verizon's compliance with section 271. Rather, the statement, made in June 2000, lauded the PaPUC's decision in the 1999 *Global Order* to require the structural separation of Verizon's wholesale and retail operations – a decision that was based on the PaPUC's finding that Verizon had abused its market power, and that in the absence of structural separation the PaPUC would not be able to exercise its "duty to enforce, execute and carry out the pro-competition mandates" of state and federal law. *Global Order* at 222-232. However, in the face of stiff opposition from Verizon – characterized by what the PaPUC Chairman described as actions that "deliberately obstructed the orderly resolution" of the proceeding that had been established to implement the structural separation requirements, as well as "an extensive, systematic campaign of misinformation" – the PaPUC abandoned this structural separation requirement this past April. *See* Statement of Chairman John M. Quain, PaPUC Docket No. M-00001353, April 11, 2001, at 1-2.

Commission's TELRIC rules – are nonetheless within the reasonable range of rates that adherence to the TELRIC rules would have produced. *See, e.g., Kansas/Oklahoma 271 Order* ¶ 29 ("the BOC applicant retains at all times the ultimate burden of proof that its application satisfies all of the requirements of section 271, even if no party files comments challenging its compliance with a particular requirement"); *New York 271 Order* ¶ 49 (the BOC applicant must make "a *prima facie* case that it meets the requirements of a particular checklist item" and "must plead, with appropriate supporting evidence, facts which, if true, are sufficient to establish that the requirements of section 271 have been met").[9] Verizon does not even attempt to satisfy that burden. In stark contrast to every Section 271 application that the Commission has approved (and most of those it has rejected as well), Verizon's Application includes no pricing affidavits, no cost studies, no substantive defense of the state commission approved UNE rates, and, indeed, nothing at all that would allow the Commission to verify Verizon's bald claim of TELRIC compliance.[10] In short, Verizon has not provided the Commission with any legitimate basis to conclude that Verizon has complied with Checklist Item Two and has instead simply thumbed its nose at the Commission's and the Act's requirements. In these circumstances, the only nonarbitrary course open to the Commission is to reject the Application.

Although fatal to its request for long distance authority, Verizon's reluctance to air the relevant UNE rate issues is understandable. Unlike any previous applicant, Verizon

[9] The United States Court of Appeals for the Eighth Circuit has held that certain of the Commission's TELRIC rules are inconsistent with the requirements of the 1996 Act. *Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), *petition for cert. filed sub nom. Verizon Communications v. FCC*, 121 S.Ct. 877 (Oct. 4, 2000) (No. 00-511). The Eighth Circuit stayed its decision pending Supreme Court review, *see Iowa Utils. Bd. v. FCC*, No. 96-3321 *et al.* (8th Cir. Sept. 25, 2000); on January 22, 2001, certiorari was granted. *Verizon Communications, Inc. v. FCC.*, 121 S.Ct. 877, (Jan 22, 2001). The Commission has held that its TELRIC rules "remain in effect" for purposes of Section 271 applications filed during the period of the stay. *Massachusetts 271 Order* ¶ 17; *Kansas/Oklahoma 271 Order* ¶ 48.

[10] The supporting Lacouture/Ruesterholz Declaration on the Competitive Checklist contains only a brief discussion of some issues related to collocation rates (¶¶ 78-96 and Attach. 11 ("December 8th Recommended Settlement (continued)

comes to the table having *admitted* – repeatedly – that the rates on which it has based its application are not TELRIC compliant. The *Global Order* rates upon which the Application is based are the product of a contested settlement of numerous issues (most of them unrelated to UNE pricing) before the PaPUC. These rates were not generated or supported by any cost studies, and Verizon has conceded that they "have no evidentiary or factual support" (PaPUC May 24, 2001 Interim Opinion and Order, 10 (citing statement by Verizon)), are "arbitrary, capricious and unsupported by any record evidence," and "are not TELRIC compliant." *Presentation of Bell Atlantic—New Jersey, Inc. Augmenting the Existing Record*, State of New Jersey, Board of Public Utilities, Docket No. TO00060356, pp. 10-11 (July 28, 2000).

Moreover, the sole after-the-fact justification that the PaPUC offered for its own determination that Verizon's *Global Order* rates are nonetheless TELRIC-compliant – *i.e.*, that those arbitrary contested settlement rates are "close" to the rates that would have been generated by cost studies that Verizon offered in support of its earlier *MFS III* rates – actually *confirms* that the *Global Order* rates are not TELRIC compliant. Those *MFS III* cost studies estimate the cost of replicating Verizon's *existing* network and not, as the TELRIC rules require, the cost of replacing Verizon's network with an efficient, least cost network that employs the most efficient currently available technology. *See* 47 C.F.R. §51.505(b).[11] Indeed, Verizon concedes the point, stating: the *MSF III* "cost model... calculate[s] forward-looking costs using Verizon's actual costs... rather than... [those of a] hypothetical, most efficient network." Brief for Appellant

Agreement")), and essentially no discussion at all of pricing for critical network elements such as loops, switching, and transport.

[11] *See also* Brief of Bell Atlantic Corp., BellSouth Corp., and SBC Communications, Inc., at 7, *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 373 (1999) (TELRIC "require[s] States to set prices solely on the incremental, forward-looking cost of an ideally efficient network-a hypothetical network that, by design, ignored nearly every aspect of an incumbent's actual current 'cost... of providing the... network element'").

Verizon Pennsylvania, Inc., *MCI Telecomm. Corp., et al. v. Verizon Pennsylvania Inc., et al.* (3d Cir., No. 00-2258) (filed Feb. 8, 2001) ("Verizon Appellant's Br."), 38.

The PaPUC's contrary claim that the *MFS III* rates are somehow TELRIC compliant has already been rejected by a federal district court. Memorandum and Order, *MCI Telecommunications Corp. v. Bell Atlantic-Pennsylvania Inc.*, No. 97-1857, p.10 (M.D. Pa. June 30, 2000), appeal pending, No. 00-2257 (3rd Cir., filed July 28, 2000) (reversing and remanding and noting substantial concerns that the *MFS III* cost models "were not forward looking and included assumptions and inputs that are inconsistent with forward looking pricing, such as embedded costs and inefficiencies, costs associated with investment unrelated to providing local telephone service, and other inflated inputs that reflected monopoly pricing rather than forward looking costs"). Although the PaPUC continues to defend the *MFS III* rates in a Third Circuit appeal, it admitted in the *Global Order* that "[t]he empirical evidence indicates that the [*MFS III*] rates in Pennsylvania are not set at the TELRIC level." *Id.* at 69. As Verizon has acknowledged, the *Global Order* "does not change the [PaPUC's] fundamental assumptions relating to UNE pricing;" in particular, the PaPUC "did not repudiate the fundamental reliance on Verizon's model and use of Verizon's actual forward-looking costs rather than constructing a hypothetical, most efficient network from scratch." Verizon Appellant's Br., 39 n.72. *See, e.g.*, *New York 271 Order* ¶ 244 ("we will reject the application . . . if basic TELRIC principles are violated").

Even as the PaPUC defended the current UNE rates in Verizon's state Section 271 proceeding, it explicitly found, in a separate proceeding, that "competition is severely lacking" in rural areas of Pennsylvania and established a new proceeding "to determine whether any further adjustment of UNE rates [beyond the minimal rate reduction the PaPUC ordered for rural Density Cell 4 loops] is necessary."[12] Under the PaPUC's Order, that new UNE rate investigation, which has not formally commenced, would only result in a preliminary report and recommendation by no later than December 31, 2001 – well after the deadline for completion of this Commission's review of the instant application – with a final decision by the PaPUC some time next year.

Against this extraordinary backdrop, the Commission can and should deny the Application without any detailed review of the specifics of the *MFS III* cost studies and determinations upon which the PaPUC defended the *Global Order* settlement rates. In all events, review of those cost studies and PaPUC determinations can only confirm the district court's concerns and Verizon's concessions. As detailed below, the TELRIC violations are clear, numerous and flagrant. Among other things, Verizon's cost models, in many respects, simply replicate its existing network without regard to more efficient alternatives, in other respects, improperly inflate UNE rates with the costs of broadband facilities, and, in virtually every important respect, rely on key input assumptions that violate core TELRIC principles.[13]

Verizon's position appears to be that the Commission should nonetheless presume that Verizon's Pennsylvania rates are TELRIC-compliant simply because the PUC has so labeled them. The Commission has properly rejected that toothless view of its Section 271

[12] *Re: Structural separation of Bell Atlantic-Pennsylvania, Inc. Wholesale and Retail Operations*, Opinion and Order, PaPUC Docket No. M-00001353, April 11, 2001, at 40.

[13] Verizon asserts that AT&T has "held out Pennsylvania as the standard that should be followed in other proceedings" (Verizon Br. at 83 & n.86). Verizon cites AT&T's comments in the Massachusetts 271 proceeding, but those comments say no such thing. Rather, in a discussion of Verizon's attempt to justify high UNE rates in Massachusetts by comparing them to those in New York, without reference to the rates set in other Verizon-dominated states, AT&T noted only that in Pennsylvania, "for example," the PaPUC adopted local switching rates that were "50 percent lower than the switching rate" adopted in New York. *Comments of AT&T Corp. In Opposition To Verizon New England Inc.'s Section 271 Application For Massachusetts*, CC Docket No. 01-9, at 18 n.26 (Feb. 6, 2001). And in the very next sentence (which Verizon conveniently omits), AT&T expressly cautioned that "the actual TELRIC rates in Pennsylvania may be even lower than that prescribed by the PAPUC." *Id.*

responsibilities. *See Massachusetts 271 Order* ¶ 20; *New York 271 Order* ¶ 244. Verizon's only other argument is that the existence of some competitive entry necessarily proves that its rates are appropriately cost-based. Even setting aside the fact that Verizon has greatly overstated the degree to which competitors have been able employ a UNE-platform based strategy to enter local markets in Pennsylvania, AT&T's margin analyses indicate that state-wide UNE-based entry in Pennsylvania would not be profitable. For that reason, AT&T has chosen to not provide such services in Pennsylvania. In all events, Verizon's burden is to prove, not merely to imply, that its proposed Pennsylvania UNE rates comply with TELRIC principles. The Application is facially deficient, Verizon's UNE rates are not remotely cost-based, and the Application should accordingly be denied.

A. Background.

The* MFS III *UNE Rates. Verizon's initial "permanent" UNE rates were set by the PaPUC in its *MFS III* proceedings, and on August 7, 1997, the PaPUC issued its final *MFS III* Order. The PaPUC majority acknowledged that the rates it was setting would be too costly to serve as a vehicle for entry by new competitors into residential markets. *MFS III* Order at 12. Two of the five PaPUC members dissented, noting that that the majority had "failed to implement the provisions of Section 252" of the 1996 Act by "failing to set permanent prices for unbundled network elements (UNEs) that are based on cost" (*MFS III* Dissent at 8), by (i) failing to respond to a welter of specific criticisms of the Verizon cost data, (ii) failing to "set forth in sufficient particularity" the majority's findings and conclusions," and (iii) failing to provide "the reviewing court" a reasoned explanation for the agency's action. *Id.* at 5-11.

The dissenters noted that the rates adopted for the two most important network elements—loop, switch port and switch usage—were significantly higher than the rates set by the PaPUC's counterparts in the "neighboring Bell Atlantic [a/k/a Verizon] states"; that the rates for switching were "higher by far than *any comparable single rate established in [any] other state*"; and that the price of the basic platform needed by new entrants was "far in excess of retail rates" paid by *residential consumers*—retail rates that the PUC had just found to be "set above cost." *Id.* at 5, 9-11 (emphasis added). Thus, they concluded, "[t]here is no plausible or logical explanation to reconcile these inconsistencies." *Id.* at 11.

Commissioner Hanger expanded on these criticisms in a separate statement. *MFS III* Hanger Dissent. Listing a "series of unreasonable judgments" about cost inputs and assumptions that underlay the PUC's results, *id.* at 3-5, he noted that the Commission had "all of a sudden" transformed Pennsylvania into a "comparatively high cost and rate jurisdiction": Although the FCC had recently determined that Verizon's cost of supplying a loop in Pennsylvania was *lower* than in Delaware, New Jersey, Maryland and Virginia, the PaPUC's newly-prescribed loop rates in Pennsylvania were *higher* than the corresponding rates in all four neighboring jurisdictions. *Id.* at 1-3. And the PaPUC's newly-prescribed switched access rates were "probably the highest in the country and close to 60% higher than the next highest rates," because "[u]nreasonable assumptions produce unreasonable results." *Id.* at 3.

AT&T and others challenged the *MFS III* Order and rates in federal court, arguing that the PaPUC erred by (1) setting rates based on Verizon's historical, embedded costs rather than those of a competitive, efficient provider, (2) inflating rates by charging narrowband, voice telephony for the costs of broadband, video facilities, and (3) inflating rates with excessive costs of capital, radically shortened depreciation lives, a failure to account for switch discounts, and excessive assumptions about space capacity ("fill factors"). *See* Opening Brief of AT&T of Pennsylvania, Inc. in Support of Motion for Summary Judgment ("AT&T Summary Judgment

Br."), *MCI Telecomm. Corp., et al. v. Bell Atlantic—Pennsylvania, Inc., et al.*, (M.D. Pa., No. 1:CV-97-1857) (filed Oct. 28, 1998). As noted above, the District Court reversed and remanded to the PaPUC because fundamental doubts existed about the cost studies relied on by the PaPUC in *MFS III*. Memorandum and Order, *MCI Telecommunications Corp. v. Bell Atlantic-Pennsylvania Inc.*, No. 97-1857, p.10 (M.D. Pa. June 30, 2000), appeal pending, No. 00-2257 (3rd Cir., filed July 28, 2000).

***The* Global Order *Rates*:** Beginning in September 1998, the PaPUC initiated a "global" settlement process involving a variety telecommunications issues, asking participants "to engage in substantive settlement discussion in several pending proceedings for the purpose of exploring an integrated resolution of the complex issues presented." *Global Order* at 5. Subsequently, two petitions (later consolidated) were filed by various interested parties seeking coordinated resolution of numerous outstanding issues. The eventual "global" resolution of these petitions involved "access charges; unbundled network elements (UNEs); enhanced extended loops (EELs) and other UNE combinations; interconnection; digital tariffs; calling areas; resale; Universal Service Fund Carrier Charge Pool; Lifeline programs; consumer education; rate caps and ceilings; the Internet and reciprocal compensation; operations support systems (OSS); separation of wholesale and retail operations; performance measures; competitive service designation; Section 271, 47 U.S.C.§271, approval; regulatory parity and filing requirements; abbreviated dispute resolution; and resolution of certain pending dockets." *Id.* at 3.

Commenting on the *MFS III* rates, the PaPUC observed in the *Global Order* that "[t]he empirical evidence indicates that the existing rates in Pennsylvania are not set at the TELRIC level. The rates for unbundled loops and local switching in Pennsylvania (including the switch port and switching per minute rate elements) are far in excess of rates that exist in other states and the FCC's Proxy Rates."[14] *Id.* at 69. Although Verizon proposed new unbundled loop rates as part of the proceedings leading to the *Global Order*, the PaPUC noted that Verizon "did not support the proposed rates with any record evidence," and "failed to address any changes that may have occurred which would address the magnitude of rate reductions necessary." *Id.* at 71. "[U]nfortunately," the PaPUC concluded, "[Verizon] has not provided us with the necessary basis upon which to find that its proposed rates are appropriate." *Id.* at 72.

Like the myriad other issues resolved by the Global Settlement, the rates approved by the PaPUC were solely the product of a contested settlement, and they were not supported by any cost studies or evidence. To support the settlement rates, the PaPUC looked back to a series of "scenarios" running Verizon's cost studies with different input assumptions that the PaPUC had required the parties to submit during the *MFS III* proceedings. The PaPUC identified one such scenario – "Scenario 9" – that produced loop rates that were close to the settlement rates. Scenario 9 differed from the scenario on which the *MFS III* rates were based (and which the federal district court rejected) in only two respects. *Id.* at 73-74. "Based upon the remarkable similarity" between the weighted 2-wire average loop rates proposed in the settlement petitions and that from Scenario 9, the PaPUC approved the settlement rates. *Id.* at 76-77 ("although not identical to the Scenario 9 Loop rates by Density Cell [*e.g.*, the four rate zones of the state], [the settlement rates] are just and reasonable when the statewide average loop

[14] For example, the PaPUC noted that the earlier order erred in assuming that the Next Generation Digital Loop Carrier systems ("NGDLC") Verizon was intending to deploy would be comparable to the costs it was then paying for Integrated Digital Loop Carrier ("IDLC"). In fact, the PaPUC concluded, "in all instances NGDLC is significantly less expensive than" than IDLC, that "this is a declining cost industry and therefore [Verizon's] loop and switching costs need to be reexamined." *Global Order* at 69-70.

rates are taken into consideration." *Id.* at 77. The PaPUC directed Verizon to amend its tariff to reflect the settlement rates. *Id.* at 83.

The May 24, 2001 Interim Rates: In a May 24, 2001 Interim Opinion and Order, the PaPUC addressed pricing issues associated with several UNEs that remained unpriced after the conclusion of the *Global Order* proceeding.[15] The PaPUC expressed frustration that Verizon had not even followed the *Global Order* methodology (*i.e.*, corrected cost of capital and fill) in its proposed rates for these elements; rather, Verizon had reverted back to the *MFS III* inputs that the PaPUC had rejected in the *Global Order*, and took other steps with respect to its UNE rate proposals that the Administrative Law Judge who presided over the evidentiary hearings in the case concluded involved "manipulating the Company data to delay competitive use of its network and maximize profits."[16] Accordingly, in the May 24, 2001 Interim Order, the PaPUC directed Verizon to recalculate these rates with the corrected fill and cost of capital inputs, as well as other modifications described in the Order, and to offer them as interim rates pending further proceedings to establish permanent rates.[17]

B. Neither The Arbitrary *Global Order* Rates Nor The "Scenario 9" *MFS III* Cost Studies Used To Defend Them Are Remotely TELRIC-Compliant.

Although the *Global Order* rates upon which the Application is based are not themselves the product of any cost studies or cost analyses, the PaPUC defends them on the

[15] That pricing issues involved in the May 24, 2001 PaPUC Interim Order primarily involved the establishment of recurring and non-recurring rates for elements of DSL services, including xDSL-capable loops. PaPUC Consultative Rept., p.10; May 24, 2001 Interim Order.

[16] Recommended Decision of Administrative Law Judge Louis Cocheres, PaPUC Docket No. R-0005261, March 26, 2001, at 92.

[17] The May 24, 2001 Interim Order directed Verizon to file the revised rates within 20 days of entry of the order. On June 21, 2001, however, Verizon moved to for an extension of time which, if granted, would push the date for filing the comprehensive compliance tariff to September 28, 2001 – in other words, beyond the normal statutory deadline for this Commission's resolution of the instant application. Motion for Extension of Time, PaPUC Docket No. R-00005261, June 21, 2001. That motion is still pending before the PaPUC.

ground that they are close to the "Scenario 9" rates generated from Verizon's *MFS III* cost studies. But far from supplying the *Global* Order rates with a TELRIC mantle, the proximity of the Global Order rates to these *MFS III* cost estimates merely confirms that the *Global Order* rates are not remotely TELRIC compliant, because those cost studies violate TELRIC in myriad respects.

As discussed below, the *MFS III* rates were inflated by Verizon cost studies assessing CLECs for costs based on the "replication" of the existing Verizon network rather than the costs of an efficient competitor as mandated by the Commission. As Verizon concedes, its cost studies generally did not attempt to estimate the cost of the most efficient "replacement" network, as required by the TELRIC rules, but instead assume reproduction of *existing* Verizon facilities, ignoring more efficient substitutes that would have to be adopted by a provider no longer able to rely on the embedded network arrangements developed in its days as a protected monopolist. That is the very approach that the Commission has repeatedly condemned and is currently challenging in the Supreme Court. *Verizon Commun., Inc.* v. *FCC*, *cert. granted*, 121 S.Ct. 877 (2001) (Nos. 00-511, 00-555, 00-587, 00-590 & 00-602) (*"Iowa Utilities Board II"*).

Ironically, Verizon did deviate from its own existing network in modeling costs by presuming to charge CLECs that purchase UNEs for the provision of voice-grade services for all of the costs associated with the construction of a gold-plated network that also provides advanced broadband services (*e.g.*, video). This improperly shifts to CLECs and their narrowband customers the costs of broadband services that should be borne by broadband providers and customers and that are not caused by narrowband, voice-grade telephony.

In addition, the Verizon studies were also inflated by errors in key inputs such as depreciation lives and switch discounts.

1. Verizon's UNE Rates Are Substantially Inflated By Unlawful "Reproduction Cost" Assumptions.

As an initial matter, the Commission's TELRIC rules require the "cost" upon which UNE rates are based, *see* 47 U.S.C. § 252(d)(1), to be "measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." 47 C.F.R. § 51.505(b)(1). This rule requires a "replacement" cost approach and forecloses a "replication" or "reproduction" cost approach. As the Commission recently explained to the Supreme Court:

> The essential objective of any forward-looking methodology is to determine what it would cost, in today's market, to replace the functions of an asset that make it useful. That is the asset's 'forward-looking' cost (also known as its 'replacement' or 'economic' cost), as distinguished from the cost of duplicating the asset in every physical particular (sometimes called an item's 'reproduction' or 'replication' cost). Thus, under a forward-looking methodology, if an incumbent bought an analog switch in 1985 at a fixed cost of $150 per line, and an efficient carrier would address the same business need today by purchasing a digital switch at a fixed cost of $100 per line (more efficient digital switches have supplanted analog switches in the market), the latter figure is the appropriate basis for determining what a new entrant would pay for leasing switching equipment.

Brief of the FCC, *Verizon Commun., Inc.* v. *FCC*, at 6-7, *cert. granted*, 121 S.Ct. 877-89 (2001) (Nos. 00-511, 00-555, 00-587, 00-590 & 00-602).[18]

Verizon's cost studies – those used in defense of its Pennsylvania UNE rates – plainly violate this fundamental TELRIC principle by relying in many key respects on a

[18] *See also id.* at 29 ("In competitive markets, the price that a firm would pay or charge to lease particular facilities varies with the cost of obtaining the function of those facilities through some other means, including the use of more efficient substitutes; the firm would not arbitrarily blind itself to the availability of such substitutes"); *Local Competition Order* ¶ 684 (recognizing that failure to adhere strictly to a replacement cost approach could produce rates "that reflect inefficient or obsolete network design and technology").

"replication" approach. Verizon itself frankly conceded this point when it boasted to the Third Circuit that its Pennsylvania cost models compute "what it would actually cost to *replicate* the *existing* network."[19]

2. Verizon's Inclusion of Broadband Costs in Computing Its UNE Rates Violates TELRIC.

Moreover, where Verizon's *MFS III* cost studies do depart from its unlawful replication approach, they do so in ways that are equally violative of TELRIC. Specifically, Verizon's cost models, as adopted by the PaPUC, improperly include the cost of a mix of 100 percent fiber network installed by Verizon in anticipation of someday providing "broadband" (video) service in its UNE loop rates. *See MFS III* Interim Order at 67; Motion of Chairman Quain (July 10, 1997). Verizon admits this in noting that its loop cost studies assumed that 20 percent of all loops would reflect the more costly 100 percent fiber cable that can carry video services, even though broadband-capable facilities are unnecessary to provide the telephone services that competing carriers seek to provide with Verizon's UNEs. *See* Baranowski Decl. ¶¶ 21-26. Thus, the *MFS III* assumptions unlawfully endorse a regime in which carriers that purchase voice-grade narrowband UNE loops from Verizon-Pennsylvania are effectively subsidizing Verizon's broadband infrastructure. *See* Baranowski Decl. ¶¶ 23-24.

That is a clear violation of the Commission's TELRIC rules, which specifically limit the costs of an element to those "that are directly attributable to, or reasonably identified as

[19] Verizon's Appellant's Brief, *MCI Telecom. Corp. et al.* v. *Verizon Pennsylvania Inc., et al.*, 3d Cir., No. 00-2258 (filed Dec. 20, 2000), pp.38-39 (emphasis added). Putting all its eggs in the basket of the Eighth Circuit's second *Iowa Utilities Board* decision (*Iowa Util. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000) ("*Iowa Utilities II*")), Verizon argues that the District Court was "clearly wrong" to remand the PaPUC's rate determinations, because the *Iowa Utilities II* case makes it clear that TELRIC rates can reflect "actual costs" rather than "costs of an efficient carrier in a competitive market." Verizon Appellant's Brief, p. 38; *see also Iowa Utilities II*, 219 F.3d at 749-51 (vacating and remanding to the FCC rule 51.505(b)(1)).

incremental to," the element. 47 C.F.R. § 51.505(b)(1).[20] To be attributed to a network element, a cost must be "causally-related to the network element being provided" in the sense of being necessary to provide it. *Local Competition Order* at ¶ 691 ("Costs must be attributed on a cost-causative basis. Costs are causally-related to the network element being provided if the costs are incurred as a direct result of providing the network elements, or can be avoided, in the long run, when the company ceases to provide them").

One reason for this "causation" standard is to ensure local exchange carriers do not attempt to subsidize ventures that are unrelated to the provision of voice grade access. But that is exactly what the PaPUC has allowed Verizon to do in Pennsylvania by approving settlement rates that are equivalent to rates produced by Verizon's broadband-bloated *MFS III* cost studies. *See* Baranowski Decl. ¶ 24.

Verizon and the PaPUC attempt to defend the inclusion broadband facilities in UNE loop rates on the grounds that, in some instances, broadband facilities are less expensive than narrowband facilities. *MFS III* Interim Order at 67-69. But that *post hoc* justification does not withstand scrutiny. The record in the *MSF III* proceeding clearly established that the inclusion of broadband services significantly *increased* UNE loop rates by (1) including fiber cable in the loop even where copper facilities would be more cost-effective for providing narrowband telephony services, and (2) shortening the depreciation lives for copper loop facilities and current generation digital switches and circuit equipment. *See* Baranowski Decl. ¶ 25. The *net* effect of these two factors inflates the *overall* loop costs in Pennsylvania by about $1.00 per loop. *See id.*

[20] Similarly, the costs of an element may not include "[r]evenues to subsidize other services," including "revenues (continued)

Even the PaPUC Chairman candidly admitted that allowing Verizon to recover broadband investment through loop rates was not based on TELRIC principles. Rather, he explained, the majority had decided to "balance" the competitive policies of the 1996 Act against the PaPUC's desire to promote the deployment of broadband (video) technology in Pennsylvania by providing Verizon "with an adequate revenue stream to meet its obligations to deploy" such technology.[21] Motion of Chairman John Quain at 1 (July 10, 1997).

3. All of Verizon's UNE Rates Are Inflated By Depreciation and Repair and Maintenance Errors That Violate Basic TELRIC Principles.

Depreciation. The radically shortened depreciation lives proposed by Verizon and uncritically accepted by PaPUC plainly violate TELRIC principles. *See* Baranowski Decl. ¶¶ 27-31. Depreciation lives are intended to provide, on an annual basis, a recovery of the cost of replacing assets that are expected to wear out or become obsolete over time. *See id.* Shorter depreciation lives mean higher network element rates, because a larger share of the investment in network equipment may be recovered from ratepayers as a depreciation expense each year. *See id.*

The depreciation lives used in the *MSF III* cost models are not economic depreciation lives, as required by the Commission's rules. *See* 47 C.F.R. § 51.505(b)(3) ("The depreciation rates used in calculating forward-looking economic costs of elements shall be economic depreciation rates"). Indeed, at the time that Verizon proposed its Pennsylvania

associated with elements or telecommunications service offerings other than the element for which a rate is being established." 47 C.F.R. § 51.505(d)(4).

[21] The "obligation" to which the PaPUC Chairman referred was in fact a 1994 *quid pro quo* under which Verizon (then Bell Atlantic-Pennsylvania) agreed to implement a so-called Network Modernization Plan ("NMP") in exchange for a price cap plan of alternative regulation that relieved it from rate base-rate of return oversight. *See* 66 Pa. C.S. §3001 *et seq.* There has been significant controversy in Pennsylvania as to whether Verizon in fact has fully complied with the promises in the NMP.

depreciation lives, they were significantly shorter than the depreciation lives used by *any* state Commission in Verizon's region, *see* Baranowski Decl. ¶ 30, and have been since *rejected* by regulators in several of Verizon's other states. *See id.* In Delaware, for example, the Hearing Examiner for the Delaware Public Service Commission rejecting these same depreciation lives, noting that "the depreciation lives proposed by [Verizon in Delaware] . . . are too short and should be rejected."[22]

A comparison of Verizon's Pennsylvania depreciation lives to those adopted by the Commission illustrates the extent to which Verizon's has understated its Pennsylvania depreciation lives. For example, Verizon's Pennsylvania rates are based on an assumed life for digital switches of 9 years compared to the Commission's approved digital switch life of 16 years. *See* Baranowski Decl. ¶ 29, Table 1. And Verizon's assumed life for underground metallic cable, a significant driver of loop and transport costs, of 16 years, compares with a 25 year life approved by the Commission (a 56 percent difference). *See id.* Critically, Verizon's Massachusetts rates and SBC's Texas and Kansas rates reflect much longer depreciation lives that are generally within the range of depreciation lives approved by the Commission. *See id.* As one PaPUC commissioner pointed out, "no other state [commission] in the country has accepted" Verizon' truncated lives. *MFS III* Final Order (Commissioner Hanger, dissenting). The impact of such inflated depreciation lives is substantial, given the importance of depreciation

[22] In the Matter of the Application of Bell Atlantic-Delaware, Inc. For Approval of Its Statement of Terms and Conditions Under Section 252(f) of the Telecommunications Act of 1996, PSC Docket No. 96-324; Findings and Recommendations of the Hearing Examiners, April 7, 1997 at 41.

assumptions and the extent of Verizon's underestimation of those lives.[23] *See* Baranowski Decl. ¶ 31.

Repair and Maintenance. Verizon's repair and maintenance factor also violates TELRIC and inflates all UNE rates. *See* Baranowski Decl. ¶ 32. Verizon based its repair and maintenance factors on the historical (or embedded) costs of Verizon's network – a direct violation of TELRIC's forward-looking methodology – by computing its repair and maintenance factor by *adding* 20 percent to its actual historical repair and maintenance costs. *See id.* There is no reason to believe (and Verizon provides no such reason) that forward-looking repair and maintenance factors would be 20 percent *higher* than those in Verizon's old embedded network. Rather, forward-looking loop repair and maintenance costs should be *lower* in a TELRIC-compatible network because those costs would be based on the assumed use of all new facilities, and would not include the obsolete and worn out facilities in Verizon's existing network. *See id.* Indeed, that is precisely why an Administrative Law Judge in New York recently rejected Verizon's repair and maintenance costs. *See Proceeding on the Motion of the Commission to Examine New York Telephone Company's Rates For Unbundled Network Elements*, Recommended Decision on Module 3 Issues, Case 98-C-1357, at 57-58 (May 16, 2001) ("*New York Re-Examination Decision*").

4. Verizon's UNE Loop Rates Are Inflated By Fundamental TELRIC Violations.

Fill Factors And The LCAM Cost Model. Even with the *Global Order's* increases to fill factors, Verizon's Pennsylvania LCAM loop cost model severely overstates Verizon's

[23] In its *Global Order*, the PaPUC continued to assert its support for the depreciation lives for electronic equipment that it had established in the *MFS-III* proceeding. *Global Order* at 75. However, the Commission acknowledged the (continued)

investment in distribution cable. *See* Baranowski ¶¶ 33-34. As a general matter, a carrier's investment in distribution cable must be adjusted upwards to account for the necessary additional capacity that the carrier will need to account for growth and to ensure that its customers receive reliable service. *See id.* ¶ 33. Accordingly, it is appropriate for Verizon to adjust its distribution cable investments upward using a fill factor. *See id.* But for reasons that Verizon has been unable to explain, it also increases its *distribution* cable investments (a second time) in its LCAM cost model by a utilization factor for copper *feeder* cable. *See id.* Thus, Verizon's cost model effectively double-counts the need for excess capacity in its distribution cables, and the second upward adjustment in that double-counting mechanism is not even related to distribution cable but is instead based on the need for excess capacity for feeder cable. *See id.*[24]

As a result of this well documented flaw in Verizon's LCAM cost model for Pennsylvania, the 2-wire analog loop costs in Verizon's initial MFS-III submission is overstated by approximately $1.00 per line per month. *See* Baranowski Decl. ¶ 34.

Digital Loop Carrier. Verizon's assumptions about the costs of Digital Loop Carrier equipment also inflated its UNE rates. *See* Baranowski Decl. ¶¶ 35-37. When the initial cost studies were performed in 1997, Verizon's cost model assumed the use of what it called "Next Generation" Digital Loop Carrier ("NGDLC") equipment. However, because Verizon claimed, in 1997, that it was unable to establish prices for NGDLC equipment that was capable of being unbundled for the provisioning of UNEs, Verizon instead developed a surrogate price

"inconsistency" between these short depreciation lives and its *MFS-III* ruling concerning fill factors, and ordered an adjustment in that model input. *Id.*

[24] Notably, this double counting often resulted in the provisioning of the lines-per-living-unit that were well above Verizon's stated maximum study distribution design criteria of three lines per living unit. And although Verizon at the time steadfastly argued the validity of this added step in the LCAM model, more recent versions of the LCAM in other jurisdictions have been corrected and no longer include this extra step. *See* Baranowski n.6.

for NGDLC that was based in part on the prices of the older, more expensive, universal digital loop carrier equipment. *See id.* ¶¶ 35-37.

There is no excuse for using the inflated costs of universal digital loop carrier equipment as a surrogate for NGDLC. Currently available Integrated Digital Loop Carrier systems with interfaces readily provide for unbundling and are widely available at prices that are firmly established. *See id.* Thus, the continued use of rates based upon the more expensive surrogate universal digital loop carrier equipment prices is clearly inappropriate and overstates Verizon's UNE rates. *See id.*

In fact, the PaPUC agrees. In the *Global Order*, the PaPUC found that Verizon's own internal documents concerning the implementation of NGDLC proved that the costing assumption Verizon had used in the *MFS III* proceeding "is no longer true."[25] That evidence showed that "in all instances" NGDLC "is significantly less expensive" that Verizon had assumed in its calculations.[26] Notwithstanding this finding, however, the PaPUC approved rates equivalent to those produced by the *MFS III* cost studies without correcting for this error.[27]

5. Verizon's Switching Rates Are Inflated By Additional TELRIC Violations.

Switch Discounts. Forward-looking, TELRIC-compatible, cost studies must assume a "scorched-node" environment where the only elements of the LEC's embedded network are the locations of existing wire centers. *Local Competition Order* ¶ 685. All assets

[25] *Global Order* at 70.

[26] *Id.*

[27] In the recent proceeding before the PaPUC that resulted in the May 24, 2001 *Interim Order* Verizon's cost witness admitted that he had not taken the *Global Order's* finding concerning NGDLC into account in calculating the UNE rates Verizon had proposed in that proceeding. PaPUC Docket No. R-00005261, November 29, 2000 Transcript at 470-71 (cross-examination of Gary Sanford).

necessary to serve demand for telecommunications in the Verizon Pennsylvania service territory would therefore have to be newly purchased. Thus, the applicable switch discounts should be those that are available for new switching equipment.

Verizon's cost models, as adopted by PaPUC, violate this fundamental TELRIC principle by computing switch discounts based on attributable growth – the volume and type of switches that would be needed to expand Verizon's *existing* network – rather than on the larger discounts that are available to Verizon for new equipment.[28] *See* Baranowski Decl. ¶¶ 38-41. Verizon itself concedes that large buyers of new switching equipment can obtain much deeper discounts from vendors' "standard" or "retail" prices for new equipment than for "add-on" equipment – primarily "line cards" – that can be used to upgrade the capacity of existing switching equipment as demand increases.[29] Brief for Appellant Verizon Pennsylvania, Inc., *MCI Telecommunications Corp.* v. *Verizon Pennsylvania Inc.*, No. 00-2258, at 47 (3rd Cir. Dec. 20, 2000).

Verizon and the PaPUC have attempted to defend the use of attributable growth discounts on the ground that Verizon, having recently replaced all of its analog switches with digital models, expects to buy little new equipment in the next five or so years. But the actual costs required by the *Local Competition Order* are the costs that an efficient firm would incur *in the long run* – the "LR" in TELRIC – not the next few years or any other short run period. According to the Commission, the "long run" is the period in which "all of the firm's present

[28] In the *MFS III* cost study Verizon repriced its *entire* switching capacity as if its entire inventory of switches were repurchased at the outset of the study period, but most were purchased at add-on discounts, not new equipment discounts. *See* Baranowski Decl. n.10.

[29] There is no question that in reality Verizon receives the larger discounts for new equipment: nearly all of its existing switches are digital equipment, purchased within the past few years at the deeper discounts available for (continued)

contracts will have run out, its present plant and equipment will have been worn out or rendered obsolete and will therefore need replacement," and "all of a firm's costs" thus have "become variable or avoidable." *Local Competition Order* ¶ 677 & n.1682; *id.* ¶¶ 691-92. Hence, the long-run time horizon assumes a firm that is free to choose assets that are optimally sized and configured, unfettered by the legacy of past fixed investments. *See, e.g.*, *Bell Atlantic Delaware*, 80 F.Supp.2d at 237-39. In the long run, a firm can replace its existing switches with new switches that are optimally sized to qualify for new equipment discounts.

Given this fundamental TELRIC error, it is not surprising that other state regulators in the mid-Atlantic have rejected Verizon's short-run approach to estimating switching costs. *See* Baranowski Decl. ¶ 41; Order, Case No. PUC970005, at 11 (Va. SCC May 22, 1998) at 11; Order, Case No. 8731, at 46-49 (Md. PSC Sept. 22, 1997); Findings and Recommendations of Hearing Examiners, PSC Docket No. 96-324, ¶¶ 135-37 (De. PSC Apr. 7, 1997), *aff'd*, Order No. 4542, at ¶ 33 (De. PSC July 8, 1997), *aff'd*, *Bell Atlantic-Delaware*, 80 F.Supp.2d at 238-39 (holding that Verizon's analysis of switch discounts was "deficient in that it does not reflect a long-run approach, but rather a series of short-run cost estimates") (internal citations omitted).

In sum, the UNE rates adopted by the PaPUC in its *Global Order* are not remotely cost based and violate numerous TELRIC principles. Even Verizon admits that those rates violate TELRIC and lack evidentiary or factual support, and two PaPUC commissioners have raised serious concerns as to whether the *Global Order* rates comply with TELRIC. Furthermore, PaPUC's *post*

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purchases of new equipment. *See, e.g.*, *Bell Atlantic Delaware* v. *McMahon et al.*, 80 F.Supp.2d 218, 237-39 (D.Delaware 2000).

hoc attempt to justify those rates by noting that they are similar to those produced by the unlawful *MSF III* cost models only confirms that the *Global Order* rates violate TELRIC.

II. VERIZON HAS NOT FULLY IMPLEMENTED ITS CHECKLIST OBLIGATIONS WITH RESPECT TO THE PROVISION OF ADVANCED SERVICES.

Verizon has failed to fully implement its checklist obligations with respect to advanced services. Specifically, Verizon is not providing CLECs with full access to the resale of DSL services at an appropriate avoided-cost discount under reasonable and nondiscriminatory conditions. Instead, Verizon makes DSL available for resale only in those situations where *Verizon* provides the voice service to the customer – effectively denying CLECs the same ability to provide consumers with both voice and DSL service that Verizon has in its retail operations.[30]

Checklist item 14 requires that Verizon fully implement the resale obligations of Section 251(c)(4), which extend to the resale of advanced services. Those obligations are: (1) "to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers"; and (2) "not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service." 47 U.S.C. § 251(c)(4). In interpreting Section 251(c)(4), the Commission has concluded that "resale restrictions are presumptively unreasonable" and that an

[30] Addressing the DSL issue in her dissenting opinion, Commissioner Brownell stated:

> [C]ompliance by Verizon for the resale of Digital Subscriber Line (DSL) service is required for non-discriminatory access. Currently, Verizon does not appear to comply because Verizon and its data affiliate, Verizon Advanced Data, Inc. (VADI) market and sell a combination of voice and DSL service on the same line to retail customers. However, this package of voice and data service is not available for resale. While each component is available for resale, the voice/data package is not. In order to be compliant, a voice/data package for resale should be made available.

PaPUC Consultative Report, Dissenting Statement of Commissioner Nora Mead Brownell at 2.