methodology. Those rates were derived from the Verizon cost model relied upon by the PUC in the MFS Phase III proceeding, see Global Order at 73, which a federal court subsequently found had not been proved to be a TELRIC model.

The district court was correct – the pricing methodology used to generate the rates is an embedded cost methodology that led to high rates that do not support competition across the state. Further reductions in the rates in the Global Order did not adequately address the problem.

As noted, Pennsylvania's UNE rates wee set initially in a 1997 proceeding referred to as the MFS Phase III proceeding. In that case a closely-divided PUC, over the vigorous dissent of two commissioners, adopted the pricing model and most of the inputs proposed by Verizon (then Bell Atlantic), and rejected the pricing model and most of the inputs proposed by WorldCom (then MCI) and AT&T. MCI and AT&T appealed this PUC decision to the federal district court. The court understood the claims before it to be

> that the PUC's pricing decision is violative of the Act insofar as the rates for UNEs must be based on forward looking economic costs and that the PUC's reliance upon Bell's cost studies was in error since those cost studies were not forward looking and included assumptions and inputs that are inconsistent with forward looking pricing, such as embedded costs and inefficiencies, cost associated with investment unrelated to providing local telephone service, and other inflated inputs that reflected monopoly pricing rather than forward looking costs.

MCI Telecomms. Corp. v. Bell Atlantic-Pennsylvania, Inc., No. 97-CV-1857, slip op. at 10 (M.D. Pa. June 30, 2000).

Adopting the decision of its magistrate judge, the district court agreed with WorldCom, finding that the PUC "expressly disavowed [the FCC's TELRIC rules] as not mandatory" at a time when the Eighth Circuit had vacated those rules. Reviewing the cost study, the magistrate's report rejecting the study as unlawful, and WorldCom and AT&T's criticisms of that study, the court was "unpersuaded that the PUC's decision was appropriately based upon the TELRIC methodology prescribed by the FCC's pricing rules" and remanded the case to the PUC to bring its pricing methodology and inputs into compliance with those rules. *Id.* at 13.

Verizon now attempts to denigrate the district court decision, but the sole authority it cites for this proposition is its own appellate brief challenging the court's decison. VZ-PA Br. at 82 n.82. But the court acknowledged WorldCom's arguments that the Bell Atlantic study was an embedded cost study that adopted inputs inconsistent with forward looking pricing (slip op. at 10), noted that the PUC had expressly concluded that it was not bound by the FCC's TELRIC rules (*id.* at 11), observed that the WorldCom TELRIC model produced substantially lower rates than the Verizon model (*id.*), and refused to accept the PUC's attempt to brush the evident problems with the rates under the carpet by asserting "in conclusory fashion, that 'in practice, there may be no discernable difference at all'" between the Verizon model and TELRIC (*Id.* at 12 (quoting PUC brief)). As we show below, the district court's reasoned skepticism about the claim that the Verizon model complied with TELRIC in substance even if not in name is entirely justified: these are not TELRIC rates.

The PUC set the current UNE rates by arbitrarily reducing by 10-16% the *MFS III* rates generated by the unlawful Bell Atlantic cost study, and thus current rates can be defended only in reference to the rates and cost study struck down by the district court.4 In a Global Settlement Order dated September 30, 1999, the PUC adopted Bell Atlantic's proposed reduction in loop rates, and the CLEC's proposed reduction in switching rates. Global Order at 77, 81. Both Verizon and the CLECs agree that, in Verizon's words, "[t]he PUC had before it no evidence suggesting that its new arbitrarily-selected rates are based on cost, and it offered no explanation of how its results meet the federal statutory standard." Brief of Bell Atlantic in Bell Atlantic v. Pennsylvania PUC, No. 2790 C.D. 1999, at 74 (Pa. Comm. Ct. filed April 27, 2000). The PUC, on the other hand, maintains that the new loop rates can be defended based on the old Bell Atlantic cost study. All parties concede that the new switching rates are entirely without cost support. See Global Order at 81, 82. Thus, on any view of the matter, the only cost support for Pennsylvania's current UNE rates derives from the original rates and Bell Atlantic cost study which have been struck down by the district court. Unlike the much larger (but similarly arbitrary) 25% reduction in rates undertaken by the Kansas Commission, which this Commission found "removed any doubt" about the lawfulness of the Kansas rates, Kansas-Oklahoma Order ¶ 66, here the underlying rates which were discounted were not found to be reasonable TELRIC rates, id., but have been found to be unlawful by the court reviewing the rates.

In previous applications when rate determinations had been *upheld* by reviewing courts, the FCC has shown great deference to these judgments. *See, e.g., Massachusetts Order* ¶¶ 21, 31 (relying on fact that rates borrowed from New York had survived judicial review). Presumably it will honor that precedent here when the courts have reached the opposite conclusion. At the very least, any presumption that the rates are valid is inappropriate. And, when this Commission evaluates the Verizon cost study, it should conclude that the district court got it right.5 As we set

5 In this application, Verizon has not attempted to make out a prima facie case that the rates can be supported by reference to rates in other states that have been found to be TELRIC. The only record evidence supporting the rates is the Bell Atlantic cost study repudiated by the district court. This Commission has repeatedly stressed that an applicant may not "at any time during the pendency of its application, supplement its application by submitting new factual information that is not directly responsive to arguments raised by parties commenting on its application," Texas Order ¶ 35, "to prevent applicants from presenting part of their initial *prima facie* showing for the first time in reply comments." *Id.* ¶ 36. See also Michigan Order ¶ 291 ("a BOC must address in its initial application all facts that the BOC can reasonably anticipate will be at issue"). As the Commission just recently warned that "it would be

out in what follows, the defects the district court identified in Verizon's cost model and in critical inputs plainly render the rates not cost-based.

Verizon-Pennsylvania itself concedes that its cost model is premised on its "actual network" instead of the proper TELRIC assumption of a hypothetical forward-looking network. See Interim Order at 16. Consequently, the cost model incorporates Verizon-Pennsylvania's embedded historical costs, which the FCC has specifically rejected as inconsistent with TELRIC methodology. Local Competition Order ¶¶ 704-707.

This error infects many of the inputs and assumptions that were used to generate the rates. For example, as the PUC itself acknowledged in its Global Order, Verizon raised loop costs above TELRIC levels by deriving that the forward-looking costs of digital loop carrier ("DLC") from the weighted average of the current Integrated DLC and Universal DLC costs. However, Integrated DLC is the forward-looking technology; there would be no Universal DLC in a forward-looking network. Verizon included Universal DLC in its model only because that reflected the current state of its physical network. Since Universal DLC is more expensive that Integrated DLC, by modeling its embedded network rather than an efficient forward-looking network, Verizon unlawfully inflated the loop price in its model. Frentrup Decl. ¶ 6.

The PUC itself recognized that setting the cost of DLC in this manner was incorrect. In its Global Order (at 70), it acknowledged that the forward-looking costs of DLC were in fact lower than the cost of either Integrated or Universal DLC. However, when the PUC ordered

rare for other parties to file satisfy the high bar set here in future applications" for waiver of these rules, Kansas-Oklahoma Order ¶ 26, see also id., Statement of Commissioner Powell ("I wish to join in the admonishment of future applicants that they risk rejection of they file evidence after the due date for initial comments"), presumably Verizon intends not to rely on evidence of rates in other jurisdictions in support of this application, and the Commission would reject any effort to make such a comparative case through reply or ex parte comments.

corrections in the Global Order, it did not correct the overstated DLC costs. Instead, the PUC required only the adjustment of cost of capital and some fill factors, which were not related to the problem nor sufficient large adjustments. Id. at 73. Thus, the DLC costs on which the Pennsylvania rates are set are based on an acknowledged but uncorrected deviation from TELRIC. Frentrup Decl. ¶ 7.

Another example of embedded costs is the use of unreasonably low fill factors, i.e., the portion of a piece of equipment that is actually used. The fill factors used for copper cable and DLCs are unreasonably low, and reflect Verizon's current fills rather than the fill that would be achieved by an efficient carrier. For fiber cable, Verizon uses a fill factor that is less than the 100 percent factor that the Commission has determined is appropriate in the Universal Service proceeding. A 100 percent fill factor is reasonable because the capacity of fiber can be adjusted by varying the electronics used. These understated fill factors also lead to overstated costs. Frentrup Decl. ¶ 8.

Verizon also overstated switching costs by again relying on its own embedded costs rather than forward-looking costs. First, it used a combination of the discounts on new and add-on switch prices to determine the price of switches, because that was the mix that happened to appear in its network. As the Commission determined in the Universal Service proceeding, the network built in a TELRIC model will place new switches at a level sufficient to meet demand, without the need for augmenting switches later. Thus, only the discounts for new switches should be used to determine the price of switching. Even if it were correct to use some weighted average of new and add-on switch discounts, Verizon presented no evidence that its current mix of those two types of switches reflects the mix that a carrier would use if it were building the most efficient network using forward-looking technology, as is required by the Commission's TELRIC rules. Frentrup Decl. ¶ 9.

A second method by which Verizon overstates switching costs is in the way that it incorporates the cost of features. Rather than developing a switching rate that includes the costs of all the features inherent in the switch, Verizon computes the cost of a package of originating and terminating features. Verizon did not explain whether it selected these features because they were the most popular in its region, or the most expensive, or on some other basis. However, it is clear that the switching rates do not include all the features available in Verizon's switches. It is also clear that Verizon has included the costs for features as if they were separate retail services rather than included in the functionality of the switch. This results in overstated switching costs and excessive rates. Frentrup Decl. ¶ 10.

Finally, Verizon projects costs for all its unbundled network elements that are too high because it uses depreciation lives that are too short. The depreciation lives proposed by Verizon and adopted by the Pennsylvania PUC reflect Verizon's view of the effect of developing competition on the value of its equipment, and its commitment to modernize its network. The alternative lives proposed in this proceeding were the Commission's prescribed lives that were used by the Commission in the Universal Service proceeding. Frentrup Decl. ¶ 11.

The lives prescribed by the Commission reflect an assessment of both the ILEC's experience with actual retirements and its projections and plans for future retirements, arrived at after consultation between the Commission, the state PUC, the ILEC, and other interested parties. As such, those lives reflect the most reasonable basis for determining lives to be used in setting UNE rates. Accepting Verizon's estimate of the effect of competition on depreciation lives ignores the fact that the prescribed lives already reflect an estimate of that effect that is arrived at based on actual data and input from all parties. In addition, shortening depreciation lives because Verizon is modernizing its network for purposes other than the provision of voice grade service would require Verizon's competitors to subsidize this modernization. Frentrup Decl. ¶ 12

In short, the cost model used to set UNE rates in Pennsylvania does not reflect TELRIC. Given the ruling by the court and the acknowledgment by all parties in the proceeding that the rates were not based on TELRIC, the Commission should give no deference to the state PUC's determination that the Pennsylvania UNE rates are reasonable TELRIC-based rates. The Commission should reject Verizon's 271 application until it has corrected its UNE rates to reflect TELRIC.

IV. VERIZON MUST RESOLVE OTHER ISSUES.

Several other issues must be resolved by Verizon in addition to the three discussed above. In addition to Verizon's billing problems discussed in section I above, other OSS issues remain unresolved, or have allegedly been resolved so recently that it is impossible to determine whether or not they have been fixed for good. Section 271 authorization should not be granted until it is clear these OSS problems have finally been resolved. Moreover, Verizon needs to eliminate the anticompetitive effects of its "local freeze," withdraw its GRIPs interconnection proposal, and refrain from attacking the underlying PUC orders and positions on which its application rests.

A. Verizon Has Not Established that It Has Finally Resolved Its Intractable Problem with Missing Notifiers.

Missing notifiers, in particular Billing Completion Notices ("BCNs"), have plagued Verizon throughout its region. Missing notifiers nearly killed competition in New York before it had taken root, and until recently were a notorious feature of Verizon's poor performance in Pennsylvania. The good news is that with this section 271 application approaching, performance reports over the last several months indicate that Verizon has greatly reduced the number of missing notifiers. The bad news is that this is a recent development, and it is far from clear that the problem has been permanently fixed. Because Verizon has never adequately provided a root cause analysis, it is impossible to know whether Verizon has provided long-term solutions or instead has instituted temporary manual fixes in order to keep the number of missing notifiers down until section 271 authority is granted. Lichtenberg Decl. ¶¶ 60-62. The fact that there is not even a BCN metric makes future compliance even more uncertain. Kinard Decl. ¶¶ 12, 19. A longer track record of good performance, meaningful performance metrics and penalties, and adequate explanations of the nature of the problems that plagued Verizon's performance in the past are needed before there can be any confidence that this problem has really been resolved.

B. Verizon Has Not Corrected Errors on Orders for Blocking.

Until February 3, 2001, Verizon failed to correctly process orders that included multiple blocking options. Thus, if a customer ordered both blocking of third party calls and 900/976 blocking, the customer would not all blocking options. This was so even though, according to Verizon's documentation, Verizon's systems should be able to process such orders. Verizon acknowledges "a programming error by Verizon that caused the system to truncate a field on the LSR for blocking options." (McLean Decl. ¶ 184.) Unfortunately, Verizon has not yet corrected the orders that Verizon processed prior to its February fix. Thus, if a customer ordered multiple blocking options prior to that fix, the customer still may not be receiving all of the blocking options that were ordered. If, for example, a customer's child calls a 900 number that was supposed to be blocked, the harm could be great and the damage to WorldCom's reputation substantial. Verizon still has not even provided a date by which this problem will be solved. In its declaration in this application, Verizon says only that it "is currently processing corrections." (McLean Decl. ¶ 184 (VZ-PA App. A, Tab B).) The Pennsylvania PUC reports that Verizon "has represented that it will fix pre-February, 2001 orders by June of 2001," (PUC Report at 96), but Verizon never informed WorldCom of this and has not told WorldCom that the problem has been resolved. Lichtenberg Decl. ¶ 63.

C. Verizon's Flow-Through Levels Are Unreliable.

At least until very recently, Verizon processed too many orders manually in Pennsylvania. Manual processing of orders inevitably results in delays and errors. Indeed, Verizon attributed much of its deficient performance – including its failure to return notifiers – to manual mistakes. The Pennsylvania PUC noted that "[t]he ability to flow-through a substantial number of orders is essential for the efficient processing of CLEC orders." (PUC Report at 87.) The FCC has found "a direct correlation between the evidence of order flow-through and the BOC's ability to provide competing carriers with nondiscriminatory access to the BOC's OSS functions." Louisiana II Order ¶ 107. Although the Commission approved section 271 applications in New York and Texas with less than ideal flow-through, it did so because significant commercial experience showed that the BOC was capable of handling increasing order volumes with existing levels of manual processing, and based on assurances that improvements in flow-through would be achieved. Verizon has never provided adequate root-cause analysis of its flow-through problems, so there is no way to know if recent improvements represent anything other than papering over of systemic problems that have not yet been addressed. Lichtenberg Decl. ¶ 64.

D. Verizon Fails To Provide Adequate Technical Assistance to CLECs.

While a BOC must "adequately assist[] competing carriers to understand how to implement and use all of the OSS functions available to them" (Texas Order ¶ 96), Verizon has repeatedly failed to do so. With each of the problems set out above, Verizon failed to make prompt efforts to determine the root causes of the problem, notify the affected CLECs, and work with them to fix it. It failed to make promised changes in a reliable or predictable manner. If the incentives created by the section 271 process are eliminated, Verizon's performance is likely only to get worse, and competitors will get even less cooperation from Verizon. Lichtenberg Decl. ¶¶ 59-66.

E. Verizon's "Local Freeze" Restrains Competition.

Verizon is attempting to retain control over local markets in Pennsylvania through its service called the Local Service Provider Protection Service ("local freeze"). The effect, and probable intent, of Verizon offering this service in the local market in Pennsylvania where competition is nascent is clearly anticompetitive. Because Verizon retains the vast majority of local customers, any service that makes it more difficult for customers to switch carriers serves to maintain Verizon's historic advantage as the incumbent. The New York commission recognized "competitive concerns" about a similar local freeze that Verizon proposed in New York and prevented Verizon's tariff from going into effect there.

When a customer signs up for service from a CLEC, the CLEC places an order to migrate the customer's service. If there is a freeze on the account, and the customer has not contacted Verizon to lift the freeze, the order will be rejected. If the order is rejected, the CLEC must then contact the customer and have the customer call Verizon before resubmitting the order. This scenario may occur because customers may not even know they have a freeze on their account or that they must lift the freeze prior to ordering service from a new provider. This adds unnecessary steps to the ordering process and has frustrated WorldCom's efforts to switch customers who want WorldCom as their local provider.

Verizon's local freeze service is unnecessary and detrimental to a developing competitive market. Verizon implemented its local freeze in Pennsylvania unilaterally and did not tariff it or seek PUC approval, which has resulted in a service that operates in a manner largely hidden from view. Verizon's offering of this service has led to difficulty in WorldCom being able to provision hundreds of customers who clearly want to switch their local service from Verizon.

WorldCom has filed a complaint against Verizon in order to suspend the operation of the freeze or otherwise mitigate its anticompetitive effects.[2] So long as this freeze is in place and cannot be lifted in a manner that is commercially viable, it cannot be said that the local markets in Pennsylvania are truly open. Verizon could resolve this issue by withdrawing the local provider freeze service until such time as the PUC determines the service is necessary and appropriate and until means of lifting the freeze are available that do not unnecessarily infringe on commercial operations.

F. Verizon Seeks to Improperly Limit Interconnection.

Competition is harmed by Verizon's continuing violation of Commission rules that allow competitors to identify the points at which they wish to interconnect with Verizon's network. In the current round of negotiations with Verizon (for section 252 agreements to replace the first interconnection agreements) Verizon continues to adhere to its aptly named "GRIPs" (Geographically Relevant Interconnection Points) interconnection position. Under its GRIPs proposal, Verizon would require CLECs in many instances to build or lease (i.e., pay for) transport all the way to each end office. In essence, Verizon is attempting to dictate to CLECs the number and location of points of interconnection. This is not an esoteric issue, for increasing the number of interconnection points makes interconnection more difficult and more costly for CLECs.

6 MCI WorldCom Communications, Inc. v. Verizon Pennsylvania, Inc. Docket No. C-00015149

Verizon's GRIPs proposal is directly contrary to the requirement that CLECs be permitted to interconnect at any technically feasible point and that CLECs have the option of selecting those points. See Local Competition Order, ¶ 220 n.464. Verizon's proposal is also directly contrary to the decision on this issue in MCI v. Bell Atlantic-Pennsylvania, No. 97-CV-1857, slip op. at 14-15 (M.D. Pa. June 30, 2000).

Verizon's continued insistence on an interconnection proposal that is in clear violation of interconnection requirements is yet another symptom that Verizon cannot be trusted to comply with applicable Commission requirements and will take every opportunity to avoid or undermine procompetitive policies. Verizon should promptly rectify this issue by abandoning its illegal GRIPs proposal.

G. Verizon Continues to Challenge PUC Orders and Authority.

In addition to disputing the PUC's authority to require performance remedies, while purporting to rely on the PAP in this application, Verizon relies for section 271 purposes on other practices ordered by the PUC, while at the same time actively opposing the PUC's rulings. Just recently, Verizon has sought reconsideration of many critical matters in the so-called Further UNE case. [Further Pricing of Verizon Pennsylvania, Inc.'s Unbundled Network Elements, Docket Nos. R-00005261, R-00005261C0001, Verizon Pennsylvania Inc.'s Petition for Reconsideration and Stay of the Commission's Opinion and Order (Pa. PUC filed June 25, 2001)] Specifically, Verizon has challenged the collocation intervals set in that proceeding, and the ruling mandating access to Verizon's OS/DA. Yet the PUC's support of this section 271 application depends in part upon those rulings that Verizon challenges. Further, Verizon has petitioned the PUC to reconsider the collocation intervals in the collocation case on which the

PUC relied in its recommendation (PUC Report at 47). In fact, Verizon asked the PUC to stay the portion of the order regarding collocation intervals. [Pennsylvania Pub. Util. Comm'n v. Verizon Pennsylvania, Inc., Docket Nos. R-00994697, R-00994697C0001, Verizon Pennsylvania Inc.'s Petition for Reconsideration and Stay of the Commission's Opinion and Order (Pa. PUC filed June 25, 2001).]

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Indeed, Verizon continues even to contest this Commission's legal authority to "conduct any analysis of local competition in its public-interest inquiry" (VZ-PA Br. at 74 n.73), despite clarity in the legislative history and the settled state of the law. Verizon, of course, has every right to raise legal arguments challenging any order or position of the PUC or FCC it wishes. But Verizon has no right to rely on those PUC or FCC orders and positions to prove the market is irreversibly open while at the same time seeking to reverse them.

Verizon's aggressive positions should prevent this Commission from assuming that Verizon will do anything that it is not strictly compelled to do, for the only thing that is clear is that Verizon will take every step it can to limit or restrain local competition. Proof of actual section 271 compliance clearly should be required prior to interLATA entry, rather than reliance on positive trend lines or Verizon's promises of future performance.

CONCLUSION

Verizon's Pennsylvania application should be denied.

Respectfully submitted,

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July 11, 2001

CERTIFICATE OF SERVICE

I, Keith L. Seat, hereby certify that I have this 11th day of July, 2001, caused a true copy of Comments of WorldCom, Inc. and attachments to be served on the parties listed below:

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*HAND DELIVERED

Keith L. Seat