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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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In the Matter of	
Access Charge Reform	CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1

COMMENTS OF THE PEOPLE OF THE STATE OF CALIFORNIA AND THE CALIFORNIA PUBLIC UTILITIES COMMISSION

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The People of the State of California and the California Public Utilities Commission (California) hereby submit these comments in response to the Public Notice released on September 17, 2001 by the Federal Communications Commission (Commission) in the above-captioned proceedings.[1]

I. INTRODUCTION

On May 31, 2001, the Commission released an order that adopted a proposal put forth by the Coalition for Affordable Local and Long Distance Service (CALLS) to modify interstate access charges and universal service funding.[2] In its order, the Commission stated that it would undertake a detailed analysis of the costs of providing local telephone service prior to allowing any increases in the residential and single-line

[1] See Public Notice, DA 01-2163 (released September 17, 2001).

[2] See *In the Matter of Deployment of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users, Federal-State Joint Board on Universal Service,*

business subscriber line charge (SLC) caps above $5.00.[3] The Commission's statement effectuates a commitment made by the proponents of CALLS in response to concerns voiced by consumer advocates that the SLC remain "well within a zone of reasonableness" and that "basic telephone service does not become too expensive."[4] To address those concerns, the CALLS proponents urged the Commission to "initiate a proceeding for the purpose of verifying that the progression of change in the primary residence and single business SLC caps is appropriate in the UNE zone or zones where they would apply and that the progression reflects higher costs in these zones."[5] The CALLS proponents went on to say that:

> [t]o facilitate this verification, the LEC members of the Coalition commit to providing the Commission with economic data, including data identifying the forward-looking costs associated with the provision of retail voice grade access to the public switched telephone network for those areas. In the event that the Commission finds that the progression of caps beyond $5.00 in a certain UNE zone or zones does not reflect higher costs in such UNE zone or zones, the Commission should at that time set an appropriate cap for such UNE zone or zones.[6]

Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, and Report and Order in CC Docket No. 99-249, and Eleventh Report and Order in CC Docket 96-56, 15 FCC Rcd. 12962 (released May 31, 2000).

[3] "As set forth in the CALLS Proposal, we shall review any increases to residential and single-line business SLC caps above $5.00 to verify that any such increases are appropriate and reflect higher costs where they are to be applied. We will initiate and complete a cost review proceeding prior to any scheduled increases above this cap taking effect to determine the appropriate SLC cap. For this proceeding, the price cap LECs have agreed to provide, and we will examine, forward-looking cost information associated with the provision of retail voice grade access to the public switched telephone network. We will address in that proceeding whether an increase in the SLC cap above $5.00 is warranted and, if not, whether a decrease in common line charges is warranted." CALLS Order, para. 83.

[4] CALLS Order, para. 33.

[5] Memorandum in Support of the Revised Plan of the Coalition for Affordable Local and Long Distance Service ("CALLS"), filed March 8, 2000, at 6, 8.

[6] Id. at 8 (footnotes omitted).

The Commission incorporated this commitment into its order adopting the revised CALLS proposal. The Commission intended that the review would be completed by July 1, 2002, at which time the Commission would address whether an increase in the SLC cap above $5.00 is warranted, or whether carrier common line charges should be reduced.

The Commission's order was largely upheld by the Fifth Circuit in Texas Office of Public Utility Counsel v. FCC, 265 F.3d 313 (5th Cir. 2001). Among other things, the court upheld the increase in the SLC over a period of years, notwithstanding challenges brought by consumer organizations. In doing so, however, the court expressly noted that the Commission had "promised to conduct a cost-study before the SLC is scheduled to rise above $5.00." 265 F.3d at 323. See also id. at 326 (Commission added provisions "to allay affordability concerns (e.g., requiring a cost-study before increasing the SLC cap over five dollars)."

By Public Notice, DA 01-2163, the Commission initiated the instant cost review proceeding to determine whether increases in the SLC over $5.00 are warranted, based on the LEC-provided "economic data, including data identifying the forward-looking costs associated with the provision of retail voice grade access to the public switched telephone network" in appropriate UNE zone or zones.[7]

Pursuant to the Commission's notice, Verizon and SBC Telecommunications, Inc. (SBC), the two price cap LECs operating in California and signatories to the CALLS plan, submitted a filing to the Commission. Verizon seeks to increase the SLC to $6.50 by July 1, 2003. SBC does not seek to increase the SLC above $5.00, but fails to provide

[7] Id. at 8.

cost information to determine whether a decrease in common line charges is warranted.[8] For the reasons set forth below, California respectfully submits that the cost submissions of Verizon and SBC are fundamentally deficient because they fail to provide both the cost input data, and the cost model to which the data is input. Without this key information, neither the parties, nor ultimately the Commission, have the ability to evaluate whether any SLC increases or common line charge reductions are warranted. California's comments address Verizon's and SBC's cost submissions and the shortcomings of their models.

II. SUMMARY

The cost submissions expressly promised by the proponents of CALLS to determine whether further increases in the SLC, or decreases in common line charges are appropriate, have not been made. As a result, the Commission has no reasonable basis upon which to authorize any adjustment to the SLC, let alone the large increases proposed by Verizon. At the same time, the Commission lacks the necessary data to determine whether common line charges should be reduced.

If the local exchange carriers (LECs) are allowed to supplement their filings, the Commission should require that all cost inputs and cost models be publicly disclosed to enable a meaningful evaluation of whether SLC increases are justified. Any further submission should be made in a timely fashion, so that the Commission can also determine, on behalf of consumers, whether common line charges should be decreased.

[8] Based on cost data provided by SBC to the California Commission in April, 2000 in evaluating the CALLS plan, SBC's SLC should not have risen above $4.35 in California for the life of the plan. California is currently investigating SBC's increase of the SLC to $5.00 in California.

The Commission should further address specifically how the LEC-cost studies are to be used to determine whether changes in the SLC or common line charges.

In the end, the failure by Verizon and SBC, signatories to the CALLS plan, to honor their commitment to provide the Commission with forward-looking cost studies raises serious concerns. Fundamentally, such failure undermines the promise made to consumers, and cited by the Fifth Circuit in upholding most of the CALLS order, that the CALLS plan would ensure affordable telephone service. Inasmuch as significant competition, assumed under the CALLS plan, has not materialized to date to mitigate the incumbent LECS' costs, consumers are ever more dependent on the Commission to ensure that basic telephone service remains affordable to those with few competitive alternatives.

III. THE LEC COST SUBMISSIONS ARE WHOLLY INADEQUATE TO JUSTIFY ANY INCREASE IN THE SLCs

Without access to actual cost inputs or cost models used by the LECs, there is no reasonable basis upon which to determine whether any increase in the SLCs is merited. In its Universal Service Order[9] the Commission understood the import of ready access to model data, formulae and software when it selected the most appropriate cost model to calculate the forward-looking costs to serve rural, insular, and high-cost areas. The Commission required that:

> [t]he cost study and all underlying data, formulae, computations, and software associated with the study must be available to all interested parties for review and comment. All underlying data should be verifiable,

[9] *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, FCC 97-157.

> engineering assumptions reasonable, and outputs plausible.

That same requirement is equally applicable here. Nevertheless, in its filing, Verizon did not provide any input data whatever, and provided an extremely terse explanation of how its model functions. SBC, in its filing, stated that its cost model was populated with *examples*. SBC's documentation was also sparse.

There is simply no way to even begin to analyze the cost submission of these companies without the inputs that were used in the models. Equally lacking is the availability of the cost models themselves. In essence, the Commission as well as California and other parties have been given nothing more than a black box whose outputs are wholly dependent on the unknown inputs. This is unacceptable.

To be sure, thousands of hours have been expended by the Commission, many State commissions, and numerous parties around the country analyzing models in cost and universal service proceedings. Such analysis was only possible because working models along with the inputs used to populate the models were available.[10] The absence of this essential information makes such analysis impossible here.

At a minimum, consistent with its requirements for forward-looking cost studies used to establish universal service funding, the Commission should require the following in order to assess the LEC cost submissions:

- The cost models and inputs must be made publicly available;
- The technology assumed in the cost study or model must be the least-cost, most-efficient, and reasonable technology for providing the

[10] Id., para 250. While even in these situations the LEC always has an advantage in any analyses of its cost models due to the fact that the LEC creates, maintains and controls the data used to populate the inputs, here the situation is absurdly one sided.

supported services currently being deployed. A model must include the incumbent local exchange carriers' (ILECs') wire centers as the center of the loop network, and the outside plant should terminate at the ILECs' current wire centers. The loop design should not impede the provision of advanced services;

- Any network function or element, such as loop, switching, transport, or signaling necessary to produce supported services must have an associated cost;

- Only long-run forward-looking economic costs may be included. The long-run period used must be a period long enough that all costs may be treated as variable and avoidable. The costs must not be the embedded cost of the facilities, functions, or elements. The study must be based on an examination of the current cost of purchasing facilities and equipment, rather than list prices;

- The rate of return must be either the authorized federal rate of return on interstate services, or the state's prescribed rate of return for intrastate services;

- Economic lives and future net salvage percentages used in calculating depreciation expense must be within the Commission-authorized range;

- The cost study must include the capability to examine and modify the critical assumptions and engineering principles.

These minimum requirements must be met to permit a meaningful evaluation of SLC levels, and whether increases or reductions in charges are warranted.

A. Verizon's Submission Lacks Essential Data and Other Information

Verizon has submitted estimates of forward-looking costs of providing voice grade retail residential service. However, Verizon opposes their use in assessing whether the SLCs should be increased, stating:

> The per-line costs in these studies are higher in some cases than the Price Cap CMP per-line and lower in others. However, in neither case should they be used to change the scheduled increases in the

> SLC caps. As noted above, the price cap system is not based on cost, and when access charges were based on cost, it was actual incurred cost, not a lesser measure of forward-looking cost.[11]

Instead of relying on forward-looking cost data, as the CALLS proponents (including Verizon) promised, Verizon now suggests reliance on revenue-based measures, which it calls a "market-based" approach. This is disingenuous at best, considering the commitment the coalition made in its modified proposal to provide forward-looking cost information as an additional safeguard against unwarranted increases in the SLC.[12] Inasmuch as the Commission incorporated this commitment into the CALLS order, the refusal to provide forward-looking cost information runs directly contrary to it.

Verizon attempts to justify its revenue-based approach by selectively citing from the Fifth Circuit's opinion in Texas Office of Public Utility Counsel v. FCC. Verizon states:

> Although the Court of Appeals reversed and remanded the CALLS Order regarding the Commission's justification of the X-factor and the $650 million universal service fund, the Court endorsed the Commission's rejection of arguments that the Commission should have used forward-looking costs to restructure access charges, nothing that "the 1996 Act does not compel the FCC to conduct forward-looking cost-studies because the cost-study requirements of § 251(c)(1) and 252(d)(1) do not apply to the interstate access services at issue in this petition."[13]

Verizon, however, neglects to cite the court's reliance in upholding the SLC increases over a period of years on the Commission's promise to conduct cost studies before increasing the SLC beyond $5.00. Id. at 323, 326. That promise was based on a

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[11] Verizon Cost Submission at 6.

[12] CALLS Order, para. 83.

[13] Verizon Cost Submission at 6-7 (footnote omitted).

pledge by Verizon and others to provide the Commission "with economic data, including data identifying the forward-looking costs associated with the provision of retail voice grade access to the public switched network..."[14] Verizon should not be allowed to abandon that pledge here.

Based on its newly-adopted revenue-based approach, Verizon next attempts to justify an extraordinary increase in the SLC of 30 percent between 2001 and 2003. Specifically, Verizon increased the SLC from $3.50 to $4.35 on July 1, 2000. Verizon then raised the SLC to $5.00 on July 1, 2001, and now plans to increase it to $6.00 on July 1, 2002 and to $6.50 on July 1, 2003, if approved by the Commission. The July 1, 2002 increase would increase Verizon's SLC revenues in California by about $38 million per year.[15] Of all the previous and scheduled increases, this increase represents the largest dollar increase and the second largest on a percentage basis (see Table I below).

Prior to granting an increase of this magnitude, the Commission must determine if it is reasonable. That determination can only be made after a rigorous examination by all parties to the proceeding. As discussed, this examination would necessarily include the submission of Verizon's cost model as well as the detailed input data along with support for those inputs.

Table I

SLC Increase Data		
Year	**Dollar Increase**	**Percentage Increase**

[14] See note 5 supra at 8.

[15] Verizon served approximately 114,000 single line business customers and 3,044,000 residential lines in 1999.

1999-2000	$0.85	24.3%
2000-2001	$0.65	15%
2001-2002	**$1.00**	**20%**
2002-2003	$0.50	8.3%

In addition to the above, Verizon's cost model is seriously flawed. In this proceeding, Verizon submitted forward-looking cost estimates using the ICM model in GTE states, including California, and the LCAM or LCM model in Bell Atlantic territories. The California Public Utilities Commission, however, expressly rejected GTE California's ICM model in a 1998 proceeding to determine forward-looking costs in California.[16] California has not been alone in its rejection of GTE's ICM model.[17] Despite this history, Verizon does not address whether the ICM model submitted here has been modified to address its deficiencies.

Moreover, based on the documentation provided in Attachment D, it is readily apparent that Verizon's ICM model and inputs suffer from several fundamental shortcomings, as discussed below.

1. Input Prices

In the documentation for the LCM model used in Bell Atlantic states, Verizon states that, "Material prices for electronic equipment and cables reflect the latest negotiated contract prices Verizon has with manufacturers..." A similar statement was

[16] Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks, Decision No. 98-12-079, issued December 17, 1998. In this proceeding, California developed forward-looking costs for GTE California based on Pacific Bells cost model, using GTE-specific data.

not made concerning the ICM. As a result, it is unclear whether Verizon has adjusted its labor and materials costs to take into account the merger and the attendant savings (more buying power, etc.). If such an adjustment was not made, then these costs will be overstated.

2. Network Design

From Verizon's filing it appears that the ICM may design aspects of the network for the provisioning of advanced services. For instance, Verizon states in the documentation that, "The next item is the Loop Module's Electronic Serving Area (ESA) development. An ESA is an area in which all customers have access to a loop capable of providing digital services." The LECs were tasked with modeling the forward-looking cost to provide retail local service, not digital services. These latter services are deregulated and as such, their associated expenses (and revenues) are booked below-the-line and should not be reflected in the model.

3. Cost of Capital

Verizon stated that it utilizes its actual current cost of raising capital. This is inappropriate. Consistent with the Commission's determination regarding forward-looking costs studies used for universal service funding purposes, the rate of return should be either the authorized federal rate of return or an intrastate rate of return authorized by a State commission. No other rate of return is appropriate.

4. Structure Sharing

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[17] See, e.g., *In the Matter of the Investigation of Universal Service in the State of Oregon*, Docket No. UM 732, Phase IV, Oregon Public Utility Commission, Order No. 00-312, June 16, 2000.

Verizon does not discuss whether it accounted for the fact that costs may be offset by structure sharing, such as pole attachments by cable companies.

5. Fill Factors

Verizon employed actual fill as an input to the ICM, which violates the principle of a forward-looking cost study. The forward-looking fill factor should reflect expected usage over the time horizon in question, including an allowance for bad pairs. Using current fill rates assumes that the plant set aside for spare capacity is never utilized, which overstates costs.

B. SBC's Submission Lacks Essential Data and Other Information

Pursuant to the rules issued in the CALLS order, SBC states that it is not able to increase the residential and single-line SLC in California because its CMT revenues are below the current $5.00 cap. As a result, SBC does not propose to increase the SLC above $5.00 at this time. SBC nevertheless asserts that it may wish to deaverage the SLC in the future. Based on the submission made here, however, the Commission lacks adequate information to determine whether such deaveraging should be allowed.

Specifically, SBC states that the input data contained in its submission are illustrative only, and that it is not providing the actual inputs for the cost models, which SBC deems proprietary.[18] Without access to the model itself and the actual cost data used in the model, the Commission cannot make any reasonable determination whether deaveraging or other measures (e.g., reduction in common line charges) is appropriate.

[18] SBC Cost Submission at 4.

In addition, the limited documentation SBC does provide raises the following concerns:

1. Data Substitutions

In SBC's accompanying documentation, it stated that there were instances where state-specific information necessary to complete the cost studies could not be gathered in time for this proceeding. This stretches the limits of credulity, considering the CALLS signatories agreed to provide this information to the Commission. The offer was accepted and set forth in the CALLS Order. Given that the CALLS Order was issued over 15 months ago, there is no justification for SBC not to develop the required information during the intervening period. To be sure, SBC has provided cost information in numerous proceedings before many of the state commissions in SBC's region, and to the Commission. Is SBC now stating that the data submitted in those proceedings was flawed?

Specifically, SBC states that Texas in-place cost information for installed cable and other outside plant components was used in the California study; and that Missouri in-place information was used for Connecticut, Illinois, Indiana, Michigan, Nevada, Ohio and Wisconsin. SBC also utilized annual charge factors (ACF) from Indiana for Illinois, Michigan, Ohio and Wisconsin. SBC, however, did not provide anything to suggest that costs in Texas are identical to California costs, or that costs in Connecticut are similar to those in other states. Just as troubling is SBC's use of ACFs from Indiana for other former Ameritech states. Indiana-approved ACFs are among the highest in the region, leading one to conclude that they were utilized for the sole purpose of artificially inflating costs.

2. Rate of Return

SBC states that it utilized its expected rate of return for the cost of capital, but offered no details. As discussed above regarding Verizon's cost study, only a federal or state authorized rate of return should be allowed in a forward-looking cost study.[19]

3. Depreciation

SBC states that it employs depreciation rates which reflect the economic lives of its investments. SBC failed to provide details regarding what it believes these lives are. It also stated that depreciation varied among the states but does not explain how these differences were taken into account.

4. Maintenance

SBC employed historical maintenance expenses and adjusted them to current cost. Following this procedure may cause maintenance factors to be overstated due to the inclusion of embedded plant, which may have higher maintenance costs, as opposed to more modern equipment, which should be used in a properly conducted forward-looking study.

5. State-Approved Costs

SBC does not clarify whether it used costs approved by state commissions or costs of its own design.

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[19]Contradictorily, SBC apparently employs an authorized rate of return to allocate shared and common costs. SBC Cost Submission, Executive Summary, at 5.

6. Fill Factors

SBC stated that the fill factors are based on actual levels, which is improper, as discussed above in the context of Verizon's cost study. Additionally, it appears that SBC is applying a fill factor of 67 percent of its digital loop carrier (DLC) equipment, which is too low, and will inflate costs. SBC's reference to universal DLC also raises the concern that SBC is using a higher percentage of universal DLC than should be assumed in a forward-looking cost study.

7. Drop

SBC uses a weighted average of one and two pair drop in its cost study. Going forward, one would expect that a single pair would be sufficient, given the gains in technology and the inroads made by cable. Currently, single pairs are routinely deployed to provide two circuits.

8. Sharing

SBC did not indicate if it offset costs with corresponding revenues from infrastructure sharing.

IV. THE ASSUMPTION THAT COMPETITION WOULD MITIGATE COSTS UNDER THE CALLS PLAN HAS NOT MATERIALIZED

The Commission recognized in the CALLS Order that, while LEC revenues would be roughly $700 million lower the first year after the CALLS plan was implemented, the CALLS plan would allow revenues to increase gradually in later years to exceed pre-CALLS levels. The Commission believed that competition among LECs

would provide a strong incentive for incumbent LECs to mitigate their costs under the CALLS plan, once common line costs are recovered through the SLC. The Commission stated that if significant levels of competition develop, the LECs would voluntarily lower their rates, and that this would prevent them from over-recovery.

To date, competition in the local exchange market is weak. Even before the dramatic contraction in the competitive LEC market, residential and small business customers were the least likely to have access to competitive alternatives for local service. Currently, the alternatives available to these customers are even slimmer, given the events of the past two years.

Information available from the Commission's Common Carrier Bureau[20] indicates that CLECs served only about 8.5 percent of the telephone lines in service at the end of 2000. Approximately 60 percent of these lines were provided to medium and large businesses, indicating a lack of competitive alternatives for most residential and small business users. In addition, only eight states were responsible for 60 percent of the reported CLEC lines. Further, only 35 percent of the CLEC lines were provided over CLEC facilities, with the remainder provided via resale or UNE loops. Together, this information speaks volumes about the lack of any real competition for local exchange service. Where competition does exist, it is focused on large business customers in a handful of urban areas.

In light of the above, it is apparent that competition is producing little incentive for the incumbent LECs to reduce their costs. Unless significant competition develops soon, the LECS' revenues may be higher than they otherwise would have been absent the

CALLS plan. Moreover, given this lack of competition today, the Commission should be very hesitant to allow any further increases in the SLC, particularly when the incumbent LECs have not provided the cost models or cost inputs to enable a thorough, careful and meaningful evaluation of any increase.

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[20] Local Telephone Competition Status As Of December 31, 2000, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, May 2001. In addition, as of December 31, 2000, the FCC reported that CLECs in California served only 6 percent of end user lines.

V. CONCLUSION

For the reasons discussed, California urges the Commission to reject the cost filings of Verizon and SBC. Inasmuch as the type of cost submission promised by the CALLS proponents has not been provided, the Commission has no reasonable basis upon which to authorize any adjustment to the SLC, let alone the large increases proposed by some. The assurance given to consumers that basic telephone service will remain affordable under the CALLS plan, based on a comprehensive cost review of SLC charges, rings hollow if the submissions made by SBC and Verizon are deemed adequate.

Respectfully submitted,

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December 17, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon all known parties of record by mailing, by first-class mail, postage prepaid, a copy thereof properly addressed to each party.

Dated at San Francisco, California, this 17th day of December, 2001.

/s/ ELLEN S. LEVINE

Ellen S. Levine