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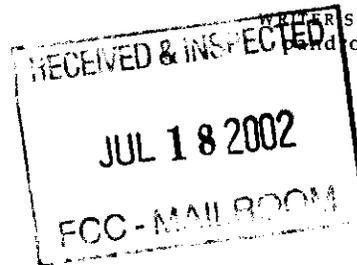
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July 17, 2002



Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

REDACTED – FOR PUBLIC INSPECTION

Re: *Application of Verizon New England Inc., Verizon Delaware Inc., et al.,
for Authorization to Provide In-Region, InterLATA Services in New
Hampshire and Delaware,
WC Docket No. 02-157*

Dear Ms. Dortch:

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 27, 2002, AT&T is submitting one (1) copy of its comments and supporting exhibits in redacted form via ECFS.

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,


Patricia A. Bunyasi
Legal Assistant

Encl.

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Before the
Federal Communications Commission
Washington, DC 20554



In the Matter of)
)
Application by Verizon New England Inc.,)
Verizon Delaware Inc., Bell Atlantic)
Communications, Inc. (d/b/a Verizon Long)
Distance), NYNEX Long Distance Company)
(d/b/a Verizon Enterprise Solutions), Verizon)
Global Networks, Inc., and Verizon Select)
Services Inc., for Authorization To Provide In-)
Region, InterLATA Services in New)
Hampshire and Delaware)
)

WC Docket No. 02-157

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July 17, 2002

TABLE OF CONTENTS

FCC ORDERS CITED		iii
COMMENTS OF AT&T CORP.		1
INTRODUCTION AND SUMMARY		1
I. VERIZON’S DELAWARE AND NEW HAMPSHIRE SWITCHING-RELATED RATES FAIL THE COMMISSION’S BENCHMARK TEST		4
A. Verizon’s Delaware Non-Loop Rates Greatly Exceed Those Of New York On A Cost Adjusted Basis.		4
B. Verizon’s New Hampshire Switching Rates Greatly Exceed Those Of New York On A Cost Adjusted Basis.....		6
II. VERIZON’S RECURRING RATES VIOLATE BASIC TELRIC STANDARDS.....		8
A. Verizon’s Non-Loop Rates In Delaware Violate Basic TELRIC Standards..		8
1. The Cost Data Underlying Verizon’s UNE Rates Fail To Reflect The Decline In Forward-Looking Costs Since The Mid-1990s.....		9.
2. Verizon Has Obtained Excessive Rates For Minutes-Of-Use And Features By Mis-Allocating Fixed Costs To Those Outputs.....		11
B. Verizon’s Recurring Rates For Switching In New Hampshire Were Also Set In Disregard For TELRIC.....		12
1. The New Hampshire PUC has never determined whether Verizon’s switching rates are TELRIC-compliant.		14
2. Verizon’s switching rates in New Hampshire reflect 1994 or 1995 switch discount percentages, which were already obsolete even by 1998.....		16
3. Verizon’s switching cost study modeled technology that was obsolete and overly costly even in 1998.		17
4. The PUC accepted a common cost factor that is patently violative of TELRIC.		19
5. Verizon’s switching cost study misallocated fixed costs to usage element.....		20
6. Verizon further overstated its MOU switching costs by overstating its peak capacity requirements.		21
III. VERIZON’S NONRECURRING CHARGES IN DELAWARE ARE INFLATED BY CLEAR TELRIC ERRORS.		22

IV. VERIZON’S UNE RATES IN DELAWARE CREATE A DISCRIMINATORY “PRICE SQUEEZE” IN VIOLATION OF CHECKLIST ITEM 2..... 36

V. VERIZON’S ENTRY INTO THE INTERLATA MARKET IS INCONSISTENT WITH THE PUBLIC INTEREST. 38

 A. Verizon Maintains Monopoly Power Over Residential Service In Delaware And New Hampshire. 41

 B. Verizon’s Local Residential Markets Remain Closed To UNE- and Facilities-Based Competition Due To Entry Barriers And Verizon’s Own Actions. 45

 C. Verizon’s UNE Rates Preclude UNE-Based Entry In Delaware..... 46

CONCLUSION..... 52

FCC ORDERS CITED

SHORT CITE	FULL CITE
<i>BellSouth Louisiana II Order</i>	Memorandum Opinion and Order, <i>Application of BellSouth Corporation, et al. for Provision of In-Region, InterLATA Services in Louisiana</i> , 13 FCC Rcd. 20599 (1998)
<i>Georgia/Louisiana 271 Order</i>	Memorandum Opinion and Order, <i>Joint Application of BellSouth Corporation et al. for Provision of In-Region InterLATA Services in Georgia and Louisiana</i> , CC Docket No. 02-35 (rel. May 15, 2002)
<i>Inputs Order</i>	Tenth Report and Order, <i>Federal-State Joint Board on Universal Service</i> , 14 FCC Rcd. 20156 (1999)
<i>KS/OK 271 Order</i>	Memorandum Opinion and Order, <i>Joint Application of SBC Communications, Inc., et al. for Provision of In-Region InterLATA Services in Kansas and Oklahoma</i> , 16 FCC Rcd. 6237 (2001)
<i>Local Competition Order</i>	First Report and Order, <i>Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , 11 FCC Rcd. 15499 (1996), <i>aff'd in part and vacated in part, Iowa Utils. Bd. v. FCC</i> , 120 F.3d 753 (8th Cir. 1997), <i>aff'd in part and rev'd in part, AT&T Corp. v. Iowa Utils. Bd.</i> , 119 S. Ct. 721 (1999), on remand, <i>Iowa Utils. Bd. v. FCC</i> , 219 F.3d 744 (8 th Cir. 2000), <i>rev'd, Verizon Communications Inc. v. FCC</i> , 122 S.Ct. 1646, 1678 (2002)
<i>Maine 271 Order</i>	<i>Application of Verizon New England Inc. (d/b/a Verizon Long Distance) et al For Authorization to Provide In-Region InterLATA Services in Maine</i> , CC Docket No. 02-61 (rel. June 19, 2002)
<i>Massachusetts 271 Order</i>	Memorandum Opinion and Order, <i>Application of Verizon New England Inc. (d/b/a Verizon Long Distance) et al For Authorization to Provide In-Region InterLATA Services in Massachusetts</i> , 16 FCC Rcd. 8988 (2001)
<i>New Jersey 271 Order</i>	Memorandum Opinion and Order, <i>Application of Verizon New Jersey Inc. (d/b/a Verizon Long Distance) et al For Authorization to Provide In-Region InterLATA Services in New Jersey</i> , WC Docket No. 02-67 (rel. June 24, 2002)

SHORT CITE	FULL CITE
<i>NY 271 Order</i>	Memorandum Opinion and Order, <i>Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York</i> , 15 FCC Rcd. 3953 (1999)
<i>Pennsylvania 271 Order</i>	Memorandum Opinion and Order, <i>Application of Verizon Pennsylvania Inc. et al. for Authorization to Provide In-Region, InterLATA Services in Pennsylvania</i> , 16 FCC Rcd. 17419 (2001)
<i>Platform Order</i>	Fifth Report and Order, <i>Federal-State Joint Board on Universal Service</i> , 13 FCC Rcd. 21323 (1998)
<i>Second Advanced Services Order</i>	Second Report and Order, <i>Deployment of Wireline Services Offering Advanced Telecommunications Capability</i> , 14 FCC Rcd. 19237 (1999)
<i>South Carolina 271 Order</i>	Memorandum Opinion and Order, <i>Application of BellSouth Corporation, et al Pursuant to Section 271 of the Communications Act of 1934, As Amended, to Provide In-Region, InterLATA Services in South Carolina</i> , 13 FCC Rcd. 539 (1997)
<i>Supplemental Order Clarification</i>	Supplemental Order Clarification, <i>Implementation Of The Local Competition Provisions Of The Telecommunications Act Of 1996</i> , 15 FCC Rcd. 9587 (2000)
<i>Texas 271 Order</i>	Memorandum Opinion and Order, <i>Application by SBC Communications Inc., et al Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Texas</i> , 15 FCC Rcd. 18354 (2000)
<i>UNE Remand Order</i>	Third Report And Order And Further Notice Of Proposed Rulemaking, <i>Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , 15 FCC Rcd. 3696 (1999)
<i>Vermont 271 Order</i>	<i>Application of Verizon New England Inc. (d/b/a Verizon Long Distance) et al For Authorization to Provide In-Region InterLATA Services in Vermont</i> , CC Docket No. 02-7 (rel. April 17, 2002)

**Before the
Federal Communications Commission
Washington, DC 20554**

In the Matter of)	
)	
Application by Verizon New England Inc.,)	
Verizon Delaware Inc., Bell Atlantic)	
Communications, Inc. (d/b/a Verizon Long)	WC Docket No. 02-157
Distance), NYNEX Long Distance Company)	
(d/b/a Verizon Enterprise Solutions), Verizon)	
Global Networks, Inc., and Verizon Select)	
Services Inc., for Authorization To Provide In-)	
Region, InterLATA Services in New)	
Hampshire and Delaware)	

COMMENTS OF AT&T CORP.

Pursuant to the Commission's Public Notice, AT&T Corp. ("AT&T") respectfully submits these comments in opposition to the joint application of Verizon for authorization to provide in-region, interLATA services in Delaware and New Hampshire.

INTRODUCTION AND SUMMARY

Two months after the Supreme Court in *Verizon Communications Inc. v. FCC*, 122 S.Ct. 1646 (2002), definitively upheld the TELRIC standard for UNE pricing established by the Commission in its 1996 *Local Competition Order*, the Commission confronts a Section 271 applicant whose UNE prices satisfy neither TELRIC nor any other measure of cost.

In Delaware, Verizon charges recurring prices for switching and other non-loop elements that exceeded TELRIC when set in 1997 (based on 1994-96 data), and which have diverged even further from costs with the passage of time. Earlier this year, the

Delaware PSC concluded a supplemental phase of the 1997 rate case, instituted to set prices for a number of UNEs first offered after 1997. In its final decision, the PSC found that Verizon's capital and common overhead costs have declined significantly since 1997, and set rates for the new UNEs that reflected the cost reductions. The PSC refused AT&T's repeated request to consider reducing Verizon's obsolete recurring rates for its original set of UNEs on the basis of the same cost changes.

The Delaware PSC has also refused to set TELRIC-compliant non-recurring charges ("NRCs"). Two years ago, a reviewing court held in *Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F.Supp.2d 219 (D.Del. 2000), that Verizon's NRCs in Delaware violated TELRIC because they were calculated to recover the costs of Verizon's embedded, heavily manual, order processing rather than the operations of an efficient forward-looking firm. The court's directive to the PSC to set TELRIC-compliant NRCs has met with defiance. The revised NRCs subsequently approved by the PSC are—in the unanimous judgment of its Staff, its hearing examiner, and the Department of Public Advocate—still based on Verizon's existing processes. Indeed, in many respects, the "new" Verizon NRCs are a step backwards; NRCs for many key processes are *higher* than those struck down in *McMahon*.

In New Hampshire, there is not even a pretense that Verizon's rates are TELRIC-compliant. On July 15, 1998, in the midst of Verizon's UNE pricing case, Verizon struck a side deal with the trial staff of the New Hampshire PUC concerning the UNE prices that each party would support. The PUC, over AT&T's vehement objections, approved the "stipulated" rates as "reasonable" essentially because the PUC's trial staff had agreed to them, the switching rates were lower than what Verizon had originally proposed, and the rates appeared to be a good proxy for Verizon's *embedded* or *short-run* costs. The

switching rates remained unchanged until a month ago, near the end of the Section 271 proceedings before the PUC, when the PUC accepted Verizon's proposal in to reduce its switch usage rates by 17 percent in lieu of further cost-based adjustments to Verizon's rates. At no time since 1996 has the PUC considered whether the rate concessions doled out piecemeal by Verizon from its original maximalist position have reduced Verizon's switching rates to levels reflecting the long-run forward-looking costs of switching using the most efficient technology in a fully reconstructed network.

These patent TELRIC violations cannot be papered over by benchmarking Verizon's rates in Delaware or New Hampshire with those in New York. On a cost adjusted basis, Verizon's Delaware non-loop rates are nearly 50 percent higher than their New York counterparts. Verizon's New Hampshire switching rates likewise exceed Verizon's New York switching rates by approximately 13 percent on a cost-adjusted basis. And benchmarking obviously cannot excuse Verizon's inflated, non-TELRIC-based NRCs in Delaware.

The balance of these comments is organized as follows. Part I explains why many of Verizon's recurring rates in Delaware and New Jersey fail the Commission's benchmark test. Part II identifies the patent violations of TELRIC that taint Verizon's recurring rates for switching and other non-loop elements. Parts III demonstrates that Verizon's Delaware NRCs continue to violate TELRIC and the District Court order in *Bell Atlantic-Delaware v. McMahon*. Part IV explains why Verizon's Section 271 application in Delaware must be denied because Verizon's UNE rates create a discriminatory price squeeze in violation of Checklist Item 2. And Part V demonstrates that Verizon's monopoly power over residential service in Delaware and New Hampshire remains virtually unchecked, and Verizon's local markets in Delaware and New

Hampshire remain virtually closed to UNE- and facilities-based competition. For all of these reasons, approval of Verizon's application would be inconsistent with the public interest.

I. VERIZON'S DELAWARE AND NEW HAMPSHIRE SWITCHING-RELATED RATES FAIL THE COMMISSION'S BENCHMARK TEST.

The Commission has in the past used Verizon's New York UNE rates to determine whether Verizon's UNE rates in other states are within a range that a reasonable application of TELRIC principles would have produced.¹ As shown in the attached declaration of Michael Lieberman, Verizon's non-loop rates in Delaware and switching rates in New Hampshire fail this benchmark test.

A. Verizon's Delaware Non-Loop Rates Greatly Exceed Those Of New York On A Cost Adjusted Basis.

Verizon's non-loop rates in Delaware exceed those in New York by 64 percent. Yet, Verizon's Delaware non-loop costs are only 10 percent above those in New York. *See* Lieberman Decl. ¶ 6. A 10 percent difference in costs obviously cannot justify a 64 percent difference in rates.

Verizon does not deny this fact. Instead, Verizon invites the Commission to ignore these disparities—and Commission precedent—by “benchmarking” the sum of Verizon's loop and non-loop rates in Delaware and New Hampshire to the sum of its loop and non-loop rates in other states. The Commission has never approved a section 271 application on the basis of such a “kitchen sink” comparison, and for good reason. “TELRIC rates are calculated on the basis of *individual* elements.” *Verizon Communications Inc. v. FCC*, 122 S.Ct. 1646, 1678 (2002) (emphasis added). A BOC's

¹ *See, e.g.*, NJ 271 Order ¶¶ 49-55; VT 271 Order ¶ 26; RI 271 Order ¶ 39.

rates for a network element thus comply with Checklist Item 2 only if they are “based on the cost . . . of providing . . . *the* network element.” 47 U.S.C. § 252(d)(1) (emphasis added). Therefore, to gain § 271 approval, a BOC must show that the rates for each of its network elements complies with TELRIC principles.

Indeed, the whole purpose of unbundling is to allow an entrant to purchase – at cost-based rates – only the elements necessary to implement its particular entry strategy. If a BOC were free to evade the requirement to offer each element that qualifies for unbundling at cost-based rates by offering some elements at low rates and others at inflated rates, the BOC would have the ability to tailor its rates to impede the entry strategies that posed the greatest risk to its local monopolies. Moreover, CLECs are not indifferent to the relative levels of non-loop and loop costs. A substantial portion of non-loop costs are recovered on a usage basis, whereas loop costs are fixed. A CLEC that serves high usage customers, therefore, would be very sensitive to usage costs, and less sensitive to non-usage costs.²

To be sure, the Commission has recognized that the potential arbitrariness of certain allocations may require some combination of rate elements to achieve meaningful comparisons. The Commission has, for example, compared total switching costs (and even total non-loop costs) in recognition of the fact that states may differ in the ways that they allocate such costs among usage and port charges. However, no such issues arise with non-loop and loop-related costs. That is because the Commission’s rules specifically prohibit state commissions from allowing carriers to allocate loop-related

² In the past, Verizon’s has claimed that no CLEC *currently* purchases switching elements separately from loop elements. That claim is beside the point. If Verizon were permitted to charge above-cost rates for certain elements simply because they were not purchased separately today, that would enable Verizon to foreclose all future entry strategies that rely on purchasing those elements separately.

costs to a switching element or vice-versa. *See* 47 U.S.C. 51.509(a)-(b). *See also* PA 271 Order ¶ 66 (“we consider the reasonableness of loop and non-loop rates separately”); KA/OK 271 Order ¶¶ 82-95 (comparing loop costs only); MA 271 ¶ 26 (comparing only non-loop rates).

Where, as here, the applicant’s non-loop rates are higher (on a cost-adjusted basis) than those in a valid benchmark state, the applicant must prove – with specific cost evidence – that its non-loop rates are appropriately cost-based. Verizon did not, and could not, do that. As demonstrated below, Verizon’s Delaware UNE rates are riddled with clear fundamental TELRIC errors.

B. Verizon’s New Hampshire Switching Rates Greatly Exceed Those Of New York On A Cost Adjusted Basis.

As noted above, the Commission has in the past used the Synthesis Cost Model to make cost-adjusted state-to-state comparisons of non-loop rates – which include the costs of the switch port, switch usage, switch features, transport, signaling, and tandem switching. However, such a comparison is not appropriate when comparing rates in very rural states (*e.g.*, New Hampshire) to rates in more densely populated states (*e.g.*, New York) because the Synthesis Cost Model substantially overstates non-loop costs in rural states relative to less rural states, thereby substantially overstating any such cost justification for non-loop *rate differences*. *See* Lieberman Decl. ¶¶ 11-13. Thus, Verizon’s assertion that this Commission should rubber stamp its New Hampshire non-loop rates based on Verizon’s non-loop benchmarking analysis between New Hampshire and New York must be rejected.

The primary reason that the Synthesis Cost Model overstates non-loop cost differences between New Hampshire and New York is that the Synthesis Cost Model

vastly overstates cost differences for transport and for tandem switching (non-loop costs are equal to the sum of the costs of switch port, switch usage, switch features, *transport*, signaling, and *tandem switching*). See Lieberman Decl. ¶ 11-12. Therefore, to the extent that any switching-related benchmark analysis between New Hampshire and New York is appropriate, that analysis should at least exclude the costs of transport and tandem switching. See *id.* ¶¶ 13-14. And that analysis confirms that Verizon's New Hampshire switching rates cannot be justified by a comparison to Verizon's New York switching rates. Verizon's New Hampshire switching rates are 13 percent higher than those in New York on a cost adjusted basis. See *id.* Thus, on this record, the Commission cannot reasonably rubberstamp Verizon's New Hampshire switching rates based on a benchmark comparison of Verizon's New Hampshire rates to Verizon's New York rates.

Moreover, the fact that Verizon's New Hampshire *switching* rates are 13% higher than in New York on a cost adjusted basis is fatal to Verizon's claim that its rates can be rubber-stamped by this Commission for a second independent reason. As noted, "TELRIC rates are calculated on the basis of *individual* elements." *Verizon Communications Inc. v. FCC*, 122 S.Ct. 1646, 1678 (2002) (emphasis added). Hence, a BOC's rates for a network element comply with Checklist Item 2 only if they are "based on the cost . . . of providing . . . *the* network element." 47 U.S.C. § 252(d)(1) (emphasis added). Therefore, to gain § 271 approval, a BOC must show that the rates for *each* of its network elements – including switching – complies with TELRIC principles. Because Verizon's switching rates cannot be justified based on a valid benchmark comparison, Verizon must prove, not simply assert, that its New Hampshire switching rates are TELRIC-compliant. Verizon has not done so, and as demonstrated below, Verizon

cannot show that its switching rates are TELRIC-compliant. On the contrary, Verizon's New Hampshire switching rates are inflated by myriad clear TELRIC errors.³

II. VERIZON'S RECURRING RATES VIOLATE BASIC TELRIC STANDARDS.

A. Verizon's Non-Loop Rates In Delaware Violate Basic TELRIC Standards.

Verizon's recurring rates for switching and other non-loop elements in Delaware are inflated by numerous clear violations of TELRIC. Some of these violations taint only the switching rates; others inflate the rates of every network element that Verizon is required to offer. The resulting cost overrecovery is large. As Catherine Pitts and Michael Baranowski explain in their attached declaration, for example, Verizon's recurring rates for switch utilization, if applied to projected utilization over the projected lives of Verizon's switching equipment in Delaware, would overrecover Verizon's initial switch investment by *126 percent*. Pitts/Baranowski Decl. ¶¶ 6-8.

How can the Delaware UNE prices for switching, purportedly based on cost estimates generated by Telcordia's well known SCIS/MO model, be so wide of the mark? One reason is how Verizon used SCIS. Verizon estimated the cost of a minute of use ("MOU") of switching in Delaware by combining the individual unit cost outputs of SCIS/MO to produce an aggregate cost per MOU. Although it is permissible for SCIS model to be run in this fashion, Verizon's bottoms-up approach produces accurate results only if three fundamental input quantities—percent utilization of processor capacity, busy hour traffic on a per line basis (e.g., busy hour calls per line), and busy hour usage data

³ Verizon also invites the Commission to ignore any analysis of separate rate elements and, instead, consider only a combined non-loop and loop benchmark comparison between New Hampshire and New York. For the reasons stated above, the Commission must reject Verizon's invitation.

used as inputs for the related SCIS/IN model of feature costs—are applied accurately and consistently. If these inputs are off, the results can be badly in error. This is not an uncommon occurrence, because many of the key input values are not metered by the switch, or involved predictions of future traffic volume, and therefore must be estimated or projected. Pitts/Baranowski Decl. ¶¶ 9-11.

1. The Cost Data Underlying Verizon's UNE Rates Fail To Reflect The Decline In Forward-Looking Costs Since The Mid-1990s.

The switch investment costs underlying the Delaware UNE rates are further overstated because they are based on stale switch discount and switch investment data. Most of Verizon's UNE prices for most network elements were last adjudicated by the Delaware PSC in 1997.⁴ Moreover, some of the most important input values are based on data that were no longer current even in 1997. Because many of the costs of providing local telephone service have fallen sharply since the mid-1990s, the gap between Verizon's UNE rates and TELRIC-compliant rate levels has become a gulf. Pitts/Baranowski Decl. ¶¶ 12, 15-16; Lieberman Decl. ¶ 17-19.

To determine the forward-looking cost of purchasing switching equipment, for example, Verizon's cost study used the discounts offered by Verizon's switch vendors in 1995. In the intervening seven years, however, the available discounts offered to Verizon and other incumbent LECs have become much deeper, and the effective discounted prices have fallen substantially. Pitts/Baranowski Decl. ¶¶ 12-13.

Similarly, the cost studies submitted by the parties in the 1997 UNE litigation relied on cost data for a Bell Atlantic that extended only from Virginia to Pennsylvania.

⁴ Findings and Recommendations of Hearing Examiners, Delaware PSC Docket No. 96-324 (De. PSC Apr. 7, 1997), *modified*, Order No. 4542, at ¶ 29 (De. PSC July 8, 1997), *affirmed in part and reversed in part*, *Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F.Supp.2d 219 (D.Del. 2000).

Since then, of course, Bell Atlantic has merged with NYNEX and then GTE to form Verizon, a mammoth enterprise whose footprint spans nearly the entire Northeast Corridor—the most telecommunications-intensive region in the United States—and whose revenue now exceeds that of any other telecommunications carrier in the United States, including AT&T. Verizon obtained regulatory approval for these mergers in part by representing that they would benefit ratepayers by generating substantial economies of scale and scope. Pitts/Baranowski Decl. ¶ 12-13. Both this Commission and the Delaware PSC have found that the two merger transactions were likely to generate large cost savings. None of those cost savings, however, are reflected in the pre-merger cost data underlying the Delaware PSC's 1997 UNE rate prescriptions. *id.*

The Delaware PSC's failure to update Verizon's UNE rates to reflect these and other cost changes cannot be excused on the theory that the cumulative decline in costs is still too small to warrant the trouble and expense of another rate case. The decline in Verizon's costs since the 1997 case clearly has been large. As demonstrated in the attached declaration of Michael Lieberman (¶¶ 17-19), for example, an analysis of Verizon's ARMIS data for its Delaware net switch investments and its dial equipment minutes ("DEMs") shows that net switch investments have declined on a per-minute-of-use basis for the past several years, and that net switch investment has grown much slower than DEMs. The slow growing net switch investment, combined with the explosive increase in minutes, shows that there has been a 25 percent decline in switching investment per DEM between 1996 and 2001. *See id.* Thus, Verizon's switching rates clearly exceed today's forward-looking costs by a wide margin.

Moreover, updating Verizon's 1997 UNE rates would not have required an entirely new rate case. Indeed, updating some of the most important inputs underlying those rates would have required virtually no additional work at all.

On May 24, 2001, Verizon filed a "Revised UNE Rate Filing" with the PSC, thereby triggering a second round of UNE rate litigation ("Phase II Proceeding").⁵ The scope of the Phase II case was two-fold. First, the PSC needed to revise Verizon's non-recurring charges in response to the finding of the court in *Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F. Supp. 2d 218, 250-51 (D. Del. 2000), that the NRCs set in 1997 violated TELRIC. Second, the PSC needed to set TELRIC-compliant rates for a variety of UNEs newly introduced by Verizon after the close of the 1997 rate case. During Phase II, AT&T and other parties repeatedly asked that the PSC to expand the scope of the case to update the rates set in 1997 for Verizon's existing UNEs. The PSC denied each request. *See, e.g.*, Delaware PSC Docket No. 96-324 (Phase II), Findings, Opinion and Order No. 5967 (issued June 5, 2002) ¶¶ 23-25.

2. Verizon Has Obtained Excessive Rates For Minutes-Of-Use And Features By Mis-Allocating Fixed Costs To Those Outputs.

The "getting started" cost of a switch is often called the "first cost" or "start-up cost." A small percentage of this cost is associated with the central processor, and the remainder reflects the costs associated with maintenance, administrative, test, and spare equipment, memory, and other common equipment in the switch. Starting up cost is a significant fraction of the total switch investment in Delaware. *Pitts/Baranowski Decl.* ¶ 14.

⁵ The PSC initiated the Phase II proceeding by Order No. 5735, dated June 6, 2001.

The getting started cost of a switch should be assigned to the port UNE elements. The Verizon cost studies used to justify its switching UNE charges, however, allocated the “getting started” switch costs produced by the SCIS/MO model to the minute-of-use (traffic sensitive) and feature rate elements. This allocation was improper. Getting started switch costs do not vary with the number of lines and trunks on the switch or switch usage. The average current processor utilization for Verizon switches in Delaware is sufficiently low that the amount of traffic could increase several fold without exhausting the processors. Because adding calls or features requires no additional switch processing capacity, use of the processor has no economic cost. Likewise, removing calls or features from the switch will not result in a decline in processing costs. *See id.*

A cost-based switching rate structure requires that non-traffic sensitive switch costs be recovered via non-traffic sensitive switch rate elements. Otherwise, as minutes of use increase, over-recovery of the getting started cost will occur because the getting started costs do not change as minutes increase. The Verizon cost study suffered from Verizon’s misassignment of a substantial share of switch investment to the minute of use rate element. The resulting rates for switching UNEs are almost certain to generate a massive overrecovery of cost overrecovery as minutes grow and Verizon collects increased revenues. Pitts/Baranowski Decl. ¶¶ 14.

B. Verizon’s Recurring Rates For Switching In New Hampshire Were Also Set In Disregard For TELRIC.

Verizon’s recurring rates for switching in New Hampshire are also inflated by clear TELRIC errors. Moreover, the New Hampshire PUC has not even pretended to comply with the Commission’s TELRIC requirement that costs for UNEs “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). In its UNE decision of July 6, 2001, the PUC announced that it had decided to disregard this requirement because the July 18, 2000, decision of the Eighth Circuit in *Iowa Utilities Board v. FCC*, 219 F.3d 744 (8th Cir. July 18, 2000) ("*Iowa III*"), had found Section 505(b)(1) unlawful. See PUC Order No. 23,738 (issued July 6, 2001) at 5-6, 57-59, 85-88. Hence, the PUC stated, it would base its cost findings on the Eighth Circuit's holding in *Iowa III*, not the FCC's TELRIC rules as written.⁶

AT&T moved for reconsideration, noting the Eighth Circuit had stayed the portion of its *Iowa III* decision that would have suspended the effectiveness of the TELRIC rules pending further judicial review.⁷ On reconsideration, the PUC waffled, asserting that its July 6 decision "was not based upon a misunderstanding that *Iowa III* is the law," but rather on two more generic benchmarks for setting "just and reasonable rates":⁸

(1) economic cost modeling is an imprecise art that aspires to establish a zone of reasonableness rather than a single correct answer, and (2) a reasonable approach to modeling a forward-looking network requires some relationship to the reality of the current network world.⁹

The PUC did not retreat, however, from its refusal to apply the TELRIC standard of the efficient long run costs of the "lowest cost network configuration."

⁶ See Docket DE 97-171, Order No. 23,738 at 5-6, 57-59, 85-88 (July 6, 2001).

⁷ Order on motion to stay mandate, *Iowa Utilities Board v. FCC*, Docket Nos. 96-3321 *et al.* (8th Cir., Sept. 25, 2000).

⁸ See Docket DE 97-171, Order No. 23,847 at 12-13 (November 21, 2001).

⁹ *Id.* at 14.

The switching rates ultimately approved by the PUC confirmed that it had no intention of tethering its ratesetting to TELRIC. In July 1998, in the middle of hearings, Verizon and the PUC's trial staff struck a side deal concerning the rates they would support.¹⁰ The PUC, over the objections of AT&T,¹¹ approved the "stipulated" rates as "reasonable" essentially because (1) the PUC's trial staff had agreed to them, (2) the stipulated switching rates were intermediate between the levels originally proposed by Verizon and the levels proposed by AT&T, and (3) the sample of switch purchase prices selected by Verizon to support its proposed switching prices satisfied the PUC's desire to model a "forward-looking" in a way that bore "some relationship to the reality of the *current* network world"—i.e., to Verizon's *embedded* network. See PUC Order No. 23,738 (issued July 6, 2001) at 95-97 (emphasis added).

The switching rates remained unchanged until a month ago, near the end of the Section 271 proceedings before the PUC, when the agency accepted Verizon's proposal to reduce its switch usage rates by 17 percent in lieu of a further inquiry into Verizon's switching costs. At no time since 1996 has the PUC even tried to determine whether the rate reductions doled out piecemeal by Verizon have reduced its switching rates to levels approaching TELRIC compliance.

1. The New Hampshire PUC has never determined whether Verizon's switching rates are TELRIC-compliant.

The rates approved by the New Hampshire PUC are the result of a bilateral side deal ("stipulation") between Verizon and the PUC's trial staff, and are not based on costs.

¹⁰ NH PUC Docket No. DE 97-171, Exh. 61 (Verizon/Staff stipulation).

¹¹ See, e.g., NH PUC Docket No. DE 97-171, AT&T initial brief (Feb. 10, 1999) at 10-15; *id.*, AT&T Reply Brief (filed March 3, 1999) at 5-8; *id.*, AT&T Motion for Rehearing (filed Jan. 8, 2002) at 14-16.

Outside the hearings during the summer of 1998, the Staff requested Verizon to run its cost model assuming a meld of 80% new switch discount and 20% growth discount, and Verizon and Staff agreed upon an arbitrary value of \$325 per line for switching investment. By the admission of the witness who sponsored the switching cost study, Verizon's cost personnel then ran their cost model with various combinations of switching price data as inputs until the model disgorged the desired result. Pitts/Baranowski Decl. ¶¶ 15.

In fact, the samples of purchase price data that Verizon seized upon to make the \$325 value fall out of the model were grossly unrepresentative of the forward-looking costs that Verizon actually faced as a purchaser of switches in 1996 or 1997, let alone today. The sampled purchase contracts covered switch purchases *before 1992*, at higher prices than Verizon's contracts established at that time. Another set of data samples involved primarily remote switches, all of which were smaller than the normal remote switch in New Hampshire, thus producing a higher cost per line (as Verizon also admitted in the hearings). Pitts/Baranowski Decl. ¶¶ 16-17.

Despite the crudely result-oriented process that gave birth to the \$325 value, the PUC found it an acceptable estimate of embedded or short-run costs, the version of ostensibly "forward-looking" costs that the PUC had decided to apply instead of TELRIC.¹² The PUC reduced the \$325 value to \$294.61 to reflect a reduction in engineering and installation costs, but otherwise embraced the Verizon/Staff bargain without modifying the underlying switch material investment. Pitts/Baranowski Decl. ¶¶ 15.

¹² See PUC Order No. 23,738 (issued July 6, 2001) at 95 ("As we have determined above, a reasonable approach to modeling a forward-looking network requires some relationship to the reality of the current network world.").

The PUC's foray into result-oriented ratemaking did not end in 1998. In the recent state Section 271 proceeding, the PUC accepted another Verizon deal: Verizon cut its switch usage rates by 17 percent, and the PUC agreed not to probe further into the cost justification for Verizon's switching rates. Verizon's arbitrary reduction of selected switch UNE rates on June 14, 2002, has not cured the foregoing violations of TELRIC.¹³ To this date, the PUC has never judged Verizon's switching rates against the benchmark actually established by the FCC: the long run forward-looking costs of an efficient firm unconstrained by a legacy of inefficient embedded investment. For these reasons, Verizon's rates remain patently in violation of TELRIC.

2. Verizon's switching rates in New Hampshire reflect 1994 or 1995 switch discount percentages, which were already obsolete even by 1998.

Verizon's based its switching cost study on equipment contract prices that were outdated even by the 1998 proceeding. Verizon used a 1995 version of the SCIS/MO model to develop the switch investments that underlie the rates for unbundled switching. Telcordia typically releases at least one update per year, making the model version three-years old in 1998. And Verizon used switch contract prices for 1994 to determine the discount input for SCIS/MO model, even though more recent contracts were available. Pitts/Baranowski Decl. ¶ 16-17.

As in Delaware, using more recent information would dramatically reduce the per-line investment cost of switching. First, it is well known that switch prices are declining for both the purchase of new switch equipment and for add-on equipment to existing switches ("growth"). Second, switch components have been evolving, allowing

¹³ Pitts/Baranowski Decl. ¶¶ 15-23; Docket No. DT 01-151, letter-decision from the PUC to J. Michael Hickey, President of Verizon-New England, dated June 14, 2002.

greater capacities, thus reducing unit costs. Hence, Verizon's use of old, higher prices at the time of the hearing resulted in switch UNE rates that were not cost based. Pitts/Baranowski Decl. ¶¶ 16-17.

3. Verizon's switching cost study modeled technology that was obsolete and overly costly even in 1998.

The SCIS/MO model is periodically updated to reflect advances in technology as soon as components incorporating it are made available from switch manufacturers. The 1995 version of SCIS/MO that Verizon used in New Hampshire therefore reflected older technology than assumed in the current versions of the SCIS model in 1997 or 1998. Verizon also modeled obsolete technology by assuming that all digital loop carrier lines were served via TR008 SLC-96 technology instead of the forward-looking GR303 already available in 1998. Pitts/Baranowski Decl. ¶¶ 18-19.

The cost and engineering advantages of GR-303 (formerly called TR-303) over TR008 are well known and widely accepted in the industry. In particular, TR008 has very little dedicated port cost, but a high usage-sensitive cost as modeled in SCIS/MO, resulting a low port rate, but contributing to an excessive MOU rate. Indeed, another incumbent LEC, BellSouth, recently filed expert testimony which asserted that

Generic Requirement 303 ("GR-303") (authored by Bellcore) provides a set of generic requirements that describe more flexible [than TR008] NGDLC system types and a more flexible interface at a local digital switch. . . . The concentration allowed over these interfaces is variable and can be matched to the services being made available from the remote NGDLC site to allow the most economic concentration ratio consistent with the service being provided. While there are many variables that impact the decision of which switch termination type to use for the interface between a remote NGDLC site and the local digital switch, generally the most economic configurations are provided by using GR-303 sites with more than 150

lines in the three to five year planning period.

Direct Testimony of W. Keith Milner on behalf of BellSouth Telecommunications, Inc., Oct. 1, 2001, Georgia Docket No. 14361-U. *See also* Pitts/Baranowski Decl. ¶¶ 18-19.

Nevertheless, Verizon chose to model *none* of its lines in New Hampshire study as forward-looking GR-303 IDLC lines. Instead, Verizon assumed that *all* of the IDLC lines would employ older technology based on TR-008 standards (specifically Verizon used TR-008 Mode I). Verizon's assumption that approximately 90 percent of the lines in New Hampshire would be on less-efficient IDLC produces switch UNE rates that exceed TELRIC. *See also* Pitts/Baranowski Decl. ¶¶ 19; *accord, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc.*, Docket No. TO00060356 (March 6, 2002) ("New Jersey UNE Rate Decision") at 71-72 (adopting assumption that forward-looking network would use 100% IDLC GR-303); *Generic Investigation Re Verizon Pennsylvania, Inc.'s Unbundled Network Element Rates*, Penn. PUC Docket No. R-00016683, Recommended Decision issued May 3, 2002, at 37-39 (same).

The PUC's failure to address the GR-303 issue cannot be blamed on AT&T's failure to present it squarely: AT&T raised the issue repeatedly.¹⁴ The PUC rejected AT&T's position on the ground that Verizon, given the constraints of its *existing* network, would find a migration to GR-303 uneconomic in the next few years. Order No. 23,738 at 61-62, 88. This embedded or short-run perspective is a basic violation of the forward-looking, reconstructed-network paradigm of TELRIC.

¹⁴ *See, e.g.*, NH PUC Docket No. DE 97-171, Ex. 89, AT&T witness Petzinger (subsequently Pitts) Rebuttal at 4, 8-9; *id.*, AT&T initial brief (Feb. 10, 1999) at 43-44; *id.*, AT&T Reply Brief (filed March 3, 1999) at 18; *id.*, AT&T letter to the PUC dated Dec. 16, 1999 (lodging Verizon testimony from Massachusetts and engineering documents); *id.*, AT&T letter dated Apr. 4, 2000 (lodging Verizon testimony in New York); *id.*, AT&T Motion for Rehearing (filed Jan. 8, 2002) at 10-14.

4. The PUC accepted a common cost factor that is patently violative of TELRIC.

In their July 1998 agreement, Verizon and the PUC Staff agreed to recommend that a joint and common cost factor of 15 percent should be added to the revised investment cost outputs from the SCIS model. The 15 percent factor represented a 50 percent increase over the common cost factor originally supported by the PUC Staff and AT&T witnesses.¹⁵ The proponents of the 15 percent value offered no data or analysis to indicate that an efficient forward-looking company would have overhead costs so large, and the number appears to have been pulled out of thin air. To the contrary, Dr. Johnson candidly admitted that he was acquiescing in the 15 percent factor instead of his original proposal, 10 percent, because “Bell Atlantic preferred something higher.”¹⁶

The PUC likewise offered no reasoned explanation for adopting the higher figure, and cited no data in its support. Instead, the PUC stated only that it was accepting the 15 percent value “on the basis of credibility” or—more candidly—because “[t]o judge that the cost study’s results are reasonable, we must find that the common cost factor is reasonable.” Docket No. DE97-171, Order No. 23,738 (issued July 6, 2001) at 93.

In its *Local Competition Order*, the Commission found that the common costs recoverable from prices for UNE are limited to the forward-looking common costs of an efficient firm. *Local Competition Order* ¶¶ 694-96. Moreover, because of the “likely asymmetry of information regarding network costs,” incumbent LECs have the “burden to prove the specific nature and magnitude of these forward-looking common costs.” *Id.* ¶ 695. Under the circumstances, the New Hampshire PUC’s uncritical acceptance of the 15 percent factor was a patent violation of TELRIC.

¹⁵ Johnson, Tr. 9/1/98 at 33 & 172.

¹⁶ Johnson, Tr. 9/1/98 at 33.

5. Verizon's switching cost study misallocated fixed costs to usage element.

As in Delaware, Verizon has included in its New Hampshire minute of use rate element the fixed cost of "getting started." In New Hampshire, the getting started cost is 25 percent of the total switch investment. The average current processor utilization for Verizon switches in New Hampshire is only a small fraction of processor capacity. At these low levels of utilization, the amount of traffic could expand greatly without exhausting the processors; therefore, using the processor does not have an economic cost because adding calls or features causes no additional switch processing costs. The mis-assignment of 25% of the total switch investment to the minute of use rate element will result in severe cost overrecovery as minutes grow and Verizon collects increased revenues, but its fixed costs remain static.¹⁷

AT&T raised this point repeatedly during the UNE proceedings below.¹⁸ The PUC dismissed AT&T's objections on the ground that the "getting started" and other non-traffic sensitive switching costs are recurring, and therefore must be recovered from recurring rates:

AT&T's objection to the inclusion of switching costs in the recurring cost portion of the SGAT is not credible. Just as

¹⁷ Pitts/Baranowski Decl. ¶¶ 20-21; *accord*, Massachusetts D.T.E. Docket No. 01-20, *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided-Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts* (decision issued July 12, 2002) at vii, 248-50, 262, 270-71, 287-90 (accepting AT&T's position and rejecting Verizon's).

¹⁸ *See, e.g.*, New Hampshire PUC Docket No. DE 97-171, Ex. 89, AT&T witness Petzinger (subsequently Pitts) Rebuttal at 9-10; *id.*, Initial Brief Of AT&T Communications Of New England, Inc. Regarding Proposed Recurring And Non-Recurring Charges For Unbundled Network Elements, Operations Support Systems Access, Collocation, And Using BA-NH's House And Riser Cable (filed Feb. 10, 1999) at 14-15; *id.*, Motion By AT&T For Rehearing Of The Recurring Cost And Non-Recurring Cost Issues Addressed In Order No. 23,738 (filed Aug. 2, 2001) at 16.

loop costs “recur,” as that term is used in UNE cost modeling, so too do switch costs. The forward-looking nature of these studies includes the concept that neither loop nor switch costs occur as one-time costs.

Order No. 23,738 at 92. That response, however, merely begs the question of *which* recurring charge should be used to recover the costs: the recurring charge for ports, or the recurring charge for minutes of use.

6. Verizon further overstated its MOU switching costs by overstating its peak capacity requirements.

Another highly significant error in Verizon-New Hampshire’s cost methodology relates to its MOU rate element. To calculate a minute of use rate element for unbundled switching, Verizon initially calculated the cost for a “busy-hour,” *i.e.*, the peak usage. Those busy-hour minute of use costs are then converted to a cost for “any hour of the day” by multiplying a 11 percent busy hour to total business day (BHTD) ratio and then dividing by 252 business days per year. This calculation ensures that Verizon will recover 100 percent of the costs from traffic that occurs on business days, an outcome that is consistent with sound economic principles for attributing the costs of peak load capacity requirements. Pitts/Baranowski Decl. ¶¶ 22-23.

This calculation may be acceptable for business-related service cost studies, such as Centrex, but it is entirely inappropriate for a wholesale rate element that will be used by residential and business customers. The revenue received from the minute of use rate element in the remaining 113 days of the year would be pure profit to Verizon because it has calculated that rate element to ensure that it fully recovers its costs from the traffic occurring on business days. Instead of Verizon’s method, the proper approach is plainly to divide the peak period costs over all 365 days per year, because the switch will in fact be used all of the days of the year. Pitts/Baranowski Decl. ¶¶ 22-23.