BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 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

REPLY DECLARATION OF
MICHAEL R. LIEBERMAN AND BRIAN F. PITKIN
ON BEHALF OF AT&T CORP.

I. QUALIFICATIONS AND SUMMARY

1. **Michael R. Lieberman:** My name is Michael R. Lieberman. I am a District Manager in AT&T's Law and Government Affairs organization. I am the same Michael R. Lieberman who submitted a declaration on behalf of AT&T in this proceeding on July 17, 2002.

2. **Brian F. Pitkin:** My name is Brian F. Pitkin. I am a Director in the Financial Services Division of FTI Consulting, Inc., with offices located at 1201 Eye Street, NW, Washington, DC 20005. My curriculum vitae is Attachment A to this declaration.

3. The purpose of this declaration is to respond to an ex parte submission filed on August 6, 2002, by Richard T. Ellis, Director—Federal Affairs for Verizon. A declaration filed by one of us (Michael Lieberman) with AT&T's initial comments in this case demonstrated that

Verizon's switching rates in New Hampshire are 13 percent higher than Verizon's switching rates in New York, after adjusting for cost differences between the two states. This disparity precludes the Commission from using a benchmarking approach to validating Verizon's UNE rates in New Hampshire. The declaration also explained that, although Verizon's New Hampshire non-loop UNE rates may satisfy a similar benchmarking analysis in the aggregate, Verizon's switching rates do not, because the Synthesis Model—the model used to estimate state-to-state cost differences for this analysis—overstates the costs of transport, making the New Hampshire switching rate deficiencies, particularly in lower density states. July 17 Lieberman Decl. ¶¶ 11-16.

4. Mr. Ellis' August 6 ex parte filing offers three baseless responses to these showings. *First*, the filing asserts that the Commission should reject the possibility that the Synthesis Model overstates transport costs in New Hampshire, because (1) AT&T has supported the Synthesis Model in the past, (2) resolving the accuracy of the transport cost module is beyond the scope of this proceeding, (3) the Synthesis Model does not overstate transport costs in rural states; and (4) New Hampshire is not a rural state. August 6 Verizon Ex Parte at 1-2, 4. *Second*, the ex parte filing asserts that Verizon's rates for unbundled switching in New Hampshire in fact would satisfy a properly done benchmarking comparison with New York switching rates because the Synthesis Model understates switching costs in rural states. *Id*. at 3 (1st full paragraph). *Third*, the ex parte filing contends that whether Verizon's rates for unbundled switching in New Hampshire flunk the New York benchmark test is moot, because CLECs so far have ordered switching in New Hampshire only in combination with transport. *Id*. at 4-6. These arguments do not withstand scrutiny.

A. Verizon Cannot Satisfy Section 271 Without Offering Unbundled Switching In New Hampshire At Reasonable Prices—Regardless Of Whether CLECs Currently Order It.

5. The notion that the Commission should never consider benchmark comparisons of stand-alone switching rates, but only consider switching in combination with transport, ignores the basic competitive policies that are implicit in any rational economic interpretation of Section 271.

6. As a preliminary matter, the failure of CLECs to purchase switching elements separately from transport today does not mean that they would not do so in the future. Proper TELRIC pricing of *each element* is critical to ensuring that CLECs can continue expanding new technologies and new methods of entering local markets with various UNE combinations. Allowing BOCs to foreclose particular methods of entry by manipulating the individual UNE prices within a more aggregate basket of UNEs would enable the BOCs to foreclose particular entry strategies, thereby undermining the core competitive terms of the 1996 Act.

7. One of the most important lessons of economic regulation is that regulators, no matter how knowledgeable and prescient, almost always harm competition when they try to anticipate and handicap the future path of competition in an industry, rather than simply creating a level playing field. As the Commission noted in its *Local Competition Order* ¶ 12:

> [G]iven the likelihood that entrants will combine or alter entry strategies over time, an attempt to indicate such a preference in our section 251 rules may have unintended and undesirable results. Rather, our obligation in this proceeding is to establish rules that will ensure that all pro-competitive entry strategies may be explored. As to success or failure, we look to the market, not to regulation, for the answer.

8. Chairman Powell likewise noted three days ago in a speech on spectrum policy, "There is no question that we need to be able to deal with unpredictable and dynamic changes fast enough to be meaningful in the market and meaningful to consumers. . . . The 'laborious process' of government command and control 'has served the country well to this point, but is futilely too slow to rapidly move things to new and better innovative uses."[1] Peter Huber, a lawyer and polemicist for Verizon and other RBOCs, has made the same point. *See* Peter Huber, *Law and Disorder in Cyberspace* (1997) at pp. xiii-xv (listing major changes in communications technology and competition assertedly not foreseen by Commission and other expert observers).

9. We understand that Section 271(d)(3)(A) entitles a Bell operating company like Verizon to begin providing in-region interLATA service only if the Commission finds (among other things) that the company has satisfied the competitive checklist set forth in Section 271(c)(2)(B). The second item in the checklist, Section 271(c)(2)(B)(ii), requires that the Bell company provide "[n]ondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1)." And Section 252(d)(1) in turn requires that charges for network elements and interconnection shall be "based on the cost . . . of providing . . . the network element." 47 U.S.C. § 252(d)(1).

10. We also note that Congress, apparently recognizing the particular competitive potential of unbundled switching and unbundled transport, expressly required that each be offered separately, unbundled from the other. Competitive checklist item five requires Bell companies to offer "[l]ocal transport from the trunk side of a wireline local exchange carrier

[1] "FCC Chairman Michael K. Powell Outlines Critical Elements of Future Spectrum Policy," FCC New Release issued Aug. 9, 2002, http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-225310A1.pdf (site visited Aug. 11, 2002).

switch *unbundled from switching or other services*." 47 U.S.C. § 271(c)(2)(B)(v) (emphasis added). And competitive checklist item six requires Bell companies to offer "[l]ocal switching unbundled *unbundled from transport, local loop transmission, or other services.*" *Id*., § 271(c)(2)(B)(vi) (emphasis added). The competitive potential of unbundling switching and transport will remain stillborn, however, unless each element can be ordered an appropriate separate price.

11. The Commission's benchmarking policy need not (and should not) be interpreted to produce such an anticompetitive result. The benchmarking policy is essentially an indirect method of determining whether price charged by the BOC for each network element is TELRIC-compliant. Rather than making this determination directly and separately for each element, the Commission has adopted two shortcuts. First, network elements in a particular state will satisfy the statutory cost standard if (a) the same carrier's prices for network elements have been found to satisfy the cost standard in another state, and (b) the rate-to-cost ratios of the carrier's prices in the state at issue do not exceed the corresponding ratios in the state where the Commission has already made a direct determination of the carrier's costs (with the relative costs in the two states based on Commission runs of the Synthesis Model in both states). Second, if the rates for the entire basket of non-loop UNEs satisfy a benchmark comparison in the aggregate, each of the individual network elements with the basket of will be presumed to satisfy the benchmark comparison as well. Rhode Island 271 Order ¶ 40; New Jersey 271 Order ¶ 52.

12. In appropriate circumstances, these shortcut presumptions may be appropriate. If the costs of UNEs in one state bear a known ratio to the costs of UNEs in another, rate benchmarking has obvious merit as a way to simplify the litigation process by not directly determining the costs of UNEs in the second state. Likewise, if CLECs regard two or more

UNEs as complementary goods, order them in fixed proportions, and for structural reasons are certain to continue doing so permanently, it is not unreasonable to benchmark the combination of UNEs in the aggregate rather than individually—just as it would not be unreasonable to redefine the combination as a single UNE. These conditions are not satisfied, however, for switching and transport in New Hampshire.

13. Verizon's evidence that CLECs necessarily will regard Verizon-supplied switching and transport as rigid complements, let alone in fixed proportion, is flimsy or nonexistent. Whether CLECs in New York and New England have ordered unbundled switching from Verizon without unbundled transport (August 6 Verizon Ex Parte at 5) has little significance: only a tiny amount of CLEC entry has occurred in those states through *any* combination of Verizon UNEs. New Hampshire exemplifies this fact: of the 144,500 lines served by CLECs in Verizon's service territory in New Hampshire, only 6,500 involve the purchase of UNEs.[2] And Verizon does not even contend that CLECs in New Hampshire (or anywhere else) order Verizon switching and transport UNEs in fixed proportions.

14. One prediction can safely be ventured. If the Commission refuses to scrutinize the cost justification (if any) for Verizon's switching rates in New Hampshire on the assumption that Verizon's switching rates in isolation have "no competitive significance," the Commission's judgment will be a self-fulfilling prophecy. Whatever promise that switching, unbundled from transport, would have offered as a vehicle for UNE-based entry will be unfulfilled if the Commission prejudges the issue by declining to consider evidence that Verizon's prices for switching exceed TELRIC-compliant levels.

[2] AT&T Comments filed July 17, 2002, at 43 (citing Verizon Application, Torre Decl., Attachment 1, Table 1).

B. Verizon's Elaborate Defense of the Synthesis Model *Transport* Costs Provides No Basis For Ignoring Direct Evidence That Verizon's *Switching* Rates In New Hampshire Fail A Benchmarking Comparison With New York.

15. Because the cost basis (or lack thereof) of Verizon's prices for unbundled switching has independent economic and regulatory significance under Section 271, Verizon's elaborate defense of the transport cost module of the Synthesis Model is irrelevant. Regardless of where Verizon's transport prices in New Hampshire stand in relation to TELRIC, Verizon fails checklist item two if Verizon's prices in New Hampshire for unbundled switching exceed levels justified by TELRIC (or have not be shown to satisfy TELRIC). In any event, Verizon's analysis of the transport cost issue bears virtually no likeness to reality.

16. Verizon asserts that AT&T "previously has championed the FCC's Synthesis Model for use in determining relative costs between states (rural and non-rural alike) and for determining TELRIC costs for non-loop elements in individual states (again, rural and non-rural alike). August 6 Verizon Ex Parte at 2-3. There is no question that the Synthesis Model is an effective and useful tool for many purposes, including the determination of costs for unbundled loops and switching. It is equally clear, however, that the Model provides a conservative—indeed, overstated—measure of the costs of transport.

17. Verizon knows this perfectly well, for the issue came to a head in the pending arbitration before the Commission over Verizon's UNE prices in Virginia. In that case, the transport cost estimates generated by AT&T's runs of the Synthesis Model were *three times* as high as the transport costs estimated by Verizon using another model. Provoked by this anomaly, a member of the Commission's staff asked AT&T's transport witness, Steve Turner, "why don't you just all agree that we should use [Verizon's transport cost estimates] and we

could all go home?"[3] Mr. Turner replied that, if forced to choose between the Synthesis Model and Verizon models for transport costs without modifying either one, he would choose the latter.[4]

18. Verizon, for its part, agreed that the "MSM's Switching and Transport Module" (Verizon's term for AT&T's runs of the transport module of the Synthesis Model) was "inappropriate for use in a UNE proceeding."[5] The model was "flawed," Verizon added, "as AT&T/WorldCom admitted."[6]

19. Verizon's criticisms of the Synthesis Model went much further, however. Verizon assailed the Model as "incapable of estimating company- and state-specific UNE rates with any accuracy."[7] The Model, Verizon added, "is not designed to model, nor can it be modified to account for, the costs of the full and robust network that is the focus of UNE proceedings."[8] The "underlying platform" of the Model "prevents it from accurately measuring the forward-looking costs that Verizon VA or, for that matter, any efficient carrier, would incur in providing the full range of UNEs required by the Commission."[9] Verizon has never retracted these criticisms.

---

[3] *Id*., 19 Tr. 5552 (Nov. 29, 2001) (Mr. Morris).

[4] *Id*. at 5553 (Mr. Turner).

[5] *Petitions of WorldCom, Inc., Cox Virginia Telecom, Inc., & AT&T Communications*, CC Docket Nos. 00-218 and 00-251, Verizon Initial Post-Trial Brief on Cost Issues (Dec. 21, 2001) at 173.

[6] *Id*.

[7] *Petitions of WorldCom, Inc., Cox Virginia Telecom, Inc., & AT&T Communications*, CC Docket Nos. 00-218 and 00-251, Verizon Reply Post-Trial Brief on Cost Issues (Jan. 31, 2002) at 133.

[8] *Id*.

[9] *Id*. at 134.

20. Verizon's support for the Synthesis Model transport cost module in the present docket is also at odds with Verizon's continued sponsorship of its own transport cost study in the Virginia arbitration. Verizon's transport costs, according to its own studies, are only about *one-third* the corresponding estimates generated by the Synthesis Model. Verizon has represented to the Commission that its own, lower estimates are realistic: "Verizon VA's methodology for calculating the costs of the interoffice transport (IOF) and entrance facilities UNEs assumes the use of a forward-looking, cost-minimizing SONET network configuration that is capable of serving Virginia demand . . . and reflects reasonable assumptions about IOF in a forward-looking network."[10] Verizon cannot have it both ways. If its own transport cost estimates are accurate, the corresponding Synthesis Model outputs are overstated by a factor of three.

21. Verizon's suggestion that the Commission has endorsed the Synthesis Model as a reasonably accurate measure of state-to-state differences in transport costs (August 6 Verizon Ex Parte at 2) is equally unfounded. Verizon quotes paragraph 84 of the Commission's Kansas/Oklahoma 271 Order for the proposition that "while the USF cost model should not be relied upon to set rates for UNEs, it accurately reflects the relative cost differences among states." But the Commission's task here falls within the first half of the quoted sentence, not the second. Verizon would have the Commission rely on the USF cost model "to set rates for UNE's"—precisely what the Commission declined to do. The Commission's Fifth Report and Order in the Universal Service rulemaking underscores this distinction. There, the Commission found that the Synthesis Model provided reasonable estimates of state-to-state differences in costs for universal service *not* because the model measured transport costs accurately, but

[10] *Id*. at 116.

because transport (and switching costs) are less significant in this context than are state-to-state variations in the costs of *loops*.[11]

22. Because the Synthesis Model overstates transport costs in every state, the model gives disproportionate weight to transport costs in any benchmarking analysis. The problem is most acute, however, when the benchmark ("anchor") state has significantly higher average line densities than the comparison state. Because the transport cost algorithms of the model imply large economies of density, the overstatement of transport costs will be relatively more severe in the lower-density state, and thus the overstatement of total non-loop costs in the lower-density state. The result is to understate the profitability of the non-loop rates in the lower-density state, and increase the likelihood of an erroneously favorable outcome from the benchmark analysis.

23. Considering the switching-only benchmark analysis offered by AT&T nonetheless does not require the Commission to resolve broader issues such as the continued appropriateness of using the Synthesis Model "to determine relative cost levels for universal service, benchmarking, or any other purpose.". *Cf.* August 6 Verizon Ex Parte at 2. AT&T asks only that the Commission consider AT&T's separate benchmarking analysis of Verizon's New Hampshire switching rates, and—if the rates fail the comparison—refrain from adopting a benchmark-based presumption that those rates satisfy TELRIC. The Commission can require Verizon to prove directly that its New Hampshire switching rates comply with TELRIC without

[11] *See Federal-State Joint Board on Universal Service*, Fifth Report and Order, 13 FCC Recd 21323 (1998) ("Platform Order"), ¶ 75.

reaching any definitive conclusions about the accuracy of the Synthesis Model transport cost estimates, let alone venture into the further morass of policy issues conjured up by Verizon.[12]

24. Verizon's assertion that the Synthesis Model provides valid estimates of TELRIC costs for transport because the use of OC-48 transport rings in New Hampshire is efficient and cost-effective (August 6 Ex Parte letter at 2) is equally unfounded. First, Verizon's embedded network is not at issue here, where the Commission's TELRIC methodology -- a methodology upheld by the Supreme Court of the United States -- must be used to determine UNE costs. Second, Verizon states that it "typically does use OC-48 rings in New Hampshire, and plans to continue to use such rings going forward, for the simple reason that it is the most efficient interoffice facility design that provides a carrier with the greatest flexibility in its service provisioning." This argument, however, is vague and unsupported. Moreover, this argument raises a third problem with using Verizon's embedded architecture as a comparison -- its transport network provides a vast array of services not included in the Synthesis Model. As such, Verizon's decision to use OC-48 rings, if in fact true, does not necessitate the Model using only OC-48 rings for the modeled services.

25. Moreover, the assumed sizing of fiber optic rings by the model is only one of several conceptual errors in it. The Synthesis Model also fails to recognize the efficiencies that can be achieved when carriers work together to provide interoffice transport. In more rural states

[12] The only other conceivable obstacle to benchmarking switching and transport separately is the existence of common trunk ports. At times, Verizon has created amalgam rates for hybrid switch/interoffice facilities of this kind. It is a simple matter, however, to back out the explicit rate for such a service, and AT&T's switch-related analysis has in fact treated the common trunk port as a separate and explicit charge.

where a carrier's service territory is not contiguous, the Synthesis Model will build duplicative facilities rather than allowing carriers to share transport facilities.

26. Furthermore, even if these cost errors occurred equally in urban and rural areas (which they do not), the smaller economies of scale in rural areas endow these errors with a larger impact in rural areas, where the costs are spread over a smaller number of lines. For example, a ten percent overstatement of cost has a larger dollars-per-line impact on higher per-line transport cost than it does on a lower per-line transport cost. We also know that the transport calculations overstate the fiber costs (which the FCC adjusted for the loop portion but failed to adjust in the interoffice portion). This overstatement has a larger impact in New Hampshire than in New York because New Hampshire's average transport distances per line is more than four times greater than New York's. Thus, the relative overstatement of transport costs is greater in lower density states.

27. It is therefore telling that interoffice costs account for 17 percent of total non-loop costs in New Hampshire, but only seven percent of total non-loop costs in New York. This fact underscores how widely the ratio of transport costs to total non-loop costs will vary enormously from state to state—most likely in relation to density—when the Synthesis Model is used to estimate interstate cost differentials. Unless the Commission allows intervenors to submit separate benchmarking comparisons for transport and other non-loop elements, the possibility of error is severe.

28. Verizon's claim that New Hampshire is not a "very rural" state (August 6 Ex Parte at 3-4) is frivolous. The only relevant comparison is with New York, the state that Verizon has chosen as its rate benchmark. New York, on average, has approximately *five times* the number of lines per square mile as New Hampshire: data previously provided by Verizon

show[13] that the average number of lines per square mile in New Hampshire is 101 versus 487 in New York.[14] How New Hampshire compares in population density with Michigan, Missouri, Arkansas,[15] or any state other than New York, is irrelevant to the validity of the New York/New Hampshire benchmark analysis.

C. New Hampshire Switching Rates Greatly Exceed Those Of New York On A Cost Adjusted Basis.

29. Verizon relegates to a single paragraph the only issue in its ex parte filing that matters: whether its switching rates in New Hampshire would in fact pass a properly cost-adjusted comparison between its New York and New Hampshire rates. The Synthesis Model "understates switching costs" in New Hampshire and other rural states, Verizon argues, because the model assumes far less use of host/remote switch architecture than Verizon actually has in place. August 6 Verizon Ex Parte Letter at 3). The host/remote architecture, Verizon adds, is "more expensive than the standard switch architecture. " *Id*.

30. The Commission has repeatedly found, however, that host/remote switches can be more effective than standard switching networks in many low-density areas.[16] In any event, whether the host/remote "switch architecture" is "more expensive than the standard switch architecture" is irrelevant. If Verizon is provisioning its switches in an inefficient manner

[13] Verizon's response to the FCC's 1997 Universal Service Data Request, Attachment 1.

[14] Or consider the benchmark for comparison offered in Verizon's August 6 ex parte: population density. According to the source cited by Verizon, New Hampshire has an average population of 132.2 people per square mile. The corresponding figure for New York is 348.4. *See* Netstate, Census 2000 State Population Information, http://www.netstate.com/states/tables/st_population.htm (cited in Aug. 6 Verizon Ex Parte).

[15] All three states, by the way, contain large rural hinterlands.

[16] *See Federal-State Joint Board on Universal Service*, Tenth Report and Order, 14 FCC Recd 20156 (1999) ¶ 320.

(presumably the case if the Synthesis Model uses a more efficient configuration without remotes), then Verizon's existing host/remote relationships should not be considered as part of an evaluation of TELRIC-compliant switching rates.

31. Significantly, Verizon has offered no evidence that the switch configurations assumed in the Model for low density areas understate the cost of the most efficient configurations actually available for those areas. While Verizon is undoubtedly correct in its claim that "switching usage and port costs will be higher in a rural state … than in non-rural states," the cost differential is captured by the Synthesis Model algorithms, which specify much higher switching costs in rural areas (on a per-line basis). The Synthesis Model models Verizon's host-remote relationships to an appropriate extent by specifically using the Local Exchange Routing Guide ("LERG") host-remote relationships and estimating different investments for each switch type. Thus, none of Verizon's arguments undermine using the switching costs from the Synthesis Model as an appropriate basis for performing a cost-adjusted benchmark comparison between New Hampshire and New York.

VERIFICATION PAGE

I declare under penalty of perjury that the foregoing Declaration is true and correct.

/s/ Michael R. Lieberman
_____
Michael R. Lieberman

Executed on: August 12, 2002

VERIFICATION PAGE

I declare under penalty of perjury that the foregoing Declaration is true and correct.

/s/ Brian F. Pitkin
_____
Brian F. Pitkin

Executed on: August 12, 2002