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

In the Matter of	)	
	)	
Application by SBC Communications Inc.,	)	
Pacific Bell Telephone Company, and	)	WC Docket No. 02-306
Southwestern Bell Communications Services,	)	
Inc. for Provision of In-Region, InterLATA	)	
Services in California	)	

DECLARATION OF DALE E. LEHMAN

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INTRODUCTION

1. My name is Dale E. Lehman. I am Associate Professor of Economics and Director of the MBA program in Telecommunications Management at Alaska Pacific University. I am the same Dale Lehman that previously submitted an affidavit in this proceeding, filed on September 20,2002

2. The purpose of my Declaration is to address three alleged "price squeezes" discussed by AT&T. The first is in the local exchange market, the second is in the intraLATA toll market, and the last concerns vertical features. I addressed the first two of these allegations in my Initial Affidavit. AT&T apparently agrees that there is no price squeeze in the local market, but makes misleading claims about my analysis that I will address here. In addition, AT&T incorrectly asserts that there is a price squeeze in the intraLATA toll market. Finally, the third allegation, that a price squeeze exists with respect to vertical features, does not satisfy the definition of price squeeze, as I will discuss below

3. A price squeeze is defined as follows:

> "A price squeeze occurs when a vertically integrated provider of essential inputs charges downstream competitors one (high) price for the input while charging itself a lower price for the input. Doing so squeezes the profit margin out of the downstream market for competitors, possibly forcing them to exit the market."[1]

Another description of a price squeeze states:

> "the monopoly input supplier charges a price for the input to its downstream competitors that is ***so*** high they cannot profitably sell the downstream product in competition with the integrated firm."[2]

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[1] D.E.M. Sappington and **D.L.** Weisman, ***Designing Incentive Regulation for the Telecommunications Industry***, The **MIT** Press and the AEI Press, 1996, **pgs. 255-56.**

[2] P. Joskow, Mixing Regulatory and Antitrust Policies in the Electric Power Industry: The Price Squeeze and Retail Market Competition. In ***Antitrust and Regulation:*** *Essays* ***in Memory*** of ***John*** *J. McGowan*, ed. F. Fisher, 1985, p. 186.

These definitions make it clear that there are two parts to a price **squeeze.** First, there must be a divergence between the cost to the vertically integrated firm and the price it charges for an essential input. Second, the divergence must be great enough to "squeeze" the potential profit of a competitor sufficiently to threaten their ability to compete.

UNE-P PRICE SOUEEZE

4. Messrs. Lieberman and Pitkin claim, "AT&T is not raising price squeeze issues in this proceeding."[3] Nonetheless, they attempt to point out several "conceptual" and "methodological" errors contained in my analysis. They characterize my analysis as relying on the profit potential available to CLECs that serve "a small sliver of the local residential market" and "only the wealthiest customers."[4] An accurate portrayal of my analysis, however, shows that there is a profit available to CLECs, on average ($8.53/line/month statewide average) serving the residential market in California using a UNE platform (UNE-P).[5] Far greater profit margins are available for more targeted entry strategies.[6] Indeed, AT&T does not even attempt to rebut my analysis that indicates that for the "average feature" consumer, those consumers subscribing to three features, the CLEC's

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3 **Declaration of Michael R. Lieberman and Brian F. Pitkin** ¶ 21, n.18, **Comments of** AT&T **Corp.,** ***Application of SBC Communications Inc., Pacific Bell Telephone Company, and Southwestern Bell Communicazions Services. Inc. for Provision of In-Region, InterLATA Services in California,*** **WC Docket No.** 02-306 **(FCC tiled Oct. 9,2002)** ("Lieberman/Pitkin **Decl.").**

4 **Id.**

5 **Affidavit of Dale E. Lehman** ¶ 13, ***Application of SBC Communications Inc., Pacific Bell Telephone Company, and Southwestern Bell Communications Services, Inc. for Provision of In-Region, InterLATA Services in California,*** **WC Docket No. 02-306 (FCC filed Sept. 20,2002) ("Lehman** Aff.").

6 **Id.**

profit margin increases to $17.17/line/month on a statewide average basis.[7] Thus, the Liebetman-Pitkin claims are without foundation.

INTRALATA PRICE SOUEEZE

5. Messrs. Liebetman and Pitkin inaccurately portray my statement where I discuss the alleged price squeeze in the intraLATA market. They incorrectly claim, "Mr. Lehman concedes that there is a 'theoretical price squeeze situation' in California."[8] However, I merely stated, "Ms. Cabellon's situation refers to a theoretical price squeeze situation, but is incorrectly portrayed."' That is, the situation would represent a price squeeze if her analysis had been correct – but it was not. Messrs. Lieberman and Pitkin then attempt to restate Ms. Cabellon's analysis – this is also incorrect.

6. Messrs. Lieberman and Pitkin claim that my analysis "misses the point" that the "ILEC's actual costs are substantially lower than the IXC's actual costs."" Apparently, they wish to make a distinction between "actual costs" and "opportunity costs." As indicated in my Initial Affidavit, the foregone access charges (foregone when the ILEC carries a minute of traffic rather than the IXC) are an opportunity cost to the ILEC." The alleged price squeeze depends on characterizing this opportunity cost as somehow being different than an "actual cost." There is no basis for this distinction in economic theory. Indeed, there is

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7 Id.

8 Lieberman/Pitkin Decl. 721, fn. 18.

9 Lehman Aff. ¶17.

10 Lieberman/Pitkin Decl. ¶ 21, fn. 18.

11 Lehman **Aff. ¶ 17.**

no such economic term as "actual cost" and all economic costs are opportunity costs. For example,

> "It follows that the cost to society of producing anything consists, really, in the other things that must be sacrificed in order to produce it: in the last analysis, "cost" is opportunity cost – the alternatives that must be forgone.""

The opportunity costs faced by the ILEC and the IXC are identical. Accordingly, there is no price squeeze in the intraLATA market.

VERTICAL FEATURES PRICE SQUEEZE

7. The final alleged price squeeze situation is articulated in AT&T's Brief and in the Declaration of Ms. Murray.[13] Ms. Murray discusses the fact that CLECs pay a rate for each vertical feature and claims that Pacific "does not impute to itself' any cost to manage or bill these features. **Ms.** Murray is careful, however, not to refer to this situation as a price squeeze. Even if Ms. Murray's claim that these costs are borne by CLECs but not by Pacific were accurate, it would not constitute a price squeeze. The definition of a price **squeeze** requires two things. First, *the* cost and the price for the essential input must diverge (which is what Ms. Murray alleges). Second, the divergence must be sufficient to squeeze out the profit potential for the competitor. The second condition cannot be met in this case. The UNE prices for vertical features are far lower than the retail prices. Call Waiting is subscribed to by approximately half of residential customers and

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12 **Alfred** Kahn, ***The Economics of Regulation***, MIT Press, 1988, **p.** 66.

13 Comments of AT&T Corp. at 27-28, ***Application of SBC Communications Inc., Pacific Bell Telephone Company, and Southwestern Bell Communications Services, Inc. for Provision of In-Region, InterLATA Services in California,*** WC Docket No. 02-306 (FCC filed Oct. 9,2002) ***(See also*** Declaration of Terry L. Murray ¶¶ 8-1**1,** attached to Comments of AT&T Corp).

Caller ID is one of the most popular services ever launched.[14] Consider the three most popular features:

Feature	UNE rate (monthly)	Pacific's Retail Price (monthly)
Caller ID	**$0.29**	$6.17
Call Waiting	$0.17	**$3.23**
Call Forwarding	$0.17	**$3.23**

The vertical feature price is too small relative to the retail price to cause a price squeeze." Thus, AT&T's assertion that a price squeeze exists with respect to Pacific's vertical feature charges is unfounded.

CONCLUSION

8. **As** I have shown, retail/wholesale price margins are adequate in both the local market and for vertical features. The alleged price **squeeze** in the intraLATA toll market is also fictional – the result of a fundamental misrepresentation of true opportunity costs. Accordingly, none of the alleged price squeezes discussed by AT&T hold up to economic analysis.

9. This concludes my Declaration.

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14 For examples, ***see*** SBC News Release, ***A 'Ringing' Success: Five Years After Launch, Caller ID Now Californians' 2nd Most Popular Telecommunications Feature*** (Dec. 20,2001) (http://www.pacbell.com/About/NewsCenter/ShowRelease/1,,373,00.html?id=4250); J. Adame, ***Caller ID Service Aiding Residents, Police in Curbing Unwanted Calls,*** Abilene Reporter-News (July 13, 1999). http://www.reporter-news.com/1998/1999/local/id0713html).

15 I am not offering any analysis of the claim that CLECs face a feature price for which Pacific does not bear any cost. ***See*** Reply Affidavit of Richard **L.** Scholl ¶¶ 19-23 (Reply App., Tab **12) for** Pacific's response to this claim. **It** is not a proper application of a price squeeze, independent of the merits of this argument.

1declare under penalty of perjury that the foregoing is true and correct.

Executed on October 30, 2002.

[DALE E. LEHMAN]

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In the Matter of	)	
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Application **by** SBC Communications Inc., Pacific Bell Telephone Company, and southwestern Bell Communications Services, Inc. for Provision of In-Region, InterLATA Services in California	)	WC Docket No. *02-306*
	)	

REPLY AFFIDAVIT OF THOMAS J. MAKAREWICZ

REGARDING COST AND PRICING ISSUES

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I, Thomas J. Makarewicz, being first duly sworn upon oath, do hereby depose and state as follows:

1. My name is Thomas J. Makarewicz. I am Director – Cost Analysis at SBC Telecommunications Inc. My business address is One Bell Center, Room 38-Y-5, St. Louis, Missouri 63101. I am the same Thomas J. Makarewicz who filed an Initial Affidavit on September 20, 2002.

PURPOSE OF THE AFFIDAVIT

2. I will respond to the incorrect assertions in the comments filed by AT&T Corp. ("AT&T") and XO California, Inc. ("XO") and in the declaration of Michael Lieberman and Brian Pitkin of AT&T regarding SBC's use of Texas as the proper benchmark state for the FCC's benchmark comparison. The comments filed by AT&T and XO and AT&T's declarants disregard all of the arguments SBC put forward in its Application and my Initial Affidavit demonstrating why Texas is the proper state to be used in the FCC's benchmark analysis. The FCC, in numerous decisions, has affirmed Texas as an appropriate benchmark state.

AT&T'S CONCLUSION THAT TEXAS IS NOT A PROPER BENCHMARK STATE IS UNFOUNDED

3. AT&T states that the FCC's benchmark is a "short-cut method for assessing whether rates in an applicant state are TELRIC-compliant."[1] AT&T further states: "Given these limitations, there is no question that Texas is not a valid benchmark state for assessing California's rates because: (1) Texas rates are not TELRIC compliant; (2) Texas rates are based on a different rate structure than those in California; (3) Texas and California have

[1] Comments of AT&T *Corp.* at 19, Application by SBC Communications, Inc., Pacific Bell Telephone Company, and Southwestern Bell Communications Services, Inc. for Provision of In-Region, InterLATA Services in California, WC Docket No. 02-306 (FCC filed Oct. 9, 2002) ("AT&T Comments").

substantial geographic and demographic differences; and (4) Texas and California are served by different BOCs."[2] I will respond to each of these four allegations individually.

ALLEGATION 1: TEXAS RATES ARE NOT TELRIC COMPLIANT

4. AT&T's major contention in its comments is that Texas rates are not TELRIC compliant. AT&T attempts to demonstrate this using a number of arguments. Each of these arguments is faulty. AT&T **first** proffers two analyses by Michael Lieberman and Brian Pitkin using the USF Cost Model and ARMIS data.

AT&T DECLARANTS MICHAEL LIEBERMAN AND BRIAN PITKIN's CONCLUSIONS ARE WITHOUT MERIT

1. DECLARANTS CLAIM THE FCC'S USF COST MODEL SHOWS THAT SBC'S FORWARD-LOOKING COSTS FOR SWITCHING AND LOOPS HAVE DECLINED

5. Messrs. Lieberman and Pitkin contend that the FCC's USF Cost Model indicates that SBC's forward-looking costs of providing loops and switching in Texas have declined by 29% and 33% respectively.[3] Messrs. Lieberman and Pitkin did not describe how they applied the 1996 and 2001 line count and dial equipment minutes ("DEMs") to run the USF Cost Model. Therefore, it is impossible to substantiate **Messrs.** Lieberman and Pitkin's claims. If, however, they simply changed the DEM inputs in the USF Cost Model, reran the model and divided the loop cost results by the updated line counts, this would not allow accurate information to conclude a downward trend in costs. One would have to account *fully* for changes to loop and switching investments that would have accompanied an increase in lines and minutes. Wire-specific line counts for both 1996

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2 **Id. at 19-20.**

3 **Declaration** of **Michael** R. Lieberman and Brian F. Pitkin on Behalf of AT&T *Corp.*, ¶ 10 ("Lieberman/Pitkin Decl."), attached **to** AT&T Comments **as Tab A.**

and 2001 would be necessary to account fully for changes in loop and switching costs. It would have been extremely difficult, if not impossible, for Messrs. Lieberman and Pitkin to have incorporated these data into their model reruns. Even if all inputs were changed, the USF Cost Model still would not produce true forward-looking costs for SWBT Texas. The USF model cost results that the FCC has relied upon in its approved benchmark analyses do not reflect company-specific inputs for many important variables. Therefore, the output does not reflect SWBT Texas company-specific TELRIC results.

2. DECLARANTS CLAIM ARMIS DATA SUPPORTS THE CONTENTION THAT TEXAS RATES ARE ABOVE TELRIC LEVELS

6. Messrs. Liebeman and Pitkin discuss how ARMIS data also purport to provide additional confirmation that the Texas rates are far above TELRIC levels. First and foremost, it is not legitimate to use historical, embedded ARMIS cost information to evaluate TELRIC-based UNE rates. ARMIS costs contradict the most fundamental tenet established by the FCC related to TELRICs, namely that TELRICs must be forward-looking and must exclude historical, embedded costs.[4] In fact, it is completely contradictory for AT&T to offer embedded costs as a standard for judging the reasonableness of Pacific's TELRIC-based UNE prices. AT&T strenuously argued before the FCC that "forward-looking economic costs, not historical costs, should be the only basis for setting rates for interconnection and unbundled network elements."[5] In short, ARMIS cost data cannot be used as a test because the underlying cost standard (embedded cost) violates TELRIC principles.

7. Second, Table 2 in Messrs. Lieberman and Pitkin's declaration generally refers to two

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[4] First Report and Order, Implementation of the Local Cometition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd 15499 ¶¶ 704-707 (19%) ("Local Comuetition Order").

[5] Local Comuetition Order, ¶ 655 & n.1614.

ARMIS schedules, but does not provide specifics as to which accounts or line items were used to derive Table 2 results. Therefore, Pacific was unable ***to*** replicate AT&T's results or to *make* adjustments to correct for improper data application. Despite this limitation, given the general sources that Messrs. Lieberman and Pitkin provided, **I** conclude that the AT&T analysis is flawed for at least two reasons: 1) it misstates investments (the numerator) ***relative to the line counts used,*** and ***2)*** it overstates access line counts (the denominator) ***relative to the investments used.***

8. Investments: The AT&T analysis relies on ARMIS report 43-03 to represent cable and wire facility investment, circuit equipment investment and switching investment! The cable and wire facility accounts in ARMIS report 43-03 include facilities used for interoffice transport. Investments for interoffice transport do not belong in **an** analysis attempting to show loop investment per access line. The more appropriate source to calculate loop investments per access line is ARMIS report 43-04 (line 1460). The 43-04 report identifies cable and wire facility investments and circuit equipment investment exclusively attributable to loop plant. Though ARMIS 43-04 investments, in concept, limit loop-related investments further **than** what AT&T proffered, they represent a more appropriate value relative to the corrected access line count information explained below.

9. Access Line Counts: The AT&T analysis uses an access line count that creates a mismatch when compared to AT&T's chosen **ARMIS** investment values. The line count data reported in **ARMIS** Report 43-08 that Messrs. Lieberman and Pitkin used in Table 2 consist of switched access lines (i.e., POTS), special access-analog and special access-digital. DS1 and DS3 loops, which *are* part of the special access-digital count, *are* expressed as voice grade equivalents. DS1 lines are counted as **24** voice grade

[6] Lieberman/Pitkin Decl., ¶ **11.**

terminations and DS3 lines are counted as 672 voice grade terminations.[7] However, using voice grade equivalent line counts, as AT&T's analysis does, incorrectly assumes that a DSI circuit uses 24 times the investment that a 2-wire analog loop uses. DS1 loops over copper are provisioned using only two pairs of copper wires (i.e., the equivalent of two loops) even though DS1s are capable of providing **24** voice grade circuits. Using voice grade equivalent line counts to compare with the cable and wire investments AT&T grossly overstates the physical loops required to provision DS1 and DS3 service. This has the effect of understating the per line investments that AT&T's analysis cites.

10. I created an alternative to Messrs. Lieberman and Pitkin's Table 2 using the relevant investment accounts and access line measures from ARMIS. The **key** to my corrected analysis is applying access line counts that correspond to **ARMIS** investments. The resulting analysis appears below in Table 1.

Table 1

Net Investments per Unit of Demand

	Net investment per Unit							Total
Category	1996	1997	1998	1999	2000	2001		Change
1) Cable & Wire Facilities per Line	$ 754.80	$ 755.41	$ 762.26	$ 602.68	$ 842.54	$ 847.52	*	12.3%
2) Total Cable, Wire & Circuit per Line	$ 949.69	$ 977.82	$ 994.19	$ 790.48	$1.113.41	$1,133.32	*	19.3%
3) Switching Equipment per DEM	$0.01384	$0.01284	$0.01254	$0.01168	$0.01145	$0.01304		-5.7%

To calculate investments in lines 1 and 2 of Table 1, I used the cable and wire facilities investment account from ARMIS 43-04 report, line 1460. This ARMIS report identifies the cable and wire facilities investment that is attributable exclusively to loop plant. In

[7] For federal USF purposes, the FCC did order the ILECs to submit, from 1998, wire center specific 1998 line counts for DS1 and DS3 on a voice grade basis and on a facilities basis. However, the only reasonably accurate analysis would apply facilities level access line counts as these correspond to loop-related investments identified in ARMIS. It would grossly understate investment per line to apply VGE line counts in the denominator and investments based on facilities in the numerator, which is what Messrs. Leiberman and Pitkin appear to have done.

line **2** of Table 1, **I** added the circuit equipment investment attributable to loops. This amount is found on ARMIS report 43-04, line 1277. To correctly account for access lines applied in lines 1 and 2 of Table 1, I used the total working loops from the ARMIS report 43-04, line 1270.[8] Total working loops express lines on a facilities basis (i.e., number of 2-wire analog loops) rather than a voice grade equivalent basis. Therefore, total working loops correspond correctly to the investment data used in the numerator because investment is driven by working loops installed, not by voice grade equivalent line counts. While it is true that SWBT Texas reports both types of line counts in ARMIS (voice grade equivalents in report 43-08, and working loops in report 43-04 prior to 2001), it is only appropriate to use loops counted on a facilities basis when calculating investment per access line.

11. Correcting AT&T's overstatement of access line counts (the denominator) and applying more appropriate investment and line count data from ARMIS results in cost trends contrary to what AT&T alleges. Line 1 of Table 1 above shows a 12.3% ***increase*** in cable and wire facilities investment per loop instead of a 28% decrease. Line 2 of Table 1 below shows a 19.3% ***increase*** in total investment per loop (cable & wire facilities and circuit equipment) between 1996 and 2001, not a 13.7% decrease as shown by Messrs. Lieberman and Pitkin in their declaration. Though my analysis indicates a decrease in switching equipment per DEM on line 3 of Table 1, the decrease is not as exaggerated as what Messrs. Liebeman and Pitkin display. By using local switching equipment investment located in ARMIS report 43-04, we do not ***see*** a significant decrease in the switching cost.

12. **As** discussed earlier, **ARMIS** data are not an appropriate gauge to validate forward-

[8] **Because** the **ARMIS doesn't require** this **data any longer, the data** source for **2001 working** loops is SBC's Data *Submission* **to NECA for** *the* **Universal** Service **Fund, dated 12/31/01.**

looking costs. The fact that ARMIS suggests that switching investment per DEM has declined by 5.7% since 1996 tells us nothing about what the forward-looking, TELRIC costs of a unit of switching in Texas **are** today. But even if it were the case that the Texas switching rates were currently *5.7%* higher than **ARMIS** trends suggest that they should be, Pacific's non-loop rates would remain well within the benchmark of the Texas non-loop rates.' Therefore, the AT&T analysis using ARMIS data is flawed and provides no basis for the FCC to reject the findings **of** Pacific's benchmark analysis.

THE FCC HAS FOUND THAT THE TEXAS RATES ARE TELRIC COMPLIANT

13. **As** pointed ***out*** in my Initial Affidavit, the FCC has found in numerous 271 orders that Texas rates are TELRIC compliant. The FCC has recommended that Texas rates be used because of the diligence shown by the Texas Public Utility Commission (TPUC) in establishing TELRIC compliant rates. For instance, in the Kansas/Oklahoma **271** Order, the FCC stated:

> [W]e encourage states with limited resources to take advantage of the efforts devoted by New York and Texas in establishing TELRIC-compliant prices, by relying where appropriate on the existing work product for those states.]'

Further, the FCC has stated:

> SWBT need *only* show that the Missouri rates fall within a reasonable range that TELRIC would produce. The rates we have approved in both

[9] Table **2** in my Initial Affidavit demonstrates the large degree by which Pacific passes the benchmark test for the non-loop portion. California non-loop costs are only 2% lower than Texas, while California non-loop rates are 34% lower than Texas. Reducing Texas switching rates by *5.7%* would still allow Pacific non-loop rates to pass the benchmark by a comfortable margin. In fact, SWBT's proposed unbundled switching rates in the current UNE proceeding in Texas (Docket No. 25834, Proceeding on Cost Issues Severed from P.U.C. Docket No. 24542) are higher than current switching rates. This provides evidence that calls into question switching cost trends derived using any **ARMIS** data.

[10] Memorandum Opinion and Order, Joint Avvlication by SBC Communications Inc., Southwestern Bell Teleuhone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region. InterLATA Services in Kansas and Oklahoma, 16 **FCC** Rcd 6237 ¶ 82, n.244 (2001).

> Kansas and Texas provide some definition to the reasonable range of rates.''

And:

> [T]he Commission has found, for example, that the New York, Texas and Kansas Commissions have applied TELRIC correctly for recumng UNE charges."

14. The above references demonstrate the FCC's belief that the Texas rates are TELRIC compliant. Not only has the FCC stated that Texas rates are TELRIC compliant, but even AT&T itself has recommended the use of Texas as a benchmark state in Verizon's application for **271** approval for the state of Massachusetts. The Massachusetts **271** Order reads:

> We disagree with AT&T's assertion that New York rates should not be used as the benchmark for measuring whether Verizon's UNE rates are TELRIC-based in Massachusetts. AT&T would like the commission to use rates found to be TELRIC-based in the SWBT states of Texas, Kansas, or Oklahoma for comparison. (emphasis added)[13]

Clearly, AT&T would not have recommended using Texas as the appropriate benchmark state in that case if AT&T truly believed that Texas rates were not TELRIC compliant.

15. AT&T further alleges that the TPUC agrees that Texas UNE rates are not TELRIC compliant. Again, this is simply not true. Messrs. Liebetman and Pitkin cite a portion of a non-specific "2002 Texas Arbitration Award."[14] Put in context, this citation reveals

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11 Memorandum Opinion and Order, Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services. Inc. d/b/a Southwestem Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region. InterLATA Services in Arkansas and Missouri, 16 FCC Rcd 20719 ¶ 56 (2001).

12 Memorandum Opinion and Order, Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc.. **and** BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Georgia **and** Louisiana, 17 FCC Rcd 9018 ¶ 24, fn. 86 (2002).

13 Memorandum Opinion and Order, Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Lone Distance). NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) and Verizon Global Networks Inc.. For Authorization to Provide In-Region. InterLATA Services in Massachusetts, 16 FCC Rcd 8988 ¶ 28 (2001)

14 Lieberman/Pitkin Decl., ¶ 9.

that the TPUC drew no conclusions about TELRIC compliance that would question its previous approval of SWBT's rates. **A** further reading of the same citation reveals that the TPUC indicated that loop costs may have changed, not the costs for all UNEs. What AT&T failed to present is that the TPUC stated

> Therefore, the Arbitrators conclude that sufficient evidence exists in the record of this proceeding to support the reevaluation of loop costs in a subsequent cost proceeding. However, the Arbitrators also note that. until cost study evaluations are conducted. it is unclear whether or in which direction forward-looking loop costs might move. Loop rates are a function of numerous costs, some of which may have increased over time and others which may have decreased." (emphasis added)

The TPUC clearly recognizes that until the studies are actually ruled on, one cannot make the automatic assumption that the costs have decreased. Nowhere has the TPUC stated that SWBT's UNE rates in Texas established in the MegaArbitration are no longer TELRIC-compliant. In fact, other CLECs have commented that loop costs are increasing.[16] The simple assertion that costs may have changed over time is not a reason to deem the benchmark state's approved TELRIC rates as no longer TELRIC compliant.

16. The FCC has consistently recognized that rates may change over time, but that fact alone does not cause TELRIC-compliant rates to automatically become non-compliant. **As** the FCC stated in the Vermont 271 Order:

> The commission has recognized that rates may well evolve over time to reflect new information on cost study inputs and changes in technology, engineering practices, or market conditions. The United States Court of Appeals for the District of Columbia Circuit agrees:

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[15] Arbitration Award at 96, Petition of MCIMetro Access Transmission Services. LLC, Saee Telecom Inc., Texas UNE Platform Coalition. McLeod USA Telecommunications Services. Inc., and AT&T Communications of Texas. L.P. for Arbitration with Southwestern Bell Teleuhone Company under the Telecommunications Act of **1996,** TPUC Docket No. **24542** (May **1,2002).**

[16] In WorldCom's Reply Brief **at** the Supreme Court of the United States, WorldCom stated: "The incumbents have grossly exaggerated the extent to which declining costs put their **sunk** investment at risk. Although the computer-based elements of the network (such as the switches) **may** be characterized **by** declining costs, other elements (such as the loop plant) are not declining: for many elements costs are rising." (emphasis added). Reply Brief for Petitioners, ¶ II.2.a, WorldCom. Inc., et al., **v.** Verizon Communications. Inc., On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit, No. **00-555** (July 23, 2001).

> [W]e suspect that rates may often need adjustment to reflect newly discovered information . . . If new information automatically required rejection **of** section 271 applications, we cannot imagine how such applications could ever be approved in this context of rapid regulatory and technological change. (footnotes omitted)"

17. Again, in its recent Five-State BellSouth 271 Order, the FCC stated:

> **As** background for **our** analysis, we have consistently recognized that rates may well evolve over time to reflect, among other things, new information and technology. The U.S. Court of Appeals for the D.C. Circuit agreed that section 271 applications might never be approved if rates had to be updated constantly to reflect new information. (footnotes omitted)[18]

ALLEGATION 2: TEXAS AND CALIFORNIA HAVE DIFFERENT RATE STRUCTURES

18. AT&T states that the Texas rates are based on a different rate structure than those in California. It is true that the two states do not have exactly the same rate structure; in fact, there are very few states that have exactly the same rate structures and this fact has not negated the use of the benchmark comparison. As shown in my Initial Affidavit, SBC has made appropriate adjustments to allow for a meaningful comparison. The benchmark analysis converts element-specific rates to composite, per line prices based on an agreed-upon set of demand assumptions. The non-loop line item in the benchmark is, by its very nature, intended to demonstrate what a CLEC would pay for the sum of the non-loop rate elements in both the benchmark state and the applicant state. Indeed, the FCC has stated that, "In addition, we combine per-minute switching with other non-loop

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[17] Memorandum Opinion and Order, Application bv Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance). NYNEX Long Distance Company (d/b/a Verizon Enternrise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization to Provide In-Region, InterLATA Services in Vermont, **17** FCC Rcd **7625 ¶ 23 (2002)**

[18] Memorandum Opinion and Order, Joint Application by BellSouth corporation, BellSouth Telecommunications, Inc.. and BellSouth **Lone** Distance. Inc. for Provision of In-Region. InterLATA Services in Alabama. Kentucky. Mississippi, North Carolina and South Carolina, 17 FCC Rcd 17595 ¶ **100 (2002).**

rates such as port, signaling, and transport rates because competing LECs most often purchase them together rather than separately, and because state commissions often differ in determining how to recover certain costs. For example, in some states shared trunk port costs are recovered through a separate rate, while in other states these costs are recovered as part of switching rates."[19] This composite price point is fashioned using state specific inputs that are similar in relationship to the costs reflected on the HCPM side of the analysis. This ensures that the comparison of ratios between the benchmark state and the applicant state on both the HCPM and price point sides of the model are fair.

19. AT&T claims that "to compare the average non-loop rate structure differences between California and Texas it is necessary *to* know the average vertical feature rate – which is a component of the non-loop rate – in both California and Texas."[20] Continuing, AT&T states: "That calculation is complex, requiring, among other things, estimation of penetration rates for vertical features in California."[21] A complex calculation is, in reality, not necessary. **As** stated in my Initial Affidavit, Pacific conservatively used three vertical features as the standard; **a** number that Mr. Liebeman has supported previously.[22]

20. Next, AT&T claims that since the switching rates in California utilize a "set-up and duration" cost structure, one must have "accurate assumptions about the duration of the

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[19] Memorandum Opinion and Order, Application of Verizon New England 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-Reaion, InterLATA Services in Rhode Island, 17 FCC Rcd 3300 ¶ 40 (2002).

[20] AT&T Comments at 24.

[21] Id.

[22] Makarewicz **Aff. ¶ 13,** Table **2,** n. 17, citing Declaration of Michael R. Lieberman attached to Brief of AT&T Communications of California, Inc. in Opposition to Pacific Bell Telephone Company's Showing Establishing Compliance with Public Utilities Code Section 709.2 Requirements, R.93-04-003, et al. (filed Aug. 23,2001).

average call in California in order to develop rates that can be benchmarked to Texas."[23] This is not the case. Accurate call set-up and duration measurements are available and are clearly shown in Attachment B to my Initial Affidavit. To develop the switching price for benchmarking, one simply multiplies the rate times the number of minutes of use or number of calls as appropriate. AT&T also states that the rate structure for the Texas port rate is based on rate-groupings. This is true, but it is a straightforward calculation to weight the rate groupings in order to arrive at a rate per loop.

21. AT&T has given no sound proof that, simply because the rate structures are not exactly matched, the benchmark analysis should be discounted. Again, through simple calculations, the benchmark costs and rates on a per line basis for both the loop and non-loop elements can be readily calculated using available resources.

ALLEGATION 3: TEXAS AND CALIFORNIA HAVE SUBSTANTIAL GEOGRAPHIC AND DEMOGRAPHIC DIFFERENCES

22. AT&T claims that Texas and California have substantial geographic and demographic differences. The Lieberman and Pitkin Declaration offers a different set of geographic and demographic statistics, without sourcing or providing a citation. AT&T argues that Pacific ignores the key geographic statistics that have a direct impact on costs; that is incorrect. ***As*** stated in my Initial Affidavit, both states host large numbers of densely populated urban areas; the metrics I cited relating to urban concentrations have a direct impact on telephony costs. The density metrics I cite in Table 1 of my Initial Affidavit indicate that the two states' populations are centered in urban areas. As such, those states' average loop costs **will** be largely influenced by the urban loop cost averages. Conversely, the density metrics proffered by AT&T dilute the effect that urban

[23] AT&T Comments **at 24**

concentrations have on statewide costs. By dwelling exclusively on statewide statistics, with no acknowledgement of urban concentration similarities between California and Texas, AT&T erroneously discounts the fact that urban concentration similarities contribute to parallel cost structures.

23. Without disputing the accuracy of AT&T's statistics, I simply point out that the FCC has stated that demographic and geographic differences are not a major determination of a comparable state:

> **As** we stated in the SWBT Arkansas/Missouri Order, the BOC need only show that the benchmark state's rates fall within the TELRIC range. The standard is not whether a certain state is a better benchmark, but whether the state selected is a reasonable one.[24]

In that same order, the FCC further states:

> Moreover, even assuming ***arguendo*** that Vermont is more similar geographically to New Hampshire, such a fact would not undermine a benchmark comparison to New York rates. The USF cost model, as we have stated in prior section **271** orders, is designed to account for relative cost differences between states on, among other things, geographical differences. (footnote omitted)[25]

Again, AT&T has not put forth **a** convincing argument that Texas is not an appropriate benchmark state nor that Pacific's benchmark comparison should be dismissed.

ALLEGATION 4: TEXAS AND CALIFORNIA HAVE DIFFERENT BOCS

24. AT&T claims that Texas is not a proper benchmark state because Texas and California have different BOCs. **As** indicated in my Initial Affidavit, Texas and California share the same holding company, SBC Communications, Inc. Just as it was reasonable for the

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[24] Memorandum Opinion and Order, 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, 17 FCC Rcd 18660 ¶ **42** (2002).

[25] Id. ¶ 43

FCC to compare Verizon's Pennsylvania and New York rates even though they were not part of the same original BOC, see Pennsylvania 271 Order, ¶ 64, it is reasonable for the FCC to compare SBC's California and Texas rates. Even if Texas and California don't have the same regional company, this does not result in nullifying the benchmark comparison. In the Pennsylvania **271** Order, the FCC stated:

> The cost model makes no distinction between data among BOCs and we have no reason to suspect that such a comparison has been made less significant because different BOCs served the two states.[26]

25. The FCC has stated that the USF cost model makes no distinction between data among BOCs; thus, discrepancy of BOCs does not impede the legitimacy of a benchmark analysis. SBC has appropriately chosen Texas as the benchmark state and AT&T has not presented any convincing arguments to the contrary that would nullify the use by **the** FCC of the benchmark comparison; therefore, AT&T's conclusions should be rejected.

XO'S EXTENSION OF THE BENC[illegible] IA[illegible] 'OMPARISON TO OTHER LOOP FACILITIES IS INAPPROPRIATE

26. XO states, "Although filed for purposes of a UNE-P price comparison, the Makarewicz Affidavit makes no differentiation between the UNE-P components and other loop facilities, such as DS1 and DS3 UNE loops."[27] **XO** continues by comparing rates for DS1 loops in other SBC states with Pacific's rates. This is a misuse of the benchmark comparison. The FCC USF cost model (HCPM) is used to compare the costs between the states for local service. This consists of loop, port, usage, signaling, and transport. The FCC looks at the loop and non-loop components (non-loop components consist of

[26] Memorandum Opinion and Order, Application of Verizon Pennsylvania Inc., Verizon Lone Distance. Verizon Enterprise Solutions. Verizon Global Networks Inc.. and Verizon Select Services Inc. for Authorization to Provide In-Region. InterLATA Services in Pennsylvania, 16 FCC Rcd 17419 ¶ 64 **(2001).**

[27] Comments of XO California, Inc. at 9, Application by SBC Communications. Inc.. Pacific Bell Telephone Company, and Southwestern **Bell** Communications Services, Inc. for Provision of In-Region. InterLATA Services in California, WC Docket No. **02-306** (FCC filed Oct. 9,2002).

port, usage, signaling and transport) separately. There are two major reasons that the FCC does not **use** other loop facilities in its benchmark comparison, 1) the USF model **does** not develop costs for DS1 or DS3 UNE loops, and 2) the costs developed by the USF model are for basic residential telephone service. Typically, DS1 and DS3 services are purchased by business customers; therefore, using the benchmark comparison as done by XO is completely inconsistent with the aim of the benchmark comparison for approval of 271 applications. XO's request that Pacific should extend its California-Texas "benchmark" analysis to DS1 and DS3 loops should be rejected by the FCC.

CONCLUSION

27. AT&T and its declarants', **Messrs.** Lieberman and Pitkin, arguments for not using Texas as the appropriate state for the benchmark analysis is simply not supported by their arguments. The FCC has consistently stated that Texas rates are TELRIC compliant, and of **the** four-part test, TELRIC-compliance is the most important.

28. XO California's use of part of the benchmark comparison (XO California only compares rates, not costs) to show a comparison between Texas and California DSI and DS3 loop rates is completely inappropriate. The benchmark analysis is not extended to other loop facilities because 1) the HCPM cost model does not develop costs for DS1 or DS3 loops, and 2) the benchmark analysis is used to compare residential local service. This would not include DS1 or DS3 loops. XO California's suggestion that **the** benchmark analysis be extended to include other loop facilities is completely unfounded and should be rejected by the Commission.

29. Pursuant to Part II. E. of the Consent Decree entered into between SBC Communications Inc. and the Federal Communications Commission (see Order, SBC Communications, Inc., 17 FCC Rcd 10780 (2002)), I hereby affirm that I have (1) received the training

SBC is obligated to provide to all SBC FCC Representatives; **(2)** reviewed and understand the SBC Compliance Guidelines; **(3)** signed an acknowledgment of my training and review and understanding of the Guidelines; and (4) complied with the requirements of the SBC Compliance Guidelines.

30. This concludes my reply affidavit.

STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS)

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

Executed on **October 28,2002.**

Thomas J. Makarewicz

Thomas J. Makarewicz

Subscribed and sworn to before me this 28th **day of** October, 2002.

Cynthia J. Housley

Notary Public

CYNTHIA J. HOUSLEY
Notary Public – Notary Seal
State of Missouri
County of Jefferson
My Commission Expires Feb 21, 2005