Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition for Forbearance From the Current Pricing Rules for the Unbundled Network Platform	)	WC Docket No. 03-157

OPPOSITION OF AT&T CORP.

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Pursuant to the Commission's Notice,[1] AT&T Corp. ("AT&T") hereby respectfully submits this Opposition to the July 1, 2003 Petition for Expedited Forbearance of the Verizon Telephone Companies.

INTRODUCTION AND SUMMARY

Rarely has a request for Commission action come bearing so *many* obvious and fatal defects. Verizon's "forbearance petition" does not seek forbearance, instead it seeks affirmative rulemaking relief that is foreclosed by statutory provisions and Commission and court decisions almost too numerous to list. It is, in truth, more a policy piece than a serious legal petition. Verizon is perfectly aware that the Petition must be denied, but apparently hopes to gain advantages in other proceedings by reminding us that it really, *really* does not like cost-based UNE-P: cost-based UNE-P, after all, forces Verizon to compete for millions of local telephone customers over whom it would otherwise enjoy monopolies, and monopolies are terrible things to lose.

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[1] *See* Public Notice, DA 03-2189 (July 3, 2003); Order, WC Docket No. 03-157 (July 15, 2003).

Verizon's war on cost-based UNE-P is now in its eighth year. In the early years, Verizon scoured the 1996 Act and the Constitution in search of a legal objection to cost-based UNE-P. Bellowing catchy slogans like "sham unbundling," Verizon pressed its arguments at the Commission, at state commissions and, ultimately, at the Supreme Court. Verizon lost.

Verizon shifted to policy objections. Verizon labeled cost-based UNE-P "the single most bizarre policy imaginable,"[2] and consultants and media advisors joined the lawyers in a campaign to demonize cost-based UNE-P as the source of all of the industry's (and, indeed, the economy's) woes. Cost-based UNE-P, we were told, threatens not only investment (including everyone's darling, broadband investment), but also regulatory parity and even national security. At the cost of more than a few academic reputations, dozens of economic and policy papers were commissioned to show that cost-based UNE-P fosters only "bad" competition. The new arguments were refined in seminars, press conferences, the halls of Congress and even the public airwaves, all culminating in the *Triennial Review* proceeding. There, Verizon did its best to come up with some real-world rationale for the Commission to "de-list" at least one element – *any* element – of the UNE-P. Verizon lost.

But Verizon's leaders have apparently ordered the troops to concoct still more challenges to cost-based UNE-P in a campaign Verizon's Vice-Chairman has dubbed: "Kill those little suckers."[3] Unfortunately for Verizon, seven years of strip-mining the available legal and policy arguments have left it precious little with which to work. And Verizon's advocacy has reached a new low with this "forbearance" Petition – which urges the Commission to promulgate new rules that would put an immediate *end* to cost-based UNE-P as a "small interim step," Petition at iii,

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[2] *See* Communications Daily, September 10, 2002.

[3] *See* TR Daily, January 7, 2003.

while the Commission considers in a forthcoming rulemaking proceeding whether it should reform the UNE cost standard. The Petition must be denied.

To begin with, the Petition is not a proper section 10 forbearance petition at all, for it does not seek non-enforcement of *existing* rules, but promulgation of entirely *new* compensation and use restriction rules. Changing rules in this section 10 proceeding (and in the absence of even a notice of proposed rulemaking) would be a most blatant violation of the Administrative Procedure Act ("APA"), as the Commission has already expressly ruled in rejecting previous attempts (by Verizon's own predecessors) to shoehorn rulemaking requests into forbearance petitions.

But even if Verizon could play fast and loose with section 10 and the APA, the Commission has, once again, already expressly determined that the particular rules that Verizon urges the Commission to adopt are foreclosed by the Act's plain language. Congress directed that UNE prices "shall" be "based on the cost" of providing them, 47 U.S.C. § 252(d)(1), and whatever can be said about Verizon's proposal to use "resale" pricing when UNEs are used in the UNE-P combination, it cannot be said that such pricing is cost-based. The Petition does not even bother to claim otherwise, because the Petition really has nothing to do with UNE rates, but is simply a repackaging of Verizon's old standby that UNE-P should be outlawed altogether as a sham and a "fiction" that is "largely identical to a resale arrangement." *See* Petition at 16. Numerous courts have ruled that these "sham unbundling" claims are entirely foreclosed.

As for the proposed use restriction – a patently anticompetitive and unlawful rule that would prohibit competitive carriers from using the UNE-P combination of elements to provide exchange access services – Verizon does not even go through the motions of constructing a legal argument. Exchange access services are undeniably telecommunications services. Thus, as the

Commission has thrice held, section 251(c)(3)'s commands that Verizon must provide nondiscriminatory access to UNEs "for the provision of a telecommunications service" and that it must do so "in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service" (47 U.S.C. § 251(c)(3)) are "plain" and "not ambiguous" in entitling competitive carriers to "purchase unbundled elements for the purpose of offering exchange access service." *Local Competition Order*, 11 FCC Rcd. 15499, ¶¶ 356, 359 (1996). The Petition never even addresses the controlling statutory language.

The Petition suggests that these clear legal infirmities could be overlooked if the Commission labels the new rules "interim." That is silly. As the very authorities upon which Verizon relies expressly state, the time for legitimate "transitional" relief to implement the 1996 Act has long since passed. In the wake of the Act's passage in 1996, the Commission was faced with an imminent and "extraordinary upheaval" created by inconsistent statutory deadlines. Here, the Commission is confronted only with the discomfort that competition has inevitably caused for a monopolist. As the courts have admonished the Commission, an "interim" label cannot insulate a rule from review for consistency with the statute it purports to implement. *See*, *e.g.*, *CompTel* v. *FCC*, 87 F.3d 522, 531 (D.C. Cir. 1996) ("[t]he proper judicial response to an interim rule is not to abdicate responsibility but rather to review it"). And, as the Petition itself makes clear, the proposed "interim" rules (complete *repeal* of cost-based UNE-P) are entirely divorced from the permanent relief (mere *reform* of the TELRIC cost standard) upon which Verizon seeks to justify those interim rules.

These are only the beginnings of the Petition's many, many incurable problems. The Commission could not grant even a *proper* forbearance request seeking non-enforcement of existing regulations implementing section 251(c), because a separate statutory "limitation," section 10(d), which the Petition acknowledges only in a footnote, bars the Commission from even applying the section 10(a) forbearance criteria to UNE-related rules until the "requirements" of sections 251(c) and 271 "have been fully implemented." Verizon attempts to tiptoe around this problem by claiming that its Petition addresses only regulations, which are not "requirements" of the Act. But like so many of the Petition's arguments, this one, too, runs aground on the statute's language, which makes clear that the "requirements of section 251 . . . includ[e] the regulations prescribed by the Commission." 47 U.S.C. § 252(e)(2)(B). The Act could hardly state otherwise, as an implementing rule is inherently an agency's authoritative view of an Act's "requirements."

Verizon's alternative argument, that sections 251(c) and 271 have, indeed, been "fully implemented," is equally unimpressive. The term's plain dictionary meaning demands a finding that those statutory requirements have been "carried into effect" "totally or completely," an impossibility in present circumstances, given ongoing development of and challenges to the relevant requirements, state commissions' ongoing efforts to implement section 251(c) (what are they doing at great cost and burden if not "implementing" the section?), and, most pertinently, the developing state of still-nascent local competition. Reading section 10(d) to permit repeal of the core regulation that makes intramodal competition possible long before ubiquitous intermodal competition – the only development that could make that regulation unnecessary – would produce the proverbial and prohibited "absurd result." Verizon's only response is that the Commission must pay tribute to the canon of statutory construction that identical words used in different parts of the same act generally are assumed to have the same meaning. As the D.C. Circuit recently ruled (against Verizon and in a forbearance case), the same term used in multiple sections of the Act most certainly can be interpreted differently – and should, where, as here, mindless consistency would produce an "absurdity." *Cellular Telecomm. & Internet Ass'n* v. *FCC*, 330 F.3d 502, 510-12 (D.C. Cir. 2003) ("*CTIA*").

But even if the Commission could entertain Verizon's Petition as a valid invocation of the Commission's section 10(a) forbearance authority, Verizon has not remotely met its burden to prove that its request satisfies the section 10(a) criteria. Because Verizon wants *new* rules and does not identify any specific existing rules that it believes should no longer be enforced, it obviously does not attempt what is required: to show why non-enforcement of *specific* regulations would satisfy the three statutory criteria. Instead, the Petition speaks abstractly of forbearance from the "current pricing rules for UNE-P." But there are no current pricing rules for UNE-P. Rather, there are current Commission rules that the States apply to determine the prices for *individual* UNEs, *see* 47 C.F.R. § 51.501 *et seq.*, and there are entirely separate Commission rules that prohibit Verizon from separating requested UNEs that it currently combines, *see id*. § 51.315. If anything, the Petition targets the "combinations" rules, but it does not even mention those rules, much less address them under the Section 10(a) framework. Verizon has likewise defaulted on its "alternative" request for "access charge forbearance," for that proposed use restriction is in no sense a UNE *pricing* rule.

Verizon falls far short of its section 10(a) burden on many other levels as well. The section 10 criteria understandably focus on the protection of consumers and competition. Even if the Petition actually sought forbearance from some specific rule, Verizon could not hope to show that repealing cost-based UNE-P would serve consumers or competition. Most obviously, it would hardly "enhance competition among providers of telecommunications services," 47 U.S.C. § 160(b), to give in to a monopolist's demand that the Commission wipe out what is, in most local markets, the *only* significant competitive mass-market alternative to the incumbent.

The relief sought in the Petition would deprive literally *millions* of consumers of their chosen local telephone service and, for most, would put an end to local telephone choice altogether. Nor could Verizon's proposal to end cost-based UNE-P conceivably "ensure that the charges . . . are just and reasonable and not unjustly or unreasonably discriminatory," 47 U.S.C. § 160(a)(1), given that Congress has directed that the *only* just and reasonable rates in this context are cost-based rates. *See id*. § 252(d)(1) ("Determinations by a State commission of the just and reasonable rate[s] . . . shall be . . . based on the cost" of providing requested elements). As detailed below, the Petition fails Section 10(a) in many additional respects.

Both the Commission and the Supreme Court have repeatedly recognized the strong connection between making cost-based UNEs available for the provision of any telecommunications service and the Act's core goals of fostering competition, ensuring just, reasonable and nondiscriminatory rates and protecting consumers – and they have done so in the face of the same misguided policy arguments that Verizon repeats in the Petition. It would take an extraordinary evidentiary showing to demonstrate that these Commission rules have suddenly become such a menace to consumers, competition and even, apparently, "national security," *see* Petition at 24, that emergency forbearance is warranted. The Petition, for obvious reasons, steers clear of any such showing.

Instead, the Petition assumes the role of policy white paper in an attempt to convince the reader of three propositions that Verizon contends establish the consummate evil of cost-based UNE-P. First, the Petition points out that UNE rates generally are lower now than in 1996, a trend which Verizon attributes to a vast state conspiracy to disregard the Commission's rules, rather than to its true causes: state commissions' discovery and correction of Verizon's cost study duplicity in the initial round of UNE rate cases, substantial real-world cost reductions in switching and other electronic equipment, and *Verizon's* own proposals to reduce its UNE rates by as much as 50%. *See* Attachment C hereto. The downward trend in UNE-P rates since 1996 is evidence that the rate-setting process is beginning to work, not that it has failed. And if state commissions were failing to apply TELRIC correctly, the proper remedy would be to ask reviewing courts to enforce TELRIC, not, as Verizon suggests, for the Commission to jettison it.

Second, the Petition contends that in telecommunications, unlike all other fields, *post hoc ergo propter hoc* (literally, "after this, therefore because of this") is *not* a logical fallacy, and that declining investment flows and all manner of other supposed industry ills must, given their timing, necessarily be attributed to declining UNE rates. Even apart from the sophomoric logical flaws in its own "analysis," Verizon simply ignores the vast body of *actual* econometric evidence that the competition fostered by lower UNE prices causes (as basic economic principles predict) *increased* investment by incumbent and competitive carriers alike.

And third, the Petition contends that it is so badgered by cable telephony, wireless, VOIP, and, of course, "instant messaging" competition, Petition Att. B. at 27, that all of this consumer protection regulation is really quite unnecessary. But the future world of intense intermodal competition that Verizon hypothesizes plainly does not relieve it of the ability and incentives to abuse substantial market power today.

Citing promotional claims for "arbitrage opportunit[ies]" offered by "telecom consultants," the Petition also carries on about the allegedly "excessive" margins produced by cost-based UNE-P. Petition, Att. B at 18-19 & nn.75-78. But entire "cottage industries" of "consultants," however, also promise lucrative returns from penny stocks, Ponzi schemes, and Nigerian advance-fee frauds. Only the gullible take these offers seriously. If entry by UNE-P were as profitable as Verizon contends, Verizon would be rushing to expand outside its footprint via UNE-P instead of sinking tens of billions of dollars annually in its own network (at the same time that it claims here that it will not – cannot – invest). *See* S. Rosenbush, *Business Week,* at 53-55 (Aug. 4, 2003) ("Verizon plans to roll out fiber-optic connections to every home . . . . How can Verizon pay for all this? Its business is one of the great cash machines of Corporate America"). In all events, the Petition neither does, nor could, identify any lawful means for Verizon's policy views, whatever their merits, to overcome the Petition's myriad fatal legal defects.

There can be no serious question that the Petition must be denied. But it is quite troubling that Verizon felt the need to force the Commission to go through the motions of conducting a proceeding to reach that inevitable result. The Petition squanders Commission and industry resources that could, and should, be devoted to far more important and pressing matters: *e.g.*, to address fundamentally flawed intercarrier compensation and universal service regimes that are literally collapsing at the Commission's feet and special access monopoly abuses that have reached truly historic proportions and now threaten existing competition in both wireline and wireless markets. Cost-based UNE-P is one of the great success stories of the 1996 Act – thanks to heroic efforts of the Commission and state commissions faithfully to implement and enforce section 251(c), more than 10 million Americans now enjoy local telephone competition and choice. The Commission should recognize the Petition for what it is – another baseless effort by Verizon to destroy any real threats to its local monopolies – quickly dispose of it, and devote its resources to the real problems facing the industry today.

ARGUMENT

I. VERIZON'S PETITION SEEKS RELIEF THAT IS BEYOND THE COMMISSION'S FORBEARANCE AUTHORITY AND THAT THE COMMUNICATIONS ACT OTHERWISE FORECLOSES.

A. Verizon's Petition Should Be Dismissed, Because Verizon Is Not Seeking Forbearance, But Rather The Promulgation Of New And Different Rules.

Although styled as a petition for "forbearance" from "applying" regulations, Verizon's petition makes clear that it actually seeks a profound *change* to existing Commission rules. New rules can be adopted and old rules replaced, of course, only through a formal rulemaking proceeding. *See, e.g., Sprint Corp.* v. *FCC*, 315 F.3d 369, 374 (D.C. Cir. 2003) ("new rules that work substantive changes in prior regulations are subject to the APA's procedures"). Until that time, the Commission remains bound by its rules. Verizon cannot even point to any Commission application or "enforcement" from which it seeks forbearance. Because Verizon does not seek forbearance, its "forbearance" petition must be dismissed.[4]

For both types of relief it requests, Verizon seeks a *new* or *changed* rule rather than a determination that the Commission simply "shall forbear from applying any regulation or any provision of this Act," which amounts to a lack of "enforcement of such regulation or provision." 47 U.S.C. § 160(a). In relation to charges for UNE-P, Verizon candidly seeks a Commission "determin[ation] that, when a competitive carrier purchases a platform of all the elements

[4] Verizon's petition is not even correctly styled as a forbearance petition, a failure that means that the usual statutory period for acting on the petition does not apply. *Compare* Pet. cover page (no reference to 47 U.S.C. § 160(c)) *with* 47 C.F.R. § 1.53 (only a petition "identified in the caption of such pleading as a petition for forbearance under 47 U.S.C. § 160(c)" shall be treated as a forbearance petition for purposes of section 160(c) and "subject to the deadline set forth therein"); 65 Fed Reg. 7460-01 (Feb. 15, 2000) (true forbearance petition for purposes of section 160 must be "clearly identified in the caption as a petition for forbearance under section 10(c) of the Act"). The Public Notice issued by the Commission likewise makes no mention of 47 U.S.C. section 160(c) in either the caption or the description of Verizon's Petition. Public Notice, DA 03-2189 (July 3, 2003).

necessary to provide service, the level of compensation to which the incumbent is entitled is no lower than it would receive under the Act's resale pricing standard." Petition iii; *see id.* at 13-14. Similarly, in relation to requested use restrictions affecting competing carriers' rights to use UNE-P to provide one type of telecommunications service, exchange access services, Verizon seeks to have the Commission "adopt interim measures" to "condition the continued availability of UNE-P at TELRIC rates on the payment by long distance carriers of per-minute access charges to the incumbent." *Id.* at 12, 15; *see id.* at 17, 18.

As section 10 confirms, forbearance, by definition, is a decision to decline to enforce a statutory provision or regulatory rule. *See, e.g.*, Webster's II (defining "forbear" as "to refrain from" or "to desist from"). Section 10 itself frames the test for forbearance in terms of "enforcement" of an *existing* "regulation" or "provision" of the Act, 47 U.S.C. § 160(a)(1), (2); *see also id.* § 160(a) ("forbear from *applying* [a] regulation") (emphases added), and its core test is whether the Commission should desist from "enforcement of such regulation or provision," *id.* § 160(a)(1), (2). This sharply contrasts with an exercise of rulemaking authority, which is required for changes to rules and which triggers the notice and other requirements of the Administrative Procedure Act. *See, e.g.*, 5 U.S.C. §§ 551(5); 553 ("'rule making' means agency process for formulating, amending, or repealing a rule"). Even Verizon does not (and could not) contend that, by enacting section 10, Congress repealed the APA or otherwise altered the Commission's obligations to revise its rules through new rulemakings proceedings.

The Commission has repeatedly enforced the distinction between true forbearance petitions, which fall within section 10, and requests for new rules, which are subject to notice and comment procedures (and not subject to the statutory deadline of section 10(c)). In 1996, Verizon's predecessor NYNEX filed a request styled as a "petition for forbearance" asking the

Commission to "forbear" from applying the Commission's Part 36 separations rules and to "instead apply a simple, fixed factor by state" in order to separate inter- and intrastate costs.[5] The Commission denied NYNEX's petition, finding that its request "goes beyond mere forbearance from regulation and instead requests" a substantial amendment of existing regulations.[6] The Commission reasoned that it was unlawful to "use . . . the Commission's forbearance authority" to "replac[e]" rules "with new ones without the notice and comment required by the Administrative Procedure Act."[7] Verizon's Petition clearly "conflates" these "distinct" Commission actions, and is in fact a request to promulgate new rules. *2002 Biennial Regulatory Review*, 18 FCC Rcd. 4726, ¶ 27 n.59 (2003).

Indeed, the Petition is structured as a justification for a rulemaking, not forbearance. Section III of the Petition (at 12-18) argues that the Act provides "authority to *adopt* [the] interim measures" that Verizon seeks. *Id.* at 12 (emphasis added). If the petition truly sought *non-enforcement* of particular requirements – which is what a forbearance determination would provide – then establishing the statutory authority to grant the relief requested (*i.e.,* adoption of interim rules) would be entirely superfluous.

Finally, the Petition does not even identify regulations that the Commission does now "enforce[]" and *could* therefore decline to enforce. 47 U.S.C. § 160(a). The Commission has already promulgated relevant rules regarding UNE pricing, UNE combinations, and use

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[5] *In the Matter of New England Tel. & Telegraph Co. and N.Y. Tel. Co. Petition For Forbearance From Jurisdictional Separation Rules,* 12 FCC Rcd. 2308, ¶ 5 (1997).

[6] *Id.* ¶ 12.

[7] *Id.* ¶ 13. *See also In the Matter of Petition for Forbearance From Enforcement of Section 54.709 and 54.711*, 16 FCC Rcd. 4382, ¶ 6 & n.16 (2001); *In the Matter of Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, 17 FCC Rcd. 27000, ¶ 31 (2000) (holding that an affirmative request for changes in regulatory treatment "unlike [a] forbearance request, is not subject to a statutory timetable").

restrictions. The parties have implemented those rules in interconnection agreements, and states have applied and continue to apply and enforce them. Except in the very unusual case where a state fails to act and the Commission must arbitrate agreements under section 252(e)(5) (which is not the object of Verizon's petition), there is simply no occasion for the Commission to "forbear" from applying or enforcing any of these rules. This is yet an additional reason why Verizon's petition does not seek forbearance and must be dismissed.

B. The Plain Language Of Section 251(c) Precludes The "Interim" Rule Changes That Verizon Seeks.

Even if bedrock APA requirements did not preclude the Commission from using a forbearance proceeding to replace the formal rulemaking that would be required to change its rules, it could not grant the relief that the Petition requests. That is because the plain text of the Act precludes the particular rule changes that Verizon seeks – as the Commission's own prior decisions make abundantly clear.

1. Verizon's Request For A Rule That UNE Rates Must Be Based On Retail Rates, Not Costs, When UNEs Are Combined Violates The Act.

Verizon first urges the Commission to promulgate new regulations that would require competitive carriers to pay "resale" rates, rather than cost-based rates, whenever they use those UNEs (that would otherwise be sold at TELRIC-based rates) in the particular UNE-P combination. That rule is foreclosed by the plain text of the Act, which requires that the rates for individual UNEs, however they may be combined, "shall be . . . based on the cost . . . of providing" them. 47 U.S.C. § 252(d)(1). Moreover, the Petition make no real effort to hide that Verizon's arguments here are really just an attempt to resurrect its earlier claim that that UNE-P is a "regulatory fiction" that is "largely identical to a resale arrangement." Petition at 16. That, too, is a position that the Commission and courts have repeatedly and definitively rejected as flatly inconsistent with the Act's plain terms.

UNE-P is simply a label for a particular combination of individual network elements. Rates for each of the individual network elements that comprise UNE-P, as the Act expressly states, "shall" be "based on the cost" of providing "the" requested element. 47 U.S.C. § 252(d)(1). The Commission – twice affirmed by the Supreme Court – has determined that UNE-P is a permissible combination of individual UNEs and that "cost" means forward-looking economic costs. The Act thus forecloses Verizon's request here that the Commission instead authorize Verizon to apply the Act's resale pricing standard, which, by its explicit terms, bases rates on prevailing "retail rates" that bear no necessary relation to the costs of providing the requested elements. 47 U.S.C. § 252(d)(3). Put simply, once elements have been found to meet the "impairment" standard of section 251(d)(1), and therefore must be unbundled pursuant to section 251(c)(3), the rates for access to those elements must be "based on the cost" of each element, *not* on the incumbent carrier's retail rates. *See Local Competition Order* ¶¶ 878-89, 907-10.[8]

In truth, of course, the Petition is just another none-too-subtle attempt to resurrect the "sham unbundling" argument that that the Commission and the courts have repeatedly and definitively rejected. Since the Commission first announced its TELRIC and UNE combination regulations, Verizon and other incumbents have sought to challenge those rules, raising the same basic claim that Verizon makes here: that UNE-P is not "really" the use of unbundled elements, but simply a variant of resale. The argument has proven spectacularly unsuccessful.

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[8] In the *Local Competition Order* (¶ 708) the Commission rejected a similar Verizon request that network element rates be set on the basis of the Efficient Component Pricing Rule ("ECPR") because the resulting network element rates would be based on "existing retail prices" and would, therefore, not be "cost-based" as required by section 252(d)(1) – a ruling expressly endorsed by the Supreme Court. *See Verizon Communications, Inc.* v. *FCC*, 535 U.S. 467, 513-14 (2002) ("*Verizon*").

In the Eighth Circuit, for example, incumbents sought to vacate the provisions of the *Local Competition Order* (¶¶ 328-41) that permitted new entrants to offer local service "entirely by acquiring access to . . . unbundled elements." *Iowa Utils. Bd.* v. *FCC*, 120 F.3d 753, 814 (8^{th} Cir. 1997). The incumbents argued that, by allowing competitive carriers to acquire customers using UNEs at "the less expensive cost-based rate," but "without achieving any true gain in efficiency or technology," the Commission's rule "enables competing carriers to circumvent" the Act's resale provisions. *Compare id. with* Petition at 16 (arguing that UNE-P "allows a competitive carrier to pay TELRIC rates rather than the wholesale rates prescribed by statute for what amounts to a resale arrangement"). The Eighth Circuit, affirmed by the Supreme Court, rejected the argument, holding that section 251(c)(3) plainly permits competitive carriers to provide telecommunications services entirely through the use of UNEs. *Iowa Utils. Bd.*, 120 F.3d at 814-15, *aff'd*, *AT&T Corp.* v. *Iowa Utils. Bd.*, 525 U.S. 366, 392-93 (1999).

Similarly, in numerous appeals of state arbitrations of interconnection agreements, Verizon and other incumbents repeatedly contended that the agreements' provisions requiring UNE-P were in fact "sham unbundling" that was unlawful and not consistent with the Act.[9] The weight of decisions against this position grew so great that those claims were routinely dismissed as frivolous. *MCI v. BellSouth,* 112 F. Supp. 2d at 1298 (issue was "definitively resolved" against the incumbents by the Supreme Court); *AT&T Comm.* v. *GTE Florida, Inc.*, 123 F. Supp. 2d 1318, 1326 (N.D. Fla. 2000) (same); *Southwestern Bell Tel. Co.* v. *AT&T Comm.*, 1998 WL

[9] *See, e.g.*, *MCI Telecomm. Corp.* v. *BellSouth Telecomm., Inc.*, 112 F. Supp. 2d 1286, 1298 (N.D. Fla. 2000) ("*MCI v. BellSouth*") (incumbent carriers claim that requirement that incumbents provide "'recombined' unbundled network elements, thus in effect allowing [competitive carriers] to purchase complete service from [the incumbent] not at the wholesale price properly charged in connection with the sale of complete service for resale, but instead at the substantially lower price determined by adding up the prices of the various unbundled network elements that, when combined, constitute complete service"); *cf*. Petition at 16.

657717, *7-8 (W.D. Tex. Aug. 31, 1998) (incumbents' "'sham unbundling' and '*de facto* resale' arguments" are "entirely foreclosed"); *U S West Comm., Inc.* v. *Hix*, 93 F. Supp. 2d 1115, 1125 (D. Col. 2000) (all "other federal district courts that have addressed 'sham unbundling' claims by incumbents" have rejected them; citing eight other district court cases). Verizon's "sham unbundling" argument has not improved with age; it remains "entirely foreclosed."[10]

2. Verizon's Request For A New Rule Prohibiting Competitive Carriers From Using The UNE-P To Provide Exchange Access Services Violates Section 251(c)(3).

The Commission also could not lawfully grant Verizon's proposed "alternative" relief of prohibiting competitive carriers from collecting access charges when they provide exchange access services using network element combinations such as UNE-P. To the contrary, the plain terms of section 251(c)(3) – which Verizon never discusses or even cites – forbid any such rule.

Section 251(c)(3) provides that Verizon and other incumbent carriers have the "duty to provide, to any requesting telecommunications carrier *for the provision of a telecommunications service*, nondiscriminatory access to network elements." 47 U.S.C. § 251(c)(3) (emphasis added). Further, an incumbent carrier "shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such *telecommunications service*." *Id*. (emphasis added). As the Commission recognized in 1996 and re-affirmed the following year and again in 1999, this language is "not ambiguous," and "its plain meaning" dictates that competitive carriers are entitled to "purchase unbundled elements

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[10] Moreover, Verizon fails to mention the upheaval that would follow even if the Commission did have authority to revive and grant these claims. The Commission relied on the existence of UNE-P at TELRIC rates in section 271 cases to determine that BOCs could not engage in price squeezes and that the public interest prong of section 271 was therefore be met. These holdings would have to be revisited if, as Verizon seeks, the costs of UNE-P are increased.

for the purpose of offering exchange access service."[11] Verizon seeks to have the Commission ignore, rather than apply, the statute's clear terms.[12]

The Commission was absolute on this point in 1996, 1997 and 1999, and it was absolutely correct. The Commission's reading is "compelled by the plain language of the 1996 Act" because access services are plainly "telecommunications services" and because section 251(c)(3) clearly states that requesting carriers can use UNEs – either singly or in combinations – to provide *any* telecommunications services.[13] As Qwest recently explained: "[w]ith respect to UNE rights under section 251(c)(3), the question . . . is whether the *requesting party* is a "telecommunications carrier" and whether the service *it* wishes to provide using the UNE at issue is a "telecommunications service."[14] Here, the answer to both questions is clearly "yes," and the Act itself requires that competitive carriers using UNEs or UNE combinations, including UNE-P, are entitled to provide exchange access services and to collect exchange access charges

[11] *Local Competition Order* ¶¶ 356, 359; *id.* ¶ 721 ("nothing on the face of sections 251(c)(3) and 252(d)(2) compels telecommunications carriers that use unbundled elements to pay [access] charges"); *Access Charge Reform*, 12 FCC Rcd. 15982, ¶¶ 337-40 (1997); *UNE Remand Order*, 15 FCC Rcd. 3696, ¶ 484 (1999); *see also* 47 C.F.R. § 51.309(b) (a "telecommunications carrier purchasing access to an unbundled network element may use may use such network element to provide exchange access services to itself in order to provide interexchange services to subscribers").

[12] *Local Competition Order* ¶ 359 (Verizon request to collect access charges asks "in effect, that we should read into the current statute a limitation on the ability of carriers to use unbundled network elements;" the "fact" is that "no such limitation" exists in the Act).

[13] *Local Competition Order* ¶ 356. Indeed, in contexts where it suits Verizon's interests, Verizon itself claims that "[w]hen a CLEC provides service over an unbundled loop, Verizon no longer has a legal right to provide *any* service over that line" and that once competitive carriers purchase "unimpeded access to the entire loop, CLECs – not Verizon – control which services they provide." Verizon Mem. In Support of Def's. Motion to Dismiss, at 1, *Greco* v. *Verizon Communications Inc., et al.*, 03 Civ. 0718 (KMW) (S.D.N.Y. filed Apr. 29, 2003).

[14] Comments of Qwest, CC Docket No. 02-33, at 21 (May 3, 2002).

from their exchange access customers.[15]

Verizon's proposal would also violate the Act's requirement that incumbent carriers provide network elements, including combinations, on "nondiscriminatory" terms. 47 U.S.C. § 251(c)(3). When Verizon uses its facilities to provide a customer's local retail service, Verizon collects any applicable access charges from long distance carriers. But, under Verizon's unlawful proposal, competitive carriers using those same facilities as network elements to provide the same services would not be able to do so.[16]

And, as the Commission has previously held, allowing Verizon to collect both UNE charges and access charges for the same facilities would guarantee that it over-recovers its costs and thus would violate the requirement of just and reasonable rates in sections 251(c)(3) and 201. As Verizon admits, the Commission has concluded that TELRIC-based UNE rates provide "*full compensation* to the incumbent LEC for use of the network elements," *see* Petition at 16; *Local Competition Order* ¶ 721. Verizon nonetheless claims that allowing it to collect access charges in addition to UNE charges would not provide double recovery, because Verizon would "collect only one *usage-based* charge for each call:" per-minute access charges from IXCs for long

[15] Further, the terms of the Act also are clear that there could be no different result when competitive carriers use combinations of network elements, like UNE-P, because section 251(c)(3) "does not impose restrictions on the ability of requesting carriers" to employ UNE combinations to provide any "telecommunications service." *Local Competition Order,* ¶ 359; *see also* 47 C.F.R. §§ 51.309(a), 51.315(a); *UNE Remand Order* ¶ 492 ("for *all* unbundled network elements, including combinations of network elements, incumbent LECs may not impose any usage restrictions on the use of such elements, or combinations thereof.").

[16] Nor, as Verizon claims (at 20), could the practice be permissible merely because Verizon would favor itself and discriminate equally against all competitive carriers. *See Local Competition Order* ¶¶ 217-18, 312, 315. As the Commission has repeatedly explained, the term "nondiscriminatory" in section 251 has a "more stringent" meaning than the term "unreasonable discrimination" in section 202; thus, section 251's nondiscrimination duty requires that incumbent carriers provide access to network elements on terms that are "equal . . . to that which the incumbent LEC provides to itself." *Id.* ¶¶ 217, 312; *see also* 47 C.F.R. § 51.313(b).

distance calls and per-minute UNE charges from competitive carriers for local calls. Petition at 16.

That is remarkably faulty logic, as Verizon well knows. In recognition of the fact that few, if any, of the costs of today's modern switches vary with usage, States increasingly require the use of *fixed* UNE port charges to recover costs that the Commission's price cap rules still allow the incumbent carriers to recover through usage-based exchange access charges. In Illinois, for example, *all* costs associated with switches that handle both local *and* long distance traffic are recovered through fixed monthly UNE charges – there are *no* usage-sensitive UNE switching charges.[17] A competitive carrier that leases the switching UNE in Illinois thus compensates the incumbent for *all* forward-looking costs of switching the competitive carrier's customer's local and long distance traffic, and an incumbent would plainly double recover if allowed to collect *any* exchange access charges in connection with that customer's long distance traffic. Although other states have adopted different rate structures, over-recovery is inevitable absent the fortuity that a state's rate structure requirements match the rate structures (*i.e.*, the split between usage sensitive and fixed rates) embodied in the Commission's price cap rules. *See Access Charge Reform* ¶ 337 (allowing incumbent carriers "to recover access charges" on UNEs "would constitute double recovery because the ability to provide access services is already included in the cost of access facilities themselves").

Moreover, the use restriction that Verizon seeks would require a radical restructuring of loop and other UNE rates, for if Verizon and *competitive carrier*s were to "share" loops in this fashion, *competitive carrier*s could not lawfully be assigned the full cost of the loop, as current

[17] *Illinois Commerce Comm'n* v. *Ill. Bell Tel. Co.*; *Investigation Into Tariff Providing Unbundled Local Switching With Shared Transport*, ICC Docket No. 00-700, 2002 Ill. PUC LEXIS 685, **8-14 (July 10, 2002) ("adopt[ing] [a] flat-rated ULS [unbundled local switching] charge").

UNE rates reflect. Rather, a portion of loop costs would have to be assigned to the incumbent to reflect the incumbent's use of the loop to provide exchange access services.

Having ignored the applicable section of the Act (section 251(c)(3)) that forecloses the relief it seeks, the Petition instead invokes another, wholly irrelevant provision. Verizon claims that section 251(g), which preserves the pre-1996 Act "equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation)" until the Commission supersedes such rules, supports its use restriction request. Once again, the Commission rejected this very argument in 1996, finding that section 251(g) is not intended to assure continued access payments to the incumbents, but rather to "preserve the right of interexchange carriers to order and receive exchange access." *Local Competition Order* ¶ 362.[18] Further, and contrary to Verizon's claims (at 15 n.33), the D.C. Circuit's holding that section 251(g) cannot preserve an obligation that did not exist prior to the 1996 Act applies with even more force here: unbundled elements and UNE-P did not exist prior to the 1996 Act; thus, there plainly could not have been any "pre-Act obligation relating to" competitive carriers' collection of access charges when they provide exchange access services via UNE-P. *See WorldCom, Inc.* v. *FCC*, 288 F.3d 429, 433 (D.C. Cir. 2002). Section 251(g) is quite plainly inapplicable here.

[18] For this reason, section 251(g) by its terms preserves requirements that ensured that access to incumbent carriers' networks would be equal as to all terms, "including receipt of compensation," but did not preserve compensation rules that do not arise from "equal access and nondiscriminatory interconnection restrictions and obligations."

3. Verizon Cannot Lawfully Justify The Impermissible Rule Changes As "Interim" Requirements.

Because Verizon's requested relief would so clearly violate the Act, Verizon apparently hopes to evade review for consistency with the Act by styling its request as one for merely "interim" relief.[19] Neither the Commission nor the courts are so easily duped. *See*, *e.g.*, *CompTel* v. *FCC*, 87 F.3d 522, 531 (D.C. Cir. 1996) ("[t]he proper judicial response to an interim rule is not to abdicate responsibility but rather to review it").

To support its claim, Verizon invokes (at 17-18) the Commission's 1996 decision to permit the incumbents, for a "specific, limited duration," to continue to charge certain usage-based access charges to purchasers of UNEs.[20] That decision only highlights the infirmity of Verizon's Petition. Nearly eight years have elapsed since the Act's passage, and any "transitional" authority the Commission may have had to impose such access charges on purchasers of UNEs has long since lapsed. As the Commission and Eighth Circuit emphasized, the basis for these transitional charges was the "unique" "dilemma" created by the Act's nine-month disparity in deadlines for Commission action to implement regulations under section 251 (August 8, 1996) and to reform universal service (May 8, 1997).[21] If the Commission did not institute some sort of interim access charge applicable for the nine month gap between the deadlines, it was readily "apparent that universal service soon would be nothing more than a memory." *CompTel*, 117 F.3d at 1074. In light of this imminent and "extraordinary upheaval,"

[19] Petition at i; *see id.* at iii (describing change to access rule as "a small interim step"), at 12 (requesting "interim measures" that last only "while [the Commission] completes its proceeding to reform" its pricing rules); *id.* at 17 (arguing that Commission could lawfully revise access rule for UNE-P, "at least on an interim basis").

[20] *See Local Competition Order* ¶¶ 720-22, *aff'd*, *CompTel* v. *FCC*, 117 F.3d 1068, 1073-75 (8th Cir. 1997).

[21] *Local Competition Order* ¶¶ 716-17, 721; *CompTel*, 117 F.3d at 1074.

the Commission permitted collection of access charges from UNE purchasers, but only as "a limited, transitional plan to address public policy concerns raised by bypass of access charges." *Local Competition Order* ¶¶ 356, 726.[22]

The Commission's limited authority to act in the face of conflicting – and since-expired – statutory deadlines plainly has no possible application here. On this record, there is no "dilemma" that could permit the Commission to adopt a rule, interim or otherwise, that so squarely violates the Act. Further, unlike the Commission's 1996 rule, which had a fixed and unalterable expiration date in order to "minimize the burden on competitive local service providers seeking to use unbundled network elements" (*Access Charge Reform* ¶ 339), Verizon's request for relief is unbounded. The rulemaking to address TELRIC has not even been initiated, and there is no timetable whatsoever for its completion.

In sum, the Petition must be dismissed as a procedurally and substantively improper attempt to obtain rule changes that are foreclosed by both the APA and the Act itself.

II. VERIZON'S PETITION IS PREMATURE AND CANNOT BE GRANTED, BECAUSE SECTIONS 251 AND 271 ARE NOT "FULLY IMPLEMENTED."

Verizon's petition must also be dismissed as premature. Section 10(d) places an explicit "[l]imitation" on the remainder of section 10, providing that the "Commission may not forbear from applying the requirements of section 251(c) or 271 . . . until it determines that those requirements have been fully implemented." 47 U.S.C. § 160(d). Because the Commission has never determined that sections 251(c) and 271 have been fully implemented – and plainly could not do so on the record provided here – it has no authority to grant a request that it forbear from

[22] The Commission found that " it is imperative" that this arrangement exist "only for a very limited period" and thus explicitly provided that these charges would end no later than July 30, 1997 and under "no circumstances . . . would be extended further." *Local Competition Order* ¶¶ 724-25.

applying any UNE-related requirements of section 251(c).

Verizon acknowledges this problem only in a footnote, arguing principally that the Petition does not trigger section 10(d). "[N]either TELRIC [n]or UNE-P" is a "requirement" of section 251(c) or 271, Verizon contends, because both are creatures of the Commission's *regulations* implementing those sections of the Act. *See* Pet. at 19 n.38. But the plain text of the Act makes clear that Congress used the term "requirement" broadly to include both the "provisions" of the Act *and* the Commission's implementing "regulations." For example, section 252(e)(2)(B) forbids a state commission from approving an interconnection agreement "if it finds that the agreement does not meet the requirements of section 251 of this title, *including the regulations prescribed by the Commission pursuant to section 251 of this title*." 47 U.S.C. § 252(e)(2)(B) (emphasis added).[23] That result would necessarily follow even in the absence of such a clear statement, however, because the Commission's rules are authoritative interpretations of the *Act*'s requirements. *See, e.g., Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984); *Chrysler Corp.* v. *Brown*, 441 U.S. 281, 296-96 (1979) (properly promulgated agency regulations "have the force and effect of law").

Indeed, the Commission has already recognized that the term "requirement" in section 10(d) applies both to "statutory provisions" and to "implementing regulations." Notice of Inquiry, *1998 Biennial Review*, 13 FCC Rcd. 21879, ¶ 32 (1998). In its *1998 Biennial Review*, the Commission stated that its regulations implementing section 251 – including its TELRIC rules, its rules on UNE combinations and UNE-P, and its prohibition against limiting competitive carriers from providing exchange access and other telecommunications services with network

[23] Likewise in section 251(b)(2), local exchange carriers are obligated to provide "number portability in accordance with the requirements prescribed by the Commission." 47 U.S.C. § 251(b)(2).

elements – constitute "requirements" of section 251(c).[24] Thus, any petition seeking forbearance from any of those requirements plainly must first establish the section 10(d) pre-condition that sections 251(c) and 271 have themselves been "fully implemented."[25]

Verizon claims in the alternative that "once a carrier receives long distance authority in a given state, the Commission itself has concluded that th[e] requirements [of section 251(c) and 271] have been fully implemented." Petition at 19 n.38. According to Verizon, the provision of section 271(d)(3)(A)(i) that precludes the Commission from approving a section 271 application until the BOC provides an interconnection agreement that "fully implements" the competitive checklist must also be interpreted as a finding that the BOC has "fully implemented" *all* of sections 251(c) and 271 immediately upon approval of a section 271 application. This is the quintessentially "absurd result" that must be avoided in interpreting every statute. Under Verizon's construction of section 10(d), the Commission could, the very *moment* after granting Verizon long distance authority premised on findings that Verizon's continuing compliance with sections 251(c) and 271 would open local markets up to the possibility of competition, end that

[24] Section 251(c)(3) states that incumbent carriers must provide UNEs at "rates" that are "just, reasonable, and nondiscriminatory" and that are "in accordance with . . . the requirements of this section and section 252." Thus, section 251(c)(3) both expressly provides that "just, reasonable, and nondiscriminatory" network element rates are a requirement of that provision and, by incorporation, that the "cost-based" pricing requirements of section 252 are a requirement of that provision. This express incorporation is likewise reflected in section 252(d)(1). That provision states that it governs "the just and reasonable rate for network elements for *purposes of subsection (c)(3)*." (Emphasis added).

[25] *See also Number Portability Order*, 17 FCC Rcd. 2578, ¶ 61 (2002) ("[T]he Commission has found that section 251(c)(3) requires incumbent LECs to price unbundled network elements under the TELRIC pricing methodology"); *Local Competition Reconsideration Order*, 12 FCC Rcd. 12460, ¶ 47 (1997) ("Section 251(c)(3) requires incumbent LECs to make available unbundled network elements at cost-based rates"); *Local Competition Order* ¶ 15 ("The statute addresses this problem [of incumbent control of bottleneck facilities] by creating an arbitration proceeding in which the new entrant may assert certain rights, including that the incumbent's prices for unbundled network elements must be 'just, reasonable and nondiscriminatory.' We adopt rules herein to implement these requirements of section 251(c)(3)").

possibility and return to the pre-Act "unregulated world" in which Verizon enjoyed an "almost insurmountable competitive advantage." *Verizon*, 535 U.S. at 490-91.

Not surprisingly, Verizon's position cannot be reconciled with section 10(d)'s terms, which require, at a minimum, the ubiquitous availability of cost-based wholesale alternatives to incumbent carriers' bottleneck facilities, such that the incumbent carriers would no longer be deemed dominant in local services markets. The word "implement" means "to carry into effect, fulfill, accomplish" and to "give practical effect to." And the word "fully" means "totally or completely." Webster's New World Dictionary. Sections 251(c) and 271 will be "fully implemented," therefore, when a practical effect results: namely, when ubiquitous and durable local competition *actually exists* and the incumbents no longer control bottleneck facilities. *Cf. Verizon,* 535 U.S. at 532, 538 (upholding Commission rules that interpret the "statutory dut[ies]" of section 251(c) to "reach the result the statute requires" and thereby "get[] a practical result").

The requirements of 251(c) and 271 are not fully implemented, according to the plain meaning of those terms, where, as is the case today, (i) final, unchallenged rules that implement the duties and obligations of section 251(c) are not currently in effect; (ii) the key cost principles that are used to determine prices for network elements and interconnection required to be provided under those sections are to be the subject of an upcoming Commission rulemaking; (iii) state commissions have yet to apply and "implement" any new rules (and, indeed, have not even finished implementing the prior rules); (iv) none of these new rules or pricing principles have been implemented in the interconnection agreements; and (v) local competition remains nascent, with no reason to believe that it could ever become robust if the Commission were now, as Verizon urges, to pull the rug out from under cost-based UNE-P. State commissions' varied regulatory activity confirms that section 10(d) is not satisfied: what are the commissions and parties before them doing, if not "implementing" section 251(c)'s requirements?[26]

Further, in the same section 271 decisions that Verizon claims the Commission has found the BOCs to have "fully implemented" sections 251(c) and 271 for purposes of section 10(d), the Commission has expressly stated that "obtaining section 271 authorization is *not* the end of the road" and that the "critically important power" in section 271(d)(6) "underscores Congress's concern that BOCs *continue to comply* with the statute."[27] The Commission could not have made these pledges in each of its section 271 orders if it were simultaneously finding that sections 251(c) and 271 have themselves been fully implemented.[28]

Verizon bases its interpretation of section 10(d) entirely on a "canon" of statutory construction that the courts have stressed in this context (and many others) cannot bear the weight that Verizon assigns it – namely, that identical words used in different parts of the same act generally are assumed to have the same meaning.[29] However, in interpreting the Communications Act, the courts and the Commission have on numerous occasions decided that

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[26] The Act also manifestly contemplates that the requirements of sections 251(c)(3) and 271 will endure long after a BOC receives section 271 authorization: section 271(d)(6) provides the Commission with a special grant of permanent enforcement authority if the BOC ceases to meet any of the section 271 requirements. That section empowers the Commission to act *sua sponte*, requires the Commission to act within 90 days on any complaint alleging a violation of section 271, and authorizes the Commission to suspend or revoke a BOC's section 271 authority. All of these post-authorization administrative remedies and enforcement powers could be rendered impotent if, as Verizon contends, the Commission's section 271 decisions necessarily must also be deemed to have determined that a BOC has "fully implemented" sections 271 and 251(c)(3) within the meaning of section 10(d).

[27] *New York 271 Order* ¶¶ 448, 453 (emphases added).

[28] Further, Congress provided that section 272, which is designed to protect against the BOCs' use of enduring market power to harm the interLATA market after receipt of section 271 authorization, would endure for a *minimum* of three years after authorization. It is ludicrous to suggest that Congress intended that sections 251(c) and 271, the cornerstones of the Act's provisions to open markets to competition, could be eliminated far earlier.

[29] *See Ex Parte* Letter from Ann Berkowitz, Verizon, to Marlene Dortch, FCC (CC Docket 01-338, July 24, 2003).

the same term used in multiple sections of the Act should be interpreted differently when, as here, there are different purposes underlying the sections in which the term are used. Thus, for example, the Commission refused to interpret the term "provide" in section 271(a) to reflect the construction it had given the same term in section 260(a). *AT&T Corp.* v. *Ameritech Corp.*, 13 FCC Rcd. 21438 (1998), *aff'd*, *U S West Comm. Inc.* v. *FCC*, 177 F.3d 1057 (D.C. Cir. 1999). Finding that the term was ambiguous and that the legislative history was unhelpful, the Commission interpreted "provide" based on the specific policies underlying section 271. The D.C. Circuit affirmed, reasoning that it was entirely appropriate for "identical words" to have "different meanings where the subject-matter to which the words refer is not the same in the several places where they are used, or the conditions are different." *U S West*, 177 F.3d at 1060.

Likewise, the D.C. Circuit, in recently upholding the Commission's interpretation of the term "necessary" in section 10(a), rejected the argument that the term "has precisely the *same* meaning in every statutory context." *CTIA*, 330 F.3d at 510-11. Previous constructions of the term "necessary" in sections 251(c)(6) and 251(d)(2) adopted by the Supreme Court and by another panel of the D.C. Circuit reflected the particular purposes of those sections, and thus the interpretation of "necessary" in those sections did not need to be imported into a controversy "involv[ing] the application of the forbearance provision of the 1996 Act," particularly where it would lead to "an absurd result."[30] *Id.* at 511.

These same principles apply to the construction of "fully implemented" in section 10(d), because, as described above, construing that term as the Commission construed the same term in section 271(d)(3)(A)(i) would lead to an absurd result and ignore the differing purposes of the

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[30] *See also The 2002 Biennial Regulatory Review*, 18 FCC Rcd. 4726, ¶¶ 18-21 (2003) (refusing to construe the term "necessary" in section 11 to mean the same as that term had been interpreted in other sections of the Act).

sections. Section 271(d)(3)(A)(i) requires only that the Commission find that a *BOC* has "fully implemented" the *competitive checklist* with regard to a single facilities-based interconnection agreement. It does *not* require a universal finding that sections 251(c) and 271 have themselves been fully implemented by all relevant parties – the state commissions, the BOCs, competing carriers, the Commission itself and federal courts – as section 10(d) requires. For example, a finding that a BOC has "fully implemented" the checklist for a particular interconnection agreement does not constitute a finding that the BOC will, as required by section 271(d)(3)(B), operate in accordance with the requirements of section 272.[31] Nor does it require a finding, consistent with section 251(c)'s objectives, that enduring local competition has *in fact* developed. Rather, it is a prognosis that the market is sufficiently open to make a predictive judgment that competition *could* take root, not a determination that competition will in fact occur and thrive.

In contrast to section 271(d)(3)(A)(i), section 10(d) is intended to ensure that the very structure of local markets has changed and that they remain open *permanently* by limiting the Commission's ability even to *consider* requests for forbearance from any of the requirements of sections 251(c) and 271, which the Commission has properly found to be the very "cornerstones of the framework Congress established in the 1996 Act to open local markets to competition."[32]

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[31] And this is not an academic point: as AT&T and other commenters have explained and as even the inadequate audits of Verizon and other BOCs have demonstrated, the BOCs are flagrantly violating their section 272 obligations.

[32] In this regard, the full implementation language of section 10(d) can be viewed as analogous to the standard for vacatur of an injunction that is intended to serve a particular purpose. In that context, the courts look to see if the purpose of the injunction has been achieved, and will only vacate the injunction if it has in fact been achieved and there is little danger of relapse. For example, in cases involving unlawful restraints on trade, the Supreme Court said that a decree "may not be changed . . . if the purposes of the litigation as incorporated in the decree . . . have not been fully achieved." *United States v. United Shoe Machinery Corp.*, 391 U.S. 244, 248 (1968). Likewise, courts have refused to permit an injunction to be vacated if the party subject to the injunction was likely to "return to its former ways" should the injunctive decree be lifted. *Board of Ed. of Okla. City v. Dowell*, 498 U.S. 237 (1991).

Advanced Services Order, 13 FCC Rcd. 24012, ¶ 73 (1998). There has not been, and could not be, any finding that the requirements of sections 251(c) and 271 have been fully implemented in even a single state, and the Petition must, accordingly, be dismissed as premature.

III. THE PETITION DOES NOT EVEN SERIOUSLY TRY TO COMPLY WITH THE SECTION 10(a) FORBEARANCE CRITERIA.

Even if the Commission could entertain Verizon's Petition as a valid invocation of the Commission's section 10(a) forbearance authority, Verizon has not remotely met its burden to prove that its request satisfies the section 10(a) criteria. Because Verizon wants *new* rules and does not identify any specific existing rules from which it seeks forbearance, it obviously does not attempt what is required: to show why non-enforcement of *specific* regulations would satisfy the statutory criteria.

Instead, the Petition speaks abstractly of forbearance from the "current pricing rules for UNE-P." But there are no such rules. Rather, there are Commission rules that the States apply to determine the prices for *individual* UNEs, *see* 47 C.F.R. § 51.501 *et seq.*, and there are entirely separate Commission rules that prohibit Verizon from separating requested UNEs that it currently combines, *see id*. § 51.315. To the extent that Verizon seeks "forbearance" at all, it targets the latter "combinations" rules – which the Petition does not even mention, much less address under the Section 10(a) framework. Verizon must likewise be considered to have defaulted on its "alternative" request for "access charge forbearance" for the use restriction rule that Verizon seeks – *i.e.*, a new rule that would prohibit UNE-P-based entrants from *providing* exchange access services – is in no sense a UNE *pricing* rule.

But Verizon falls far short of its Section 10 burden on many other levels as well. Section 10(a) requires the party seeking forbearance from enforcement of a ratemaking standard to satisfy three demanding criteria. First, the proponent of forbearance must show that enforcement of the specific regulations at issue "is not necessary to ensure that the charges . . . are just and reasonable and not unjustly or unreasonably discriminatory." 47 U.S.C. § 160(a)(1). Second, it must show that enforcement of those regulations "is not necessary for the protection of consumers." *Id.*, § 160(a)(2). And, third, it must show that non-enforcement of those regulations "is consistent with the public interest," *id.*, § 160(a)(3), and, in particular, that such non-enforcement will "promote competitive market conditions" and "enhance competition among providers of telecommunications services." *Id.* § 160(b). These requirements are "conjunctive," and the Commission must therefore "deny a petition for forbearance if it finds that any one of the three prongs is unsatisfied." *CTIA*, 330 F.3d at 509.

Even if the Petition actually sought forbearance from some specific rule, Verizon could not hope to satisfy a single one of the three criteria. Most obviously, it would hardly "enhance competition among providers of telecommunications services" to give in to an incumbent monopolist's demand that the Commission wipe out what is, in most local markets, the *only* significant competitive alternative for mass-market customers. The relief sought in the Petition would deprive literally millions of consumers of their chosen local telephone service and, for most, would put an end to local telephone choice altogether. It would also seriously reduce long distance competition, because only the BOC could offer mass market customers the bundled offers of local and long distance services that the BOCs themselves tout as the way to reduce churn.[33]

Moreover, the Commission has squarely held that a forbearance request must be denied if "forbearance would be likely to raise prices for interconnection and UNEs (particularly those

[33] *See, e.g., Value Line Investment Survey* 742 (July 4, 2003) ("VZ recently introduced Veriations, a bundled offering that includes discounts on long distance, wireless and data services, and customer response has been strong").

that may constitute bottleneck facilities), inputs competitors must purchase from incumbent carriers in order to provide competitive local exchange service."[34] Thus the Commission denied requests for forbearance of dominant LEC depreciation requirements, because the "result of forbearance" would "be higher costs for competitive carriers which could impair their ability to enter and compete in local markets" and would "adversely affect competition by raising input prices that competitors pay," thereby "retard[ing] competition." *Id.* The case against Verizon's Petition is even stronger, for "raising prices for interconnection and UNEs" is not just a potential side effect of the requested forbearance, but rather its very purpose. Verizon, lacking any possible response to this crushing objection, simply ignores it.

Verizon instead engages in rhetorical arm waving about "synthetic" (bad) and "real" (good) competition, "artificially low prices," and supposed links between cost-based UNE-P and the very decline and fall of Western telecommunications. Far more than rhetoric is required to satisfy the statutory criteria. Indeed, a request that seeks "the forbearance of dominant carrier regulation under Section 10" demands "a painstaking analysis of market conditions" supported by empirical evidence, not just unverified assertions. *Worldcom, Inc.* v. *FCC*, 238 F.3d 449, 459 (D.C. Cir. 2001); *AT&T Corp.* v. *FCC*, 236 F.3d 729, 735-37 (D.C. Cir. 2001). The Commission cannot, as Verizon would have it, simply "assume that, absent" the regulation at issue, "market conditions or any other factor will adequately ensure that charges . . . are just and reasonable and are not unjustly or unreasonably discriminatory." *1998 Biennial Regulatory Review - Review of ARMIS Reporting Requirements*, 14 FCC Rcd. 11443, 11461 ¶ 32 (1999).

The petitioner's burden is especially severe when seeking the "particularly momentous

[34] *1998 Biennial Regulatory Review - Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, 15 FCC Rcd. 242, ¶¶ 54, 63, 68 (1999) ("*1998 Biennial Review Depreciation Requirements*").

step" of forbearance from enforcing the common carrier obligation to charge prices that are "just and reasonable and not unjustly discriminatory," for these are the "core concepts of federal common carrier regulation dating back over a hundred years" and "lie at the heart of consumer protection under the Act."[35] And the evidentiary burden is heightened still further when, as here, the request for forbearance rests on judgments about competition or the public interest that the Commission has *already* considered and *rejected*. To overcome the Commission's prior findings, the proponent of forbearance bears the burden of producing "new information in the record that suggests that the factors underlying [the earlier decision] have changed, or that its conclusions should be disturbed."[36] Absent such a showing – and Verizon makes no attempt at such a showing here – a petitioner's "generalized assertions" that conditions have changed must be rejected as "unpersuasive in the face of the more detailed contrary . . . analysis" in the earlier decisions.[37]

Recognizing that it cannot hope to meet its Section 10(a) burden, Verizon attempts to shift the burden to the Commission to prove that competitive harms would be a certain or inevitable consequence of the requested forbearance. Verizon's affiliate pitched that same argument in *CTIA*, *supra*. The D.C. Circuit rejected that argument and agreed with the Commission that any such "rigid construction" of section 10(a) would be an "absurdity,"

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[35] *Personal Communications Industry Ass'n Petition for Forbearance For Broadband Personal Communications Services*, 13 FCC Rcd. 16857, ¶ 15 (1998).

[36] *Amendment of the Commission's Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services*, 14 FCC Rcd 11343, ¶ 10 (1999).

[37] *Id*. ¶ 13. Allowing parties to use Section 10(a) petitions simply to reargue claims that the Commission has already considered and rejected would impair the "orderly administration of the Commission's policies" and create "the specter of indefinite uncertainty." *Petition for Forbearance of Iowa Telecomms. Services, Inc.*, 17 FCC Rcd 24319, ¶ 13 (2002).

affirming the Commission's view that there need only be "a strong connection between what the agency does by way of regulation and what the agency permissibly [seeks] to achieve with th[at] . . . regulation." *CTIA*, 330 F.3d at 511.

Here, of course, both the Commission and the Supreme Court have repeatedly recognized the strong connection between making cost-based UNEs – including cost-based UNE-P – available for the provision of any telecommunications service and the Act's core goals of fostering competition, ensuring just, reasonable and nondiscriminatory rates and protecting consumers – and have done so in the face of the same misguided policy arguments that Verizon repeats in the Petition. Accordingly, it would take an extraordinary evidentiary showing indeed to demonstrate that these Commission rules have suddenly become such a menace to consumers, competition and even, apparently, "national security," *see* Petition at 24, that emergency forbearance is warranted. The Petition, for obvious reasons, steers clear of any such effort.

A. Cost-Based UNE-P Is Necessary To Ensure That Charges Are Just, Reasonable And Nondiscriminatory.

As the Commission, the courts, and economists of all stripes (including Verizon's most ardent supporters) have recognized, the lodestone for setting "just, reasonable and nondiscriminatory" prices is cost.[38] More to the point, in the UNE context, Congress has specifically directed that *only* "cost-based" rates can satisfy the statutory requirement that

[38] *See Verizon*, 535 U.S. at 476-88 (describing evolution of cost-of-service ratemaking) *Farmers Union Central Exchange, Inc.* v. *FERC*, 734 F.2d 1486, 1501-02 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984) (holding that costs are the starting point for determining "just and reasonable" rates). While "non-cost factors may legitimate a departure from a rigid cost-based approach," "each deviation from cost-based pricing [must be] found not to be unreasonable and to be consistent with the Commission's [statutory] responsibility." *Id*. at 1502 (quoting *Mobil Oil v. FPC*, 417 U.S. 283, 308 (1974)). And charges that "permit exploitation, abuse, over-reaching or gouging are *by themselves* not 'just and reasonable.'" *Farmers Union*, 734 F.2d at 1502 (emphasis in original). *See also* 1 Alfred K. Kahn, *Economics of Regulation* 65 (1970) ("The central policy prescription of microeconomics is the equation of price and marginal cost.").

charges be just, reasonable and nondiscriminatory. 47 U.S.C. § 252(d)(1). The Commission has specifically found, on an extensive evidentiary record, that the cost-based ratemaking standard that comports best with economic efficiency and is most likely to foster effective competition in local telephony is the forward-looking economic cost methodology known as TELRIC. *Local Competition Order* ¶¶ 672, 685. These findings were specifically upheld by the Supreme Court over Verizon's challenge. *Verizon*, 535 U.S. at 516-17, 523.[39] And the Commission (as well as state commissions and reviewing courts nationwide), have expressly rejected the use of resale pricing – based upon retail rates, not costs – for UNE-P. *Local Competition Order* ¶¶ 317, 328-34; *see supra* Part I.B.1.[40]

Thus, Verizon's claim that substituting resale rate regulation for TELRIC rate regulation would ensure that its UNE rates are just and reasonable founders immediately. Where effective competition is absent, Section 10(a) does not allow the Commission to forbear from enforcing the cost-based rate constraints it adopted to "ensure rates are reasonable . . . and non-discriminatory."[41] And the notion that UNE-P rates at "resale" price levels would be just and reasonable is, as demonstrated above, entirely foreclosed by the plain language of the statute, and

[39] "Section 252(d)(1) provides that a state commission's determination of the just and reasonable rates for network elements, must be nondiscriminatory, based on the cost of providing the network elements, and may include a reasonable profit. Pursuant to this statutory mandate, the Commission has determined that prices for UNEs must be based on the total element long run incremental cost (TELRIC) of providing those elements." *Maryland/D.C./West Virginia 271 Order*, 18 FCC Rcd. 5212, ¶ 39 (2003) (footnotes omitted). *See also Minnesota 271 Order*, WC Docket 03-90, ¶ 41 (June 26, 2003); *New Mexico/Colorado/S. Dakota Order*, 18 FCC Rcd. 7325, ¶ 64 (2003); *Florida/Tennessee 271 Order*, 17 FCC Rcd. 25838, ¶ 19 (2002).

[40] As the Commission has noted, "different pricing standards under section 252(d) apply to unbundled elements under section 251(c)(3) and resold services under section 251(c)(4)." *Local Competition Order* ¶ 317. *See also id*. ¶¶ 328-334 (recognizing that the UNE provisions of Section 251(c)(3) and the resale provisions of Section 251(c)(4) present different opportunities, risks, and costs in connection with entry into local telecom markets).

[41] *Petition for Forbearance of the Independent Telephone & Telecomms. Alliance*, 14 FCC Rcd 18040, 18052 (1999); *accord 1998 Biennial Review Depreciation Requirements* ¶ 54.

by the federal court decisions that have construed it. For these reasons, applying "resale" rates to UNE-P would be *ipso facto* unjust and unreasonable.

Requiring entrants to pay "resale" rates for UNE-P would also be unjustly discriminatory. As the Commission found in the *Local Competition Order*, the forward-looking economic cost standard mirrors the economic costs that the incumbent carrier itself incurs in accessing its own network facilities. *Local Competition Order* ¶ 685. Thus, allowing Verizon to charge competitive carriers "resale" prices for UNE-P would force competitive carriers to pay far more than the price implicitly paid by Verizon's retail operations to gain network access to Verizon's own network. That is the paradigm of unlawful discrimination. *See* Att. A, Willig Aff. ¶¶ 21-22. Recognizing as much, Verizon attempts to fight again another battle it has already definitively lost, arguing that resale applied to all competitive carriers would not discriminate *among* competitive carriers. But, as the Commission has repeatedly stressed, rates must also be nondiscriminatory *between incumbents and competitive carriers*. The anti-discrimination provision of Section 251(c)(2) forbids incumbent carriers from providing competitive carriers access to UNEs on terms and conditions "less favorable . . . than the terms and conditions under which the incumbent LEC provide such elements to itself." 47 C.F.R. § 51.313(b); *see also Local Competition Order* ¶¶ 216-18, 312, 315.[42]

[42] Although, as shown above, Verizon's alternative request for "access fee forbearance" does not address any current UNE *pricing* rules, that request would, if granted, produce unjust and unreasonable rates. TELRIC-based rates fully compensate the incumbent for *all* of its forward-looking economic costs of constructing, operating and maintaining a network that originates and terminates both intra- and inter-exchange traffic. 47 C.F.R. § 51.505(a); *Local Competition Order* ¶ 682, 690-91, 696-98. And, as explained above, allowing Verizon to recover access charges *in addition to* TELRIC-based prices – even under Verizon's proposal that UNE purchasers would not pay usage-based switching charges for interexchange traffic – would clearly give Verizon a double recovery. "Access fee forbearance" would also entail unlawful discrimination. When Verizon uses its facilities, Verizon collects any applicable access charges from long distance carriers. But competitive carriers using the same facilities as network elements to provide the same local retail services would not be able to collect access charges.

Verizon's assertion that TELRIC-based rates are too low (or, in Verizon's formulation, that the Commission's TELRIC pricing rules "produce rates that are well below any rational measure" of costs) does not begin to answer these objections. Verizon is free to assert that reforms to TELRIC are in order – as it will presumably try to show in a TELRIC rulemaking proceeding – but it does not even identify them here, much less make its case with actual evidence. There is, accordingly, no possible basis for a finding that complete non-enforcement of TELRIC rules would ensure just and reasonable rates and thus no basis for forbearing from applying "the current pricing rules for UNE-P."[43]

Verizon's related claim that state commissions have been improperly "ratchet[ing] down" UNE prices below TELRIC levels for "political reasons" since 1996 (Petition at 2) is likewise unavailing. If state commissions were failing to apply TELRIC correctly, the proper remedy is to ask reviewing courts to enforce TELRIC, not to ask the Commission to jettison it. In any event, Verizon has offered no evidence that state commissions have, in fact, been setting UNE prices below TELRIC. As detailed in the attached description of what actually happened in the state proceedings Verizon cites, it is clear that UNE prices have fallen since 1996 because state commissions have become more experienced at applying the TELRIC standard – and more adept at ferreting out the embedded and otherwise inflated costs that Verizon and the other Bells tend to hide in their cost studies. *See generally* Att. B; Att. C. The large reductions in switching prices imposed by the New York PSC after Verizon's prior switching equipment investment data

[43] Verizon's assertion that TELRIC-based UNE rates are unreasonably low because they fail to recover the incumbent's "actual" forward-looking costs (Pet. at 6, 19-20) is another obvious non-starter. "Actual" forward-looking costs, as Verizon has used the term since 1996, is just a euphemism for its embedded costs. Both the Commission and the Supreme Court have expressly rejected this position as contrary to the pro-competitive purposes of the Act. *Local Competition Order* ¶¶ 705-07; *Verizon*, 535 U.S. at 512. In any event, Verizon's Petition does not seek to base UNE rates on *either* an "actual" cost or an embedded cost standard, but rather to jettison cost-based pricing of UNEs entirely. The express terms of the Act squarely forbid such a result.

were revealed to be false is only the most dramatic of these developments. Att. C at 46-57. And notably, even Verizon itself has proposed rate reductions as deep as 50 percent in recent UNE rate cases. *Id*. at 26. The downward trend in UNE-P rates since 1996 is evidence that the rate-setting process is beginning to work, not that it has failed.

Verizon's allegation that TELRIC prices have generated windfall profit margins for *competitive carrier*s and given birth to a "cottage industry" of arbitrage (Petition at 3-4, 8-9) is equally baseless. Verizon's support for this claim consists largely of promotional puffery by self-styled telecommunications "consultants." The only source cited by Verizon that even purports to analyze actual data is a report by Legg Mason. And the Legg Mason report overstates revenues, understates costs, and considers only *gross* margins – thereby ignoring altogether the substantial marketing, billing, customer care, maintenance and other "retailing" costs that a *competitive carrier* must incur. Att. B at 11-15. Perhaps the most telling rejoinder to Verizon consists of its own investment plans. If entry by UNE-P were as profitable as Verizon contends, Verizon would be rushing to expand outside its current footprint via UNE-P instead of investing $13 billion annually in its own facilities. *Cf. BusinessWeek* (Aug. 4, 2003) at 53-55.

Finally, Verizon further exposes the fallacy of its argument by focusing solely on UNE-P and ignoring the pricing of individual network elements or more limited combinations of network elements. Under the Commission's TELRIC standard, UNE prices are set *individually* for each element, by summing (1) the forward-looking cost of providing the specific element, plus (2) "a reasonable allocation of forward-looking common costs." 47 C.F.R. § 51.505(a); *Local Competition Order* ¶ 682, 690-91, 696-98. The rules do not entitle competitive carriers to any discount from the aggregate of these prices when leasing the entire platform, and Verizon has offered no evidence that providing the entire platform causes the incumbent carrier to incur any extra costs that are not covered by the sum of the individual UNE prices (and allowed nonrecurring charges). In the absence of such a showing, there is obviously no basis for any finding that UNE prices are just and reasonable when UNEs are purchased individually or in some lesser combinations, but not when purchased in the combination that comprises UNE-P. Verizon's position is thus logically flawed and internally inconsistent.

B. Cost-Based UNE-P Remains Necessary For The Protection Of Consumers.

Verizon has also failed to show that continued application of the cost-based pricing to UNE-P is unnecessary for the protection of consumers. Petition at 20-23. In a market dominated by a single supplier, "[c]onsumer protection" requires "meaningful rate regulation." *Farmers Union*, 734 F.2d at 1507. The alternatives proposed by Verizon would not provide such protection.

In the *Local Competition Order*, the Commission found that the TELRIC rules – and their application to both individual UNEs and all possible combinations of UNEs – were necessary to protect consumers from the Bells' abuse of their bottleneck market power. *Local Competition Order* at ¶¶ 10-15, 630, 672, 679, 705 (necessity for TELRIC standard); *id.*, ¶¶ 328-41 (necessity of extending UNE pricing rules to combinations of UNEs); *Verizon*, 535 U.S. at 490-91, 511-12. There can be no serious dispute that Verizon's market power, and its corresponding incentive and ability to abuse that market power, endures. *Id.* at 490-91.

The Commission has previously held the mere *potential* for rate increases that might occur as a result of forbearance from enforcing depreciation prescription rules is sufficient to preclude the required finding under section 10(a)(2) that continued enforcement was "not necessary for the protection of consumers:"

> Forbearance of the depreciation prescription process could potentially trigger large increases in a carrier's depreciation expenses, which could in turn result in unwarranted increases in consumer rates. These increased depreciation expenses

> and consumer rates would [be] likely to continue for many years until robust competition curtails the ability of the incumbent LECs to secure these rates from consumers.

1998 Biennial Review Depreciation Requirements ¶ 59 (footnote omitted). The rule changes that Verizon now proposes would make rate increases a certainty, not just a possibility.

Moreover, marketplace experience with local service resale makes clear that raising the price of UNE-P using the Act's resale pricing standard would put an immediate end to UNE-P based competition (which is, of course, why Verizon seeks those changes) and the local services of choice of more than 10 million American consumers. This cannot be the way to "protect" consumers.[44] Further, the elimination of UNE-P would also have serious impacts on competition for long distance services. If the RBOCs alone are able to provide "bundles" of both local and long distance services, they will be able to leverage their power from their (now strengthened) local monopolies to achieve even greater success in the provision of long distance services. This is not an idle concern. Even with UNE-P available, Verizon proudly proclaims that it is the third largest long distance provider in the country. Similarly, SBC has recently proclaimed that has won a majority of the mass-market long distance business within a few years of entry into long distance in each of its states in the Southwestern region.[45] Indeed, within 90 days of its section 271 approval for California, SBC had already amassed a 10 percent overall market share in the

[44] As Verizon well knows, its alternative request for "access fee forbearance" would have a similar effect. Just as Verizon and other incumbent carriers depend upon revenues from all of the telecommunications services that they provide to a customer to cover their costs of providing service to that customer, competitive carriers depend upon the same revenue streams to cover the full cost-based rates that they pay to lease those facilities. In addition, the over-recovery that Verizon's access fee forbearance proposal would allow would ultimately be borne by consumers.

[45] *See* Statement of Edward Whitacre, CEO, SBC Communications, Transcript, April 24, 2003 Conference Call Addressing First Quarter 2003 Earnings.

state.[46] If competitors cannot compete with similar offers (and UNE-P is the only way they can reasonably do so), the RBOCs will soon be the dominant providers of *both* local and long distance service in their serving areas.

Verizon responds with the argument that forbearance will bring offsetting benefits to consumers. Verizon hypothesizes that, even as it kills existing local competition, taking the lid off UNE prices could benefit consumers by unleashing investment by *Verizon* (and other incumbents), thereby jump-starting growth in the telecom sector and the entire American economy and ushering in a new age of innovation. The extravagance of these claims is matched only by their complete lack of factual foundation.

The stimulation-of-investment scenario is a perennial favorite of regulated monopolists. Indeed, pursued to its logical conclusion, the argument ultimately calls for elimination of rate regulation entirely, because, if higher earnings encourage more investment, then removing all constraints on monopoly profits will encourage the most investment of all. The courts, however, have held this self-serving claim to a demanding standard of proof. The proposition that higher rates will lead to more investment (in addition to being false) cannot justify reduced price regulation without a showing that (i) the additional investment or capacity is *necessary* and (ii) the amount of additional investment or capacity that the higher prices will stimulate is quantifiable and large enough to justify the higher prices paid by ratepayers. A regulatory commission may not approve higher rates as an investment-stimulating device without attempting to "forecast or otherwise estimate the dimensions of the need for additional capacity," and to "calibrate the relationship between increased rates and the attraction of new capital." *Farmers Union*, 734 F.2d at 1503. "If the Commission contemplates increasing rates for the

[46] *Id.*

purpose of encouraging exploration and development . . . it must see to it that the increase is in fact needed, and is no more than is needed, for the purpose." *City of Detroit v. FPC*, 230 F.2d 810, 817 (D.C. Cir. 1955), *cert. denied*, 352 U.S. 829 (1956).

Verizon's petition does not even purport to satisfy this standard. First, Verizon has not even shown that an investment shortfall exists. The capital stock of the local telecommunications industry has skyrocketed since 1996, and remains at record levels. Att. B at 24-27. And Verizon bids to become the biggest spender of all:

> Verizon plans to roll out fiber-optic connections to every home and business in its 29-state territory over the next 10 to 15 years, a project that might reasonably be compared with the construction of the Roman aqueducts. It will cost $20 billion to $40 billion, depending on how fast equipment prices fall. . . . The company says it will pump $12.5 to $13.5 billion into capital expenditures this year, the third-largest capital budget in the world after DaimlerChrysler and General Electric Co. That's on top of the $3 billion a year it's paying in yearly interest because of its $54 billion debt load. How can Verizon pay for all this? Its business is one of the great cash machines of Corporate America. The largest local-phone operator and the largest wireless company, Verizon generates about $22 billion a year in cash from operations. That's 50% more than SBC, twice as much as BellSouth, and nearly three times as much as AT&T. . . . [Verizon CEO] Seidenberg expects to cover the fiber-optic initiative without raising the capital budget above the current level, while he continues to reduce the company's debt. 'Funding is not an issue,' he says."

Business Week (August 4, 2003), at 53-55.

Second, Verizon fails to show any evidence that its investment would have been higher absent cost-based UNE-P. Verizon simply *assumes* that, (1) because the TELRIC standard has been enforced with increasing rigor during the past few years and (2) growth in new telecom investment flows has declined during the same period, that (3) the former must have caused the latter. As Professor Willig explains, this assumption is obviously untenable, for it utterly ignores the possibility that the collapse of the telecom bubble, the fallout from corporate fraud scandals and bankruptcies, the changing profile of demand for telephony, the declining cost of many kinds of telecommunications assets, and the sluggishness of the overall American economy since the year 2000 might have had something to do with telecom investment flows. *See* Att. A, Willig Aff. ¶¶ 30-34; *see also* Att. B at 17-18. Verizon thus commits the logical fallacy of arguing *post hoc ergo propter hoc*, or that sequence proves causation. First-year statistics students have been flunked for less serious blunders. *See*, *e.g.*, *United States Steel Group* v. *U.S.*, 96 F.3d 1352, 1358 (Fed. Cir. 1996) ("to claim that the temporal link between these events *proves* that they are causally related is simply to repeat the ancient fallacy: *post hoc ergo propter hoc*").

In fact, the Commission and the Supreme Court have squarely rejected Verizon's claim that UNE-P suppresses investment by incumbent carriers. As the Supreme Court found last year in *Verizon*, the competition enabled by UNE-P, by allowing a *competitive carrier* to enter a market, gives the incumbent a powerful incentive to respond with competitive innovations of its own. "[S]o long as TELRIC brings about some competition, the incumbents will continue to have incentives to invest and to improve their services to hold on to their existing customer base." *Verizon*, 535 U.S. at 517 & n.33. *Accord Local Competition Order* ¶¶ 679, 685. And the record of actual econometric evidence in the Triennial Review docket confirms that UNE-P in fact has pro-competitive effects on investment, innovation and competition, and not the negative effects that Verizon's logical fallacy would suggest. *See* Att. A, Willig Aff. ¶¶ 29-35.

Recognizing as much, Verizon speculates that "good" competition might spring up to replace the "bad" UNE-P competition that its proposed rule changes would kill. The facts are, again, quite different.

Resale Is Not A Substitute For UNE-P. Verizon first imagines that UNE-P providers might persevere with "smaller" profit margins. In truth, Verizon's proposal would end UNE-P and replace it with pure resale. And there is no need to speculate how competition and consumers would fare with resale. Many carriers, including AT&T, tried and failed with that local entry strategy in the early years of the 1996 Act. Resale has been a dying strategy ever since, as practical experience has demonstrated that the thin margins between retail and wholesale rates associated with the "avoided cost" resale discount under the Act and the complete reliance on incumbent carrier service definitions make resale economically infeasible as a meaningful entry vehicle.[47] *See FCC Local Competition Report: Status as of Dec. 31, 2002* (June 2003) at 2 & Table 4; FCC Wireline Competition Bureau, Industry Analysis and Technology Division, *Trends in Telephone Service* (Aug. 2003) at 8-1 and 8.6 (Table 8.3). Make no mistake about it – if Verizon has its way, the millions of consumers that rely upon UNE-P today will lose their service, and in almost all cases, any local telephone choice, as well as the opportunity for competitive local and long distance bundles. There is thus no possible basis to assert that TELRIC rules are not necessary for the protection of consumers.

Facilities-Based UNE Competition Will Not Replace UNE-P. Verizon next speculates that if the Commission destroys UNE-P competition, "better" facilities-based competitors would rush to fill the gaps. This, too, is a claim that the Commission, the courts and all of the economic evidence soundly reject. The Commission and the courts have found, and the evidence shows, that the availability of UNEs at reasonable prices is a critical prerequisite for facilities investment by *competitive carrier*s, and that eliminating UNEs priced at cost would choke the investment off.

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[47] The unsustainable nature of the "avoided cost" standard is immediately apparent when it is recognized that merely stripping away the incumbents' retailing costs *guarantees* that the incumbents recover their *entire retail profit* on every customer served by resale. Thus, it is no wonder that Verizon seeks to drive all of its competitors to that suicidal strategy – as they expire in the market, the incumbent gets to keep all of its profits anyway, an obvious no-win situation for competitors and competition. This is in sharp contrast to the market-based resale discounts that the RBOCs can obtain when they enter long distance and purchase their network needs at a competitively driven resale price that is reflective of their suppliers' incremental costs. *See* Ex Parte Letter from Joan Marsh, AT&T, to Marlene Dortch, FCC, CC Docket 01-338 (Jan. 23, 2003).

The central reality is that barriers to facilities-based competitive entry into local telephony remain large and pervasive. They include the sunk character of much of the investment needed to enter the market; the large minimum viable scale of loops, switching equipment, transport facilities, and other network assets; and the first mover advantages enjoyed by the incumbents. Att. A, Willig Aff. ¶¶ 11-14. As the Supreme Court explained in *Verizon*, an incumbent local carrier

> would have an almost insurmountable competitive advantage not only in routing calls within the exchange, but, through its control of this local market, in the markets for terminal equipment and long-distance calling as well. A newcomer could not compete with the incumbent carrier to provide local service without coming close to replicating the incumbent's entire existing network, the most costly and difficult part of which would be laying down the "last mile" of feeder wire, the local loop, to the thousands (or millions) of terminal points in individual houses and businesses. The incumbent company could also control its local-loop plant so as to connect only with terminals it manufactured or selected, and could place conditions or fees (called "access charges") on long-distance carriers seeking to connect with its network. In an unregulated world, another telecommunications carrier would be forced to comply with these conditions, or it could never reach the customers of a local exchange.

Verizon, 535 U.S. at 490-91 (footnote omitted).

Verizon's facilities-based competition rhetoric simply ignores the standard under which network elements are unbundled and the Commission's Triennial Review rejection of Verizon's claims that the Commission should de-list one or more elements of the UNE-P. In this regard, the Commission requires Verizon to unbundle a network element only if duplicating and using it is to provide the telecommunications services a competitor seeks to offer uneconomic (or, in the Act's terms, that *competitive carriers* would be "impaired" if the element is unavailable for lease).[48]

[48] *See* News Release, "FCC Adopts New Rules For Network Unbundling Obligations Of Incumbent Local Phone Carriers," *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338 (issued Feb. 20, 2003).

Competitive carriers cannot be expected to enter local markets where the incumbent has an "absolute cost advantage" relative to the entrant, regardless of what UNE prices currently prevail in the market (and, therefore, what "margins" may currently exist). As Professor Willig has explained, where a competitive carrier must incur significantly higher costs to provide local services, an incumbent carrier can respond to entry by dropping prices below the competitive carrier's costs. Such a pricing strategy will still allow the lower-cost incumbent to remain profitable; but by setting prices below the entrant's costs, the incumbent would make it impossible for the entrant to remain economically viable.[49] Because the cost to an incumbent of using its own network always equals its forward-looking economic costs – regardless of the nominal internal transfer price – setting the prices paid by competitive carriers above forward-looking economic costs *ipso facto* gives the incumbent a cost advantage over the competitive carrier. Verizon's rejoinder that *competitive carrier*s "will be in no different position than incumbents" if forbearance is granted (Petition at 21) thus is simply unfounded. As the Supreme Court put it, setting UNE prices above TELRIC for the sake of encouraging more facilities-based entry "would either discourage a potential competitor from entering the market in that area, thereby denying those consumers the benefits of competition, or cause the competitor to construct unnecessarily duplicative facilities, thereby misallocating societal resources." *Verizon*, 535 U.S. at 509 (quoting *Local Competition Order* ¶ 378).[50]

A large body of econometric evidence – which the Petition simply ignores – has

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[49] *See* Robert D. Willig, *Determining Impairment Using The Horizontal Merger Guidelines Entry Analysis*, CC Docket 01-338 (Nov. 14, 2002); *see also* Att. A, Willig Dec. ¶ 13.

[50] The Supreme Court has also disagreed with Verizon's dismissal of competitive entry through the leasing of UNEs at cost-based prices as somehow "parasitic" or otherwise less "real" than facilities-based competition. *Verizon*, 535 U.S. at 503-07.

confirmed the foregoing analysis by demonstrating that there is an *inverse* relation between UNE prices and competitive carrier investment, that lower UNE prices tend to encourage facilities-based entry and investment, and that higher UNE prices tend to suppress them.[51]

Where self-provisioning of local network facilities makes economic sense, competitive carriers, including AT&T, already choose that entry vehicle, because it avoids the operational vulnerability that inevitably results from depending on an incumbent carrier for critical inputs. But facilities duplication on the massive scale necessary to serve even the existing UNE-P customer base would be pure folly (even assuming the availability of the enormous amounts of investment capital that would needed to pursue such a quixotic scheme). Thus eliminating cost-based UNE-P would inevitably cause a drastic reduction in local (and bundled local/long distance) competition, to the great detriment of consumers.[52]

Once again, there is no need for speculation on the matter. If Verizon truly believed its rhetoric, it would be doing everything in its power to preserve cost-based UNE-P and head off this wave of facilities bypass that would idle Verizon's facilities and deny it even the cost-based revenue it earns today when one of its customers chooses a rival service provider.

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[51] *See* Att. A, Willig Aff. ¶¶ 31-34; Att. B at 22-24; *see also* Kevin A. Hassett and Laurence J. Kotlikoff, *The Role of Competition in Stimulating Telecom Investment*, CC Docket 01-338 (Oct. 2002); Robert D. Willig, William H. Lehr, John P. Bigelow, and Stephen B. Levinson, *Stimulating Investment and the Telecommunications Act of 1996*, CC Docket 01-338 (Oct. 11, 2002).

[52] Verizon simply *assumes* that more investment by competitive carriers in their own facilities would have been better. But building new capacity is a better alternative for society than using existing incumbent carrier assets more intensively if, *and only if*, the forward-looking economic cost of the former is expected to be lower than the forward-looking economic cost of the latter. Unless the potential new investment passes this test, a pricing standard that encourages competitive carriers to build redundant new assets rather than make more intensive use of existing incumbent network elements would *reduce* economic performance and be harmful rather than beneficial. *See Local Competition Order* ¶ 378, *aff'd on this point*, *Verizon*, 535 U.S. at 509-10; Att. B at 27-28. By contrast, TELRIC-based prices give potential entrants efficient make-or-buy signals, and thus "ensure efficient entry and utilization of the telecommunications infrastructure" and "efficient levels of investment." *Local Competition Order* ¶¶ 630, 635, 672.

Intermodal Competition Is Insufficient To Hold Verizon's UNE Rates To Competitive Levels. Verizon's final reason why consumers would not lament the demise of UNE-P – that continued enforcement of the current rules is no longer necessary because intermodal competition is now sufficient to hold prices down to reasonable levels – is frivolous. *See* Petition at 22.

Whatever market share may be captured in the future by "intermodal" sources of competition – wireless, cable and other – their share of local services today is modest, and their effectiveness in constraining Verizon's market power is virtually nonexistent. Att. A, Willig Aff. ¶¶ 5-10. Today, wireline carriers still serve more than 95 percent of all local access lines. Wireless substitution has been largely confined to the long distance, second-line and college student markets.[53] Cable telephony still serves fewer than two percent of all switched access lines, and there is no reason to believe that the market penetration of the cable sector will increase much in the foreseeable future. Many cable carriers are financially troubled, and most are scaling back their near-term plans to provide traditional local phone service. Att. B at 32-33. And none of these alternative providers makes access to their facilities available to requesting telecommunications providers, so those facilities are effectively off-limits to *competitive carrier*s that might seek to use them to provide competing local service.

A regulatory commission may not allow market competition to substitute for direct price regulation as a means of achieving just and reasonable rates unless the competition is "effective;"

[53] And the recent blackouts demonstrated quite powerfully why wireless is not a substitute for local wireline phone service. *See* M. Richtel & S. Romero, *When Wireless Phones Failed, Callers Turned To Land Lines,* N.Y. Times, Aug. 15, 2003 ("The regular public telephone network generally kept working after the power went out in parts of six states yesterday afternoon, but the cellular systems in affected areas were unable to cope"); A. Ross Sorkin & M. Richtel, *Cellphone Failures Cause Many To Question Systems*, N.Y. Times, Aug. 16, 2003 ("The land-line telephone system has a primary advantage over wireless ones because its network of wires can carry a small electrical power current").

the mere existence of some competitive constraints on pricing behavior, even if "substantial," is insufficient. *Coal Exporters Ass'n of the United States, Inc. v. United States*, 745 F.2d 76, 90-99 (D.C. Cir.), *cert. denied*, 471 U.S. 1072 (1985). In ratemaking terms, the competition must be strong enough to "drive[] the actual prices back down into the zone" of reasonableness. *Farmers Union*, 734 F.2d at 1509. "Without empirical proof" that "existing competition would ensure that the actual price is just and reasonable," relying on market forces to constrain prices "runs counter to the basic assumption of statutory regulation," *id*. at 1510. In fact, "'regulation' by such novel 'standards' is worse than an exemption *simpliciter*. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." *Id.* (quoting *Texaco v. FPC*, 474 F.2d 416, 422 (D.C. Cir. 1972)).

Consistent with this precedent, the Commission has previously found that intermodal competition – including competition from wireless and cable carriers – is too weak and scattered to justify forbearance under Section 10(a) from enforcing cost-of-service constraints on the pricing of dominant carriers. *1998 Biennial Review Depreciation Requirements* ¶ 54. That remains true today. Unless and until intermodal competition becomes an effective constraint on Verizon's UNE prices throughout its local territory, the existence of some intermodal competition today, and the possibility that it may grow stronger in the future, are insufficient to support a contrary outcome under Section 10(a).

C. Abandoning Cost-Based UNE-P Is Inconsistent With The Public Interest.

Verizon's attempt to show that forbearance is in the public interest (Petition at 23-24) is little more than a reprise of its discredited investment incentive arguments, and should be rejected for the reasons explained above. Section 10(b) directs the Commission, in considering whether forbearance is "consistent with the public interest" under Section 10(a)(3), to consider whether forbearance will "promote competitive market conditions" and "enhance competition among providers of telecommunications services." As discussed above, the relief sought by Verizon would have the very opposite effect.

Allowing Verizon to increase its net prices for UNEs by increasing them to the level of resale rates, or by depriving the UNE-P providers of access charge revenue to which they are legally entitled, would have the Commission sacrifice the UNE-based competition that now exists on the misguided hope and prayer that other "better" competition will replace it. In exchange for wiping out the only significant competitive alternative to the incumbent in the mass market, Verizon again offers only the chimera of increased competition from facilities-based entry.

The Commission has specifically held that forbearance from enforcing cost-of-service price regulation must be denied under the third prong of Section 10(a) and 10(b) where "forbearance would be likely to raise prices for interconnection and UNEs (particularly those that may constitute bottleneck facilities), inputs competitors must purchase from incumbent LECs in order to provide competitive local exchange service." *1998 Biennial Review Depreciation Requirements* ¶ 63. When "the result of forbearance would be higher costs for competitive LECs which could impair their ability to enter and compete in local markets," the Commission "cannot find that forbearance would promote competitive market conditions." *Id.* "Because the primary purpose of requiring LECs to provide interconnection and unbundled network elements is to stimulate competition in the provision of local exchange service, allowing incumbents to raise prices for those services . . . could adversely affect competition by raising input prices that competitors pay." *Id.* ¶ 68. Hence, "forbearance would not enhance but, rather, would likely retard competition." *Id.* Verizon's Petition makes "raising prices for interconnection and UNEs" is not just a likely side-effect of forbearance, but its very purpose.

The threat Verizon's Petition poses to the public interest is confirmed by Verizon's very willingness to file the Petition. If Verizon were truly facing effective competition it would have no incentive or ability to charge above-cost rates for access to its network. Just as interexchange carriers like AT&T do, Verizon would actively seek out wholesale access customers to ensure that its sunk network remains as fully used as possible. That Verizon seeks instead to *reduce* the wholesale use of its sunk network is telling evidence that Verizon's facilities remain bottlenecks, and that competition on the merits is impossible without cost-based access.[54]

[54] Verizon's shameless appeal to "national security" (Petition at 23-24) adds nothing to its previous arguments. Because inflated UNE prices tend to choke off, not accelerate, facilities-based investment by *competitive carrier*s, the forbearance sought by Verizon is likely to make our society more vulnerable, not less, to a "a terrorist attack or some other calamity."

CONCLUSION

For the foregoing reasons, Verizon's Petition for Forbearance should be denied.

/s/ Leonard J. Cali

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Dated: August 18, 2003

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Petition for Forbearance From the Current Pricing Rules for the Unbundled Network Platform	)	WC Docket No. 03-157

AFFIDAVIT OF ROBERT D. WILLIG

I. INTRODUCTION AND BACKGROUND.

1. My name is Robert D. Willig. I am Professor of Economics and Public Affairs at the Woodrow Wilson School and the Economics Department of Princeton University, a position I have held since 1978. Before that, I was Supervisor in the Economics Research Department of Bell Laboratories. My teaching and research have specialized in the fields of industrial organization, government-business relations, and welfare theory.

2. I served as Deputy Assistant Attorney General of Economics in the Antitrust Division of the Department of Justice from 1989 to 1991. I am the author of Welfare Analysis of Policies Affecting Prices and Products; Contestable Markets and the Theory of Industry Structure (with W. Baumol and J. Panzar), and numerous articles, including "Merger Analysis, IO Theory, and Merger Guidelines." I was also a co-editor of The

Handbook of Industrial Organization, and have served on the editorial boards of the American Economic Review, the Journal of Industrial Economics, and the MIT Press Series on regulation. I am an elected Fellow of the Econometric Society and an associate of The Center for International Studies.

3. I have been active in both theoretical and applied analysis of telecommunications issues. Since leaving Bell Laboratories, I have been a consultant to AT&T, Bell Atlantic, Telstra, and New Zealand Telecom, and have testified before the U.S. Congress, this Commission, and the public utility commissions of about a dozen states. I have been on government and privately-supported missions involving telecommunications throughout South America, Canada, Europe, and Asia. I have written and testified on such subjects within telecommunications as the scope of competition, end-user service pricing and costing, unbundled access arrangements and pricing, the design of regulation and methodologies for assessing what activities should be subject to regulation, directory services, bypass arrangements, network externalities, and universal service. On other issues, I have worked as a consultant with the Federal Trade Commission, the Organization for Economic Cooperation and Development, the Inter-American Development Bank, the World Bank, and various private clients. I also served on the Defense Science Board task force on the antitrust aspects of defense industry consolidation and on the Governor of New Jersey's task force on the market pricing of electricity.

II. ASSIGNMENT AND SUMMARY.

4. I have been asked by counsel for AT&T to review the economic arguments put forward by Verizon in its July 1, 2003, petition in WC Docket No. 03-157 for "Forbearance From the Current Pricing Rules for the Unbundled Network Element

Platform." This affidavit focuses on Verizon's claims that prices for the unbundled network element platform ("UNE-P") should not be based on total element long run incremental cost ("TELRIC"); that the UNE-P prices set by state commissions in recent years have fallen below any realistic measure of costs; and that this downward trend in UNE-P prices has contributed to a massive decline in telecommunications investment. This affidavit sets out my analysis of these issues and the bases for my conclusions.

III. THE AVAILABILITY OF UNES, INCLUDING COMBINATION OF UNES, AT COMPETITIVE PRICES IS STILL ESSENTIAL TO COMPETITION IN LOCAL TELEPHONY.

5. It should be unnecessary to reiterate the now long-standing and court-tested principle that access to TELRIC-priced network elements, including the combination of elements known as the "UNE-P," is a key part of the competitive policy of the Telecommunications Act of 1996 ("Act"). Congress recognized that competitive entry into local telephony could range from resale to full facilities-based competition. Neither Congress nor the FCC have tried to prejudge which form of competitive entry should predominate; rather, the policy has been one of regulated access to incumbent networks at forward-looking cost-based prices that encourage efficient "make or buy" decisions. For this reason the Commission has found, quite properly in my view, that the availability of UNEs at TELRIC-based prices is essential for breaking down entry barriers – a finding that the Supreme Court upheld last year over Verizon's challenge.

6. The need for cost-based UNEs, and especially UNE-P, has not diminished. Although there have been advances in intermodal competition from wireless, cable telephony, and Voice over IP ("VoIP"), none of these forms of competition have become effective enough to constrain the market power of incumbent local exchange carriers ("ILECs").

7. The most prevalent of the intermodal sources of limited competition for the ILECs' local wireline services is wireless. But the evidence shows that few consumers view wireless as a substitute for local wireline service.[1] Consumer substitution of wireless service for local wireline service has been limited almost exclusively to the long distance market and to second lines.[2] The ILECs' own data indicate that only "3 percent of wireless subscribers" – which is itself a subset of all telephone users – have "abandoned wireline in favor of wireless entirely."[3] The lion's share of these "wireless-only" subscribers are likely college students and other young adults that have yet to establish a residence. Because the vast majority of local wireline subscribers would not turn to wireless in the event of a small but significant non-transitory price increase, wireless services do not provide an effective competitive constraint on ILECs' local services.

8. Cable telephony also still fails to provide effectively competitive alternatives for most ratepayers. Cable telephony today is available to only a tiny fraction of the local market.[4] And by the end of December 2002, cable telephony lines still constituted only

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[1] *See, e.g.*, Vince Vittore and Glenn Biscoff, *Access Line Count Evaporating,* TELEPHONY, October 14, 2002 ("[w]ireless substitution remains statistically insignificant at the national level").

[2] *See, e.g.,* Further Notice of Proposed Rulemaking and Report and Order, *Federal-State Joint Board on Universal Service, et al.*, 17 FCC Rcd. 3752 (2002) (noting that the availability of wireless services has led to substantial erosion of traditional interexchange traffic and is increasingly a substitute for payphones and second lines, but in only a small number of cases is wireless a substitute for primary wireline services).

[3] Comments of Verizon, CC Docket No. 01-338, UNE Fact Report at IV-13 (Apr. 5, 2002).

[4] Wireline Competition Bureau Industry Analysis and Technology Division Report, *Local Telephone Competition: Status as of June 30, 2001*, at Table 5 (Feb. 2002).

about two percent of nationwide switched access lines in service.[5] Moreover, cable offerings generally are limited to residential areas and therefore are not a practical alternative for most businesses.[6]

9. There is no evidence that cable telephony is likely to significantly gain market share in the foreseeable future. In fact, cable providers are generally scaling back or abandoning plans to provide local phone services.[7] Cable operators have stated that they generally intend to use their limited capital to upgrade their video offerings rather than to fund entry into local telephone markets.[8] AT&T Broadband, for example, "posted strong telephony growth numbers" before the company's sale to Comcast; since then, however, Comcast "has limited investment here to stabilize its finances."[9]

10. VoIP is even farther from providing effective local competition. Whatever its future promise, today it occupies only a tiny competitive niche, and does not provide an effectively competitive alternative for most consumers.

11. The only competitors that are even possibly likely to provide a sufficient and effective constraint on an ILEC's market power at this time are the carriers that provide a similar, equally prompt, and widely available local wireline service. Thus, as of now,

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[5] Wireline Competition Bureau Industry Analysis and Technology Division Report, *Local Telephone Competition: Status as of December 31, 2002,* at 2 & Table 5 (June 2003).

[6] *See, e.g.*, AT&T Comments, CC Docket No. 01-338 (April 5, 2002) & Willig Decl. ¶ 205; AT&T Reply Comments, CC Docket No. 01-338, at 161 (July 17, 2002).

[7] Ellen Sheng, *Cable Companies Take Slow Road to Telephony Rollout*, Dow Jones News Service (December 24, 2002).

[8] *See En Banc Hearing on Steps Toward Recovery in the Telecommunications Industry*, CC Docket No. 01-338 (October 7, 2002) (Lara Warner, Director, Credit Suisse First Boston) at 78-81.

[9] *Value Line Investment Survey* (July 4, 2003) at 721.

effective wireline competition still requires cost-based access to all UNEs without which competitive local exchange carriers ("CLECs") would be "impaired" – and the record in the FCC's Triennial Review proceeding demonstrates that this includes all of the UNEs that make up the UNE-P combination. That is reflection of the substantial entry barriers, which include scale and scope economies, sunk costs, and other costs that CLECs must incur but ILECs do not (such as hot cuts or backhaul costs), and which therefore create a non-transitory cost disadvantage for CLECs. As I have previously explained in detail, these entry barriers are severe.[10]

12. First, deployment of local networks requires the new entrant sink a large share of the cost of entry. Sunk costs, which are unrecoverable if the firm exits the market, make entry risky. Where entry involves sunk costs, it is rational for the incumbent to respond to new entry by pricing down towards its short run marginal cost. Because most of the cost of a local telephone network, once built, is sunk, short run marginal cost is likely to be below the incumbent's (and the entrant's) average cost. The rational prospect that the incumbent will price down towards short run marginal cost reduces the likelihood that entry will be profitable, and thus tends to deter entry. This is particularly true where, as here, the incumbent serves virtually the entire market, and the new entrant cannot achieve economic viability without convincing large numbers of customers to switch from the incumbent.

13. Second, local networks are characterized by substantial scale and scope economies. Where there are substantial economies of scale, a new entrant will ordinarily

[10] Robert D. Willig, *Determining "Impairment" Using the Horizontal Merger Guidelines Entry Analysis* ("Willig *Guidelines* White Paper") (attached to Ex Parte Letter From C. Frederick Beckner III, AT&T, to Marlene Dortch, FCC, CC Docket No. 01-338 (Nov. 14, 2002)).

need to attract a substantial share of customers to avoid facing higher per-unit costs than the incumbent. If such costs are also sunk, as they are here, a potential entrant knows that it would not be able to recover its costs if it is unable to offer a viable service on a sustained basis. Further, because the incumbent's costs in comparable facilities have already been sunk, it has very low short-run marginal costs, creating a significant threat that the incumbent could drop its prices towards, or even to, that level in response to competitive inroads. The threat that the incumbent might rationally do this makes it even less likely that the entrant could be profitable if it had to construct its own facilities, further deterring its entry.

14. Third, CLECs face significant operational barriers that put entrants at an absolute cost disadvantage *vis-à-vis* the incumbent. For example, I understand migrating customer lines to a CLEC-owned switch requires the CLEC to pay the incumbent for a hot cut to break the connection between a customer and the incumbent's switch and re-establish that connection onto the competitive carrier's network. CLECs must also incur backhaul and related costs (including collocation and equipment costs) to access customers' loops—costs that ILECs do not incur.

15. Access to UNEs priced appropriately based on forward-looking costs remains essential to help competitors overcome these barriers.

IV. COMPETITIVE PRICES FOR UNE-P AND OTHER UNES MUST REFLECT FORWARD-LOOKING ECONOMIC COSTS.

16. Both the FCC and the courts have ruled that, once the FCC has determined that the lack of a particular network element would impair the ability of CLECs to compete effectively, the ILEC is obligated to unbundle the element and offer it to CLECs at cost-based prices. From an economic perspective, this obligation is required to enable

effective competition. Without such a pricing requirement, CLECs would be at a competitively disabling cost disadvantage, because the opportunity cost of production incurred by an ILEC in self-provisioning the same element for its own retail operations is based on the forward-looking economic cost of the element, regardless of the internal transfer price at which the self-provisioning is recorded on the ILEC's books.

17. Prices based on forward-looking economic cost (or, to be precise, TELRIC, the particular form of forward-looking economic cost adopted by the Commission) also promote economic efficiency. TELRIC-based prices give potential entrants appropriate signals about whether the potential social benefits of competitive entry in a particular market are likely to exceed the social costs; they give entrants appropriate make-or-buy signals in choosing between facilities-based vs. UNE-based entry; and they give end-users efficient signals about which competing service to patronize. To the extent that further refinement of the TELRIC standard is warranted, the proper response is to adjust TELRIC, not to replace it with pricing that fails to be based on costs, as Verizon proposes.

18. If CLECs could reliably and efficiently secure the UNEs they need from an ILEC at economic costs, then competition between the CLECs and the ILEC, and among the CLECs, would drive end-user prices towards competitive levels, and drive industry structures and costs towards efficiency. Thus, requiring ILECs to offer network elements, and especially combinations of UNEs, priced at economic cost serves the public interest even if facilities-based competition for every network element never materializes.

19. Economic costs are calculated from the standpoint of building production and service capability today, at current input prices, and in the fashion that is most cost

effective in light of today's available technology, input prices, and expectations about demand. If current input prices are falling, then proper UNE prices must fall along with them. If current input prices are rising, then proper UNE prices must rise.

20. Consistent with the logic of competitive markets, TELRIC pricing should encourage new or potential entrants in local exchange markets to make efficient make-or-buy decisions, supplying a network element through self-provision only when the entrant can do so at a lower incremental cost than the ILEC. TELRIC pricing is also a prerequisite for efficient purchasing decisions by the ultimate consumers of telecommunications services. Consumers are encouraged to make optimal use of expenditures permitted by their budgets only when prices reflect the true relative scarcity of each good or service available in the market. It is competitive prices based on economic costs that can accomplish these goals.

21. There is no merit to Verizon's claim that offering the UNE-P at resale prices is an adequate competitive alternative to TELRIC-based UNE prices. Resale prices are calculated under the 1996 Act by marking down the incumbent's retail prices, and thus have no necessary relationship to the incumbent's economic costs. Hence, resale pricing of UNE-P does not move end-user prices toward cost or encourage efficient make or buy decisions. The standard under the Act for establishing the resale discount reduces the price paid by the reseller only by the retailing costs actually avoided by the ILEC. By definition, the resale discount thus has no effect at all on the ILEC's margins from providing its network services. To the contrary, the standard assures that the ILEC will retain its entire profit on the monopoly services.

22. Moreover, resale pricing of UNE-P would effectively kill the UNE-P as a vehicle for competitive entry. Because resale prices are generally higher than forward-

looking economic costs, allowing incumbents to charge CLECs "resale" prices for UNE-P would force CLECs to pay far more than the cost incurred by Verizon to supply access to its network for its own retail operations. This price discrimination would create a substantial and competitively disabling barrier to entry by CLECs.

23. Experience provides ample confirmation for these predictions. AT&T lost many millions of dollars in the late 1990s trying to enter the mass market for local service through resale.[11] Nationwide, the share of CLEC lines provisioned through resale has been dwindling for years.

V. VERIZON HAS FAILED TO IDENTIFY ANY FLAWS IN THE TELRIC STANDARD, OR TO SHOW THAT STATES HAVE MISAPPLIED IT BY SETTING BELOW-TELRIC RATES.

24. Verizon claims that the TELRIC principles lack objective criteria or standards on which to base rates, and provide considerable latitude to set prices without regard to costs. I emphatically disagree. The criteria and standards are well understood and actually are quite straightforward. I alluded to them in the preceding paragraphs. What uncertainty surrounds the TELRIC standard is, in large part, the consequence of the non-stop resistance by the ILECs to the efforts of state commissions to determine the costs of efficient technology and input prices, and to use those data in setting rates. The resulting confusion and delay, and the long-lasting ILEC litigation before state commissions and appellate courts, have been the source of the apparent latitude that Verizon seizes upon in its petition.

25. There is no validity to Verizon's claim that experience in litigating UNE pricing cases at state commissions has shown TELRIC to be invalid, or that the TELRIC-

[11] Ex Parte Letter from Joan Marsh, AT&T, to Marlene Dortch, FCc, at 2, CC Docket Nos. 01-338 (Jan. 23, 2003).

based rates set by state commissions have been too low. In fact, the history of UNE price-setting at state commissions since 1996 has been precisely what one would expect of the regulatory process. When regulated companies are the primary sources of the needed information, and have strong incentives to keep the information private, bringing the truth to light can take years of discovery, hearings and appeals.

26. There is nothing wrong with periodic revisions of TELRIC rates, and there is certainly no basis for the claim that revisions in TELRIC rates evidence any infirmity or fundamental flaws in the framework of making UNEs and UNE-P available at TELRIC based rates. I expect the cost of providing local telecommunications services to change. We do not live in a static world, and technological advances and productivity gains continue to result in price changes across the whole spectrum of industry. Telecommunications is no different, and if anything it has been much more dynamic than most sectors of the economy.

27. Further, there is likely still more information to be learned from the ILECs about TELRIC costs. Even now, seven years after the 1996 Act, I understand that the ILECs persist in proffering embedded, short-run or otherwise inflated cost studies as consistent with the principles of TELRIC. As regulators gain experience at holding fast and accurately to the principles of TELRIC, a downward trend in UNE prices is to be expected, even in the absence of the actual cost declines that have occurred.

28. Attachment C to AT&T's comments documents these points in detail. Verizon has identified a number of states in which the prices recently set for UNEs are lower than the prices originally established in 1996, 1997 or 1998. In none of these states, however, has Verizon shown that the rate reductions were inappropriate, or that the resulting rates violate the TELRIC standard. Rather, the rate reductions occurred

because the state commission found that costs had declined since the rates were first set, or because the rates originally set exceeded TELRIC-based costs from the outset.

VI. LOWER UNE PRICES TEND TO INCREASE, NOT DECREASE, TELECOMMUNICATIONS INVESTMENT.

29. Verizon's claim that the downward trend in UNE prices has suppressed desirable investment in the telecommunications sector is also unsupported. Verizon has essentially assumed that, because the rate of new investment in local telephony has slowed during the same period in which UNE prices have trended down, the downward trend in prices has caused the slowdown in new investment. This is fallacious.

30. To demonstrate that the change in UNE prices *caused* the change in investment flows, Verizon would have had to control for other potential factors, including changes in demand, the underlying costs of telecommunications infrastructure, the effects of other state and federal regulation, the fallout from the WorldCom scandal, the sluggish economy experienced in the U.S. over the past few years, and the collapse of the high technology "bubble." For business customers, other causal factors include the recent rash of CLEC bankruptcies (which has hampered both the ability of bankrupt and non-bankrupt CLECs to obtain credit). Had Verizon controlled for these other factors, it would have found that reductions in UNE prices, all other things being equal, tend to *increase* investment in local telephone networks.

31. I have carefully investigated (with several colleagues) the relationship between the level of UNE prices and telecommunications investment.[12] In particular, we tested the veracity of two competing views: the Investment Deterrence Hypothesis that

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[12] *See* Robert D. Willig, William H. Lehr, John P. Bigelow and Stephen B. Levinson, "Stimulating Investment and the Telecommunications Act of 1996," October 11, 2002 (filed in CC Docket Nos. 01-338).

the availability (and lower price) of UNE-Ps reduced ILEC investment, versus the Competitive Stimulus Hypothesis that the availability of UNE-P at lower prices led to increased investment as a reaction to the resulting enhanced competition.

32. Our test involved running a set of regressions on cross-sectional data that included investment of Bell operating companies ("RBOCs"), UNE-P prices, CLEC activity, cost of investment, and other economic and demographic variables. By controlling for other factors that might affect RBOCs' investment decisions, such as the general health of the economy and the demand patterns of customers in the region, we statistically isolated the relationship between UNE-P prices and RBOC investment. We found that, contrary to Verizon's claim, lower UNE-P prices were associated with statistically significantly *higher* levels of RBOC investment. Specifically, 10% lower UNE-P rates correspond to approximately a 21% to 29% higher level of investment. Moreover, we found that the effect of lower UNE-P rates on RBOC investment is felt through their positive impact on the extent of competitive CLEC activity in the region. We concluded that the unbundling of ILEC networks at more attractive rates promotes competition, and thereby stimulates investment in telecommunications infrastructure by incumbents and entrants alike. In other words, lower UNE-P prices are the sparks that light the fire of telecommunications infrastructure investment. Lower UNE-P prices did encourage more CLEC activity, and that competitive activity, in turn, spurred more RBOC investment in telecommunications infrastructure.

33. Verizon's analysis suffers from another fundamental error: Verizon confuses a decline in the flow of new investment with a decline in the aggregate level of capital stock. The two obviously cannot be equated. The former is part of the change in the latter, and a declining but positive net flow of investment will still produce an absolute

increase in the capital stock. This distinction has more than theoretical significance. Major competitive innovations in network industries often set off a gold rush of new investment that slows when the speculative fever cools. This phenomenon, which has occurred in industry after industry—including railroads, automobiles, airlines, radio, personal computers, and the Internet—is a causal factor independent of the level of UNE prices.

34. Verizon has assumed, without foundation, that what it experiences as flawed or at least uncomfortable regulation has diminished investment, to the harm of the public interest. As I have emphasized, the evidence points squarely the other way – where UNE-P has been available at lower prices, there has been more investment not less. But in addition to fostering competition that stimulates investment, the availability of UNEs at appropriately competitive prices helps to assure that resulting levels of investment are those that do best serve the public interest. The TELRIC standard provides the efficient make-or-buy test for whether CLEC facilities investment should be made—or whether CLECs instead should use the existing capital stock more intensively by leasing UNEs from the incumbents.

VII. VERIZON'S GROSS MARGIN ANALYSIS IS UNSOUND.

35. Verizon's supposed demonstration that TELRIC-based pricing of UNE-P gives CLECs enormous gross margins yields no valid inferences or conclusions about the reliability or desirability of mandating access to UNE-Ps at TELRIC-based rates. Verizon's calculations appear to omit sizeable elements of costs, including those for marketing, billing, customer care, maintenance and other "retailing" functions, that a CLEC must incur to provide local retail service. Thus, no valid conclusions can be

drawn from Verizon's purported demonstration about whether a CLEC would or would not be expected to operate successfully and profitably.

36. Further, while TELRIC-based rates for UNE-P reflect the relevant economic costs, it would not be surprising to find that prices for retail services in particular density zones or for particular end-user services diverge significantly from economic costs. Indeed, one of the expected socially beneficial impacts of access to TELRIC-priced UNEs is that UNE-based entry will drive supra-competitive retail rates toward cost.

VERIFICATION

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

/s/ Robert Willig
Robert Willig

August 15, 2002

AT&T'S ATTACHMENT B

TELRIC PRICING FOR THE UNE PLATFORM HAS NOT DETERRED EFFICIENT INVESTMENT AND ENTRY IN FACILITIES-BASED COMPETITION

"The TELRIC rules devalue the investments of incumbent carriers by prescribing rates for those facilities that substantially understate any real-world measure of their costs. . . . [The] application of TELRIC to UNE-P has unquestionably contributed to a massive decline in telecommunications industry investment, directly contravening the core goal of the 1996 Act. . . . As use of the UNE-P at TELRIC rates has increased, investment by all telecom carriers, incumbent LECs and competing carriers alike, has declined significantly. . . . At its peak in the year 2000, the telecom sector as a whole was investing about $110 billion per year. . . . But the TELRIC and UNE-P rules have so significantly devalued the telecom sector that this level of investment is no longer sustainable."

—Verizon Petition for Expedited Forbearance (July 1, 2003) at 6 and Attachment B at 14-15.

"Verizon plans to roll out fiber-optic connections to every home and business in its 29-state territory over the next 10 to 15 years, a project that might reasonably be compared with the construction of the Roman aqueducts. It will cost $20 billion to $40 billion, depending on how fast equipment prices fall. . . . The company says it will pump $12.5 to $13.5 billion into capital expenditures this year, the third-largest capital budget in the world after DaimlerChrysler and General Electric Co. That's on top of the $3 billion a year it's paying in yearly interest because of its $54 billion debt load. How can Verizon pay for all this? Its business is one of the great cash machines of Corporate America. The largest local-phone operator and the largest wireless company, Verizon generates about $22 billion a year in cash from operations. That's 50% more than SBC, twice as much as BellSouth, and nearly three times as much as AT&T. . . . [Verizon CEO] Seidenberg expects to cover the fiber-optic initiative without raising the capital budget above the current level, while he continues to reduce the company's debt. 'Funding is not an issue,' he says."

—BUSINESS WEEK (August 4, 2003) at 53-55.

> "Referring to prepared materials for his presentation outlining Verizon's longstanding opposition to the UNE-P rules, [Lawrence T. Babbio Jr., Verizon's vice chairman and president-telecom] said, 'I have been relatively polite in saying we want to address this issue.' More bluntly, Mr. Babbio said, 'I would want to say, 'Kill those little suckers.' That's how we feel about UNE-P.'"
>
> -TELECOMMUNICATIONS REPORT DAILY, January 7, 2003.

AT&T submits this Attachment in response to Attachment B of Verizon's Petition for Expedited Forbearance, filed July 1, 2003 ("Petition"). Verizon's Attachment B, entitled "The Negative Effect of Applying TELRIC Pricing to the UNE Platform on Facilities-based Competition and Investment" ("Petition, Att. B") makes three claims:

- The decline in prices for unbundled network elements ("UNE") set by state commissions since 1996 is evidence that the TELRIC standard is inherently flawed.

- The decline in unbundled network element rates has caused overuse of the "platform" of UNEs ("UNE-P") by competitive local exchange carriers ("CLECs"), underinvestment by CLECs in facilities-based entry, and underinvestment by the local telephone industry as a whole.

- Cost-based regulation of the prices charged for UNEs—even including the requirement that the incumbent carriers ("ILECs") unbundle their network elements—is no longer necessary because intermodal competition from wireless, cable, and voice-over-IP networks is sufficiently robust to serve as an adequate competitive constraint on the ILECs.

Verizon and other ILECs have been making similar claims since 1996. These claims were considered and rejected by the Commission in the *Local Competition Order*, 11

FCC Rcd. 15499 (1996) , and by the Supreme Court last year in *Verizon Communications Inc. v. FCC*, 535 U.S. 467 (2002). Nothing in Verizon's Attachment B warrants a fresh review of these issues, much less the relief sought.

The downward trend in UNE-P rates is evidence that the 1996 Act is beginning to work, not that it has failed. As demonstrated in detail in AT&T's Attachment C, UNE prices have fallen since 1996 because state commissions have become more adept in applying the TELRIC standard and excluding the embedded or inefficient costs that ILECs had previously succeeded in passing off as TELRIC-compliant. In fact, much of the recent downward trend in UNE rates is the direct result of Verizon's "carelessness" in the initial round of UNE rate cases. Specifically, Verizon successfully argued to several state commissions that the low prices it had traditionally obtained when it purchased "new" switches were not sustainable going forward and that, in the future, it (or any "efficient" carrier) would have to pay the much higher rates that vendors charge for "growth" switches. Proof subsequently emerged that Verizon's assertion was not accurate, and the state commissions that had previously been duped by Verizon have properly responded by lowering the UNE switching rate to reflect corrected costs.

Indeed, any doubt that initial UNE rates were well in excess of TELRIC levels is dispelled by Verizon's own actions. Contrary to Verizon's claims here, the per unit costs of providing telecommunications services have declined since 1996. And that is why, before state commissions, Verizon itself has voluntarily proposed significantly *lower* UNE rates. Verizon cannot be heard to now claim that the downward trend in UNE prices demonstrates consistent misapplication of TELRIC after Verizon has repeatedly acknowledged that earlier rates were too high.

And, as detailed below, the supposedly inflated margins offered by TELRIC-based UNE prices are a Verizon invention. Verizon makes no attempt to provide any concrete data or to perform any independent analysis, but instead points to a "report" by an investment banking firm that purports to show that UNE-P rates are well below existing retail rates. Every aspect of this report is flawed. The report both overstates the revenues and understates the costs of a CLEC that uses UNE-P to provide retail telecommunications services. Moreover, the report provides only "gross" margins and simply assumes away the substantial costs incurred by any carrier (ILEC or CLEC) in marketing, billing, customer care, maintenance and other retailing costs.

Nor has Verizon offered any credible evidence that TELRIC-based rates have led to "overuse" of UNE-P or "underinvestment" in local network assets. The most persuasive answer is simply Verizon's own investment plans. While bad-mouthing TELRIC to the Commission, Verizon has embarked upon a $13 billion-a-year plan to deploy fiber to virtually every residence and business in Verizon's local service territory.

Verizon's analysis of other carriers' investment incentives is equally unsupported. Verizon has simply *assumed*—based upon the logical fallacy *post hoc ergo propter hoc* ("after this, therefore because of this")—the existence of a causal relationship between changes in UNE prices and changes in investment flows and market capitalization. Against this sophomoric "analysis," the Commission must compare the wealth of actual empirical evidence that Verizon ignores and that demonstrates that lower UNE rates foster investment and facilities-based competition. These econometric studies, which use a variety of standard statistical techniques, have demonstrated that lower UNE prices lead to *increased*, not decreased, investment in the local telephone business, by CLECs and ILECs alike. This finding is fully consistent with economic theory, as well as "commonsense," which predicts that competition will lower prices and improve quality, increasing consumer demand and fostering additional investment. *Verizon*, 535 U.S. at 517 n. 33.

Verizon tries to make up for the obvious deficiencies in its own work by pointing to supposed "independent" investment analysts to support its position. But these studies too are statistical nonsense (and to suggest that some of these "analysts" are independent is to presume incredible naïveté by the Commission). First, these "studies" confuse *overall* investment with *changes* in investment—in fact, capital investment remains at record levels.[1] And to the extent there has been a decline in the *growth* of investment, this decline in growth clearly has nothing to do with "low" UNE-P prices. Instead, the decline is influenced by other factors which Verizon does not even attempt to control for in its "analysis" – *e.g.*, the bursting of the Internet technology bubble, the inability of CLECs to gain access to capital markets, and, most fundamentally, the realization – the same realization that informed the Commission's impairment determinations in the forthcoming *Triennial Review Order* – that persistent economic entry barriers make it generally uneconomic to overbuild ILEC facilities. In sharp contrast, TELRIC-based prices give CLECs accurate signals about the true economic costs of their make-or-buy decisions and thereby encourage the optimal mix of UNE-based entry and facilities-based entry. *See Verizon*, 535 U.S. at 508-515. The fact that a larger share of entry now occurs through UNE-P is a clear demonstration that the TELRIC standard is properly performing its price-signaling function.

Finally, Verizon attempts to round up the usual suspects (wireless, cable, and voice over Internet Protocol ("VOIP") service providers) in support of a preposterous claim that intermodal competition effectively constrains Verizon's local market power. Neither wireless

[1] Verizon never defines what it means by "investment." As used herein, "investment" means the addition to capital stock (*i.e.*, gross capital stock), as opposed to "net" capital stock (*i.e.*, gross capital minus depreciation).

service, nor cable service, nor any of the other fringe market services identified by Verizon are today viable alternatives to local wireline services for most end-users. Eliminating the principal vehicle in the 1996 Act for entering local markets is clearly improper unless and until ubiquitous intermodal competition has irreversibly broken the ILEC local monopolies and the ILECs have an economic incentive to offer CLECs wholesale access to their networks on reasonable and sustainable terms and conditions.

I. THE DOWNWARD TREND IN UNE-P RATES SINCE 1996 IS EVIDENCE THAT THE RATESETTING PROCESS IS BEGINNING TO WORK.

Verizon argues that TELRIC must be flawed because rates for the UNE platform have been "ratcheting down" to "increasingly lower levels" in recent years. *See* Petition at 2-3 & Att. B at 1-13. Asserting that the TELRIC framework gives state commissions "considerable latitude . . . to set rates without regard to costs," Verizon contends that the reduction in UNE-P rates since 1996 does not reflect decreased costs in producing UNEs during that period, but results instead from "pressure to produce the appearance of competition by providing CLECs what they claim is a 'sufficient' profit margin between UNE prices and retail rates, which themselves are often artificially low, to make it worth their while to 'compete' in a given state." *Id.* at 2-3. Verizon does not provide a shred of evidence that maverick state commissions (and reviewing courts) have abdicated their statutory responsibility in this manner. Indeed, the facts are quite different from Verizon's fantasy. UNE rates have fallen for two reasons: First, initial UNE rates included embedded and other inappropriate costs; second, the underlying cost of providing UNEs has declined, as Verizon effectively concedes in state proceedings in which it has voluntarily proposed substantial rate reductions.

Verizon also attempts to buttress its position by claiming that UNE rate reductions have enabled CLECs to realize average gross margins from 47 percent to 66 percent in nearly every Verizon state. *Id.* at 4 & Att. B at 1. Verizon can arrive at these numbers only through fuzzy math that does not withstand minimal scrutiny.

A. UNE Prices Have Fallen Because State Commissions Have Become More Proficient At Applying The TELRIC Standard And Detecting ILEC Efforts To Subvert It.

The decline in UNE-P rates that Verizon assails indicates only one thing—that the state adjudicative process is finally beginning to succeed—not that the TELRIC standard has somehow failed. The decline in Verizon's margins that has resulted from the decrease in UNE-P rates is an *intended* consequence of the 1996 Act. Congress enacted a new regulatory scheme that sought to promote competition and eschewed the preexisting rate-of-return ratemaking methodology, plainly barring the ILECs from recovering the monopoly rents and inefficient costs they had traditionally earned.[2]

First, the re-prescription of UNE prices by state commissions since the initial prescription of those prices in 1996, 1997, or 1998, is a normal part of the ratemaking process. As the Commission has stated, "[s]tates review their rates periodically to reflect changes in costs and technology," and "rates may well evolve over time to reflect new information on cost study assumptions and changes in technology, engineering practices, or market conditions."[3] Thus,

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[2] *See* G. Ford and T.R. Beard, *What Determines Wholesale Prices for Network Elements in Telephony? An Econometric Evaluation*, Phoenix Center Policy Paper No. 16 (September 2002) at 1, 4, 23 ("Phoenix Center Policy Paper No. 16"). *See also Competition and Bell Company Investment in Telecommunications Plant: The Effects of UNE-P*, Phoenix Center Policy Bulletin No. 5 (July 9, 2003) at 2 n. 3 ("Phoenix Center Policy Bulletin No. 5").

[3] Memorandum Opinion and Order, *Application by Verizon New England Inc, et al., for Authorization to Provide In-Region, InterLATA Services in New Hampshire and Delaware,* 17 FCC Rcd. 18660, ¶ 57 (2002); Memorandum Opinion and Order, *Application by Verizon New England Inc., et. al., for Authorization to Provide In-Region, InterLATA Services in Rhode Island*, 17 FCC Rcd. 3300, ¶ 31 (2002).

Verizon's attempt to portray this normal updating process as a contrivance by state commissions to "produce the appearance of competition" (Petition at 3) is completely baseless.

Second, Verizon's attempt to blame the reductions in UNE-P rates on "flaws" in TELRIC or its implementation by state commissions cannot obscure the real grievance of Verizon and other ILECs. The simple fact is that with increasing experience at applying the TELRIC standard, state commissions have begun to penetrate the ILECs' pseudo-TELRIC cost studies and to exclude the embedded, short-run or inefficient costs that all too often inflated earlier UNE-P rate prescriptions. Verizon provides no evidence at all that state commissions in recent UNE rate proceedings have done anything but apply the Commission's TELRIC pricing rules to much better cost evidence than was available in 1996 or 1998.

As detailed in AT&T's Attachment C to these Comments ("AT&T Att. C"), state commissions that had previously set much higher loop rates in the past have lowered those rates after discovering substantial errors in Verizon's cost studies. For example, the Maine commission found that Verizon's proposed feeder and distribution fill rates were "unacceptably low," and its proposed cable sizes were "overstated," resulting in a "significant overstatement of Verizon's costs." AT&T Att. C at 17. This error required reductions in Verizon's proposed recurring rates, including rates for two-wire analog loops and switching, to eliminate the "upward bias" caused by Verizon's assumptions. The Massachusetts commission refused to adopt Verizon's cost models after Verizon acknowledged that the models did not follow TELRIC's "scorched node" requirement. *Id.* at 30-31. And while the New York commission had previously accepted at face value Verizon's contention that most DLC lines would be terminated at the switch using older DLC technology (despite the use of 100 percent fiber feeder), the same commission in 2002 recognized that the use of IDLC and GR-303-compliant technology was more consistent with forward-looking principles. Thus, the New York commission ordered that loop rates should be reduced to reflect IDLC connections unless Verizon could establish that such an adjustment would be unreasonable. *Id*. at 56.

For switching, much of the "downward" trend is due to the discovery that Verizon's submissions in earlier rate proceedings grossly overstated switch prices. Basic TELRIC principles require that UNE prices reflect the costs of a "reconstructed" "least-cost" local network. In proceedings before the New York commission, however, Verizon claimed that it would no longer be able to obtain the steep discounts it had received in the past for the purchase of "new" switches. In response, the New York commission (and other state commissions that adopted the New York commission's approach) set switching prices that reflected the higher prices that Verizon claimed it would have to pay for new "growth" lines. Subsequently, Verizon's claim was revealed to be false, because Verizon has continued to obtain the steepest discounts for new switches, and Verizon will be able to obtain these discounts for the foreseeable future. *Id.* at 49-50. Once Verizon's "carelessness" was uncovered, the state commissions that Verizon had duped responded by setting lower switching rates in subsequent UNE rate proceedings. *Id.* at 50-52.

Indeed, Verizon itself has acknowledged that the UNE rates set in the initial round of rate cases were too high and can no longer be retained in light of dramatic declines in the costs of providing local services. For example, Verizon itself proposed to the California and Florida commissions that the switching rates set in prior proceedings be substantially *reduced*. *Id.* at 3, 10. Most recently, on June 5, 2003, Verizon filed a letter with the New Hampshire commission voluntarily agreeing to: (1) reduce switching and transport rates by approximately 17-18 percent; (2) reduce significantly monthly rates for 2-wire and 4-wire analog loops in the rural density zone; (3) reduce all DS1 loop rates by 20 percent; and (4) reduce daily usage file rates by approximately 70 percent. *Id.* at 40. Verizon cannot simultaneously propose lower UNE rates to the state commissions and complain that UNE rates have been unfairly "ratcheted" downward "to produce the appearance of competition."

In sum, as a recent third-party econometric analysis concluded in rejecting claims such as Verizon's, "the states have been extremely careful to ensure that TELRIC rates accurately reflect the Bells' forward-looking costs," and "wholesale prices for UNE-P are not directly related to retail prices for local telephone service."[4] When recent state pricing decisions have erred, the errors have not generally resulted in rates that are "too low"; rather the errors that have resulted are due to lingering deference to the ILECs' cost studies, which often prove to overstate costs. All too often, state commissions still suffer from a tendency to split the baby, arbitrarily picking a middle ground between the position of the ILEC and that of the CLECs rather than rigorously enforcing the TELRIC standard.[5] *See, e.g.*, AT&T Att. C at 10. This preserves more profit for the ILECs than TELRIC allows.

B. The Inflated Margins That Verizon Touts Are A Verizon Invention.

Verizon also attempts to prove that UNE-P rates are too low because of the allegedly large margins that are available to CLECs using UNE-P as an entry vehicle. *See* Petition at 4 & Att. B at 1, 18-19. At the outset, this is simply an irrelevant exercise. Even if Verizon could demonstrate that "large" margins were available to CLECs using UNE-P, that would be all the more reason to encourage UNE-based competition. Because UNE-P rates are cost-based, UNE-P based competition would make it difficult for an incumbent with gross margins that are out of line with efficient retailing costs to maintain its retail rates at current

[4] Phoenix Center Policy Bulletin No. 5, at 2 n. 3; Phoenix Center Policy Paper No. 16, at 1, 3-4, 23.

[5] Phoenix Center Policy Paper No. 16 at 1.

levels. UNE-based entry would, therefore, have the (intended) beneficial effect of driving supra-competitive retail rates toward cost and eliminating ILEC monopoly profits.

But even on its own terms, Verizon's argument is not entitled to any weight. Verizon bases its argument almost entirely on a Legg Mason Report released last December, not on any evidence that Verizon itself has provided to the Commission.[6] The Legg Mason Report, however, is fundamentally flawed. It overstates revenues, understates costs and, in all events, addresses only *gross* margins that ignore altogether the CLEC's substantial systems, marketing, billing, customer care, maintenance and other retailing costs. It thus provides no relevant measure of the actual profitability of UNE-based services. Putting an end to cost-based UNE-P, as Verizon proposes, could only drive AT&T and other CLECs from the markets where UNE-P competition is possible today and foreclose CLECs from making available local service offerings on a statewide basis in other states.

With regard to revenues, the Legg Mason Report – like the NRRI survey from which it appears to have derived its data – erroneously assumes that a CLEC gets to keep revenues that are clearly passthrough charges.[7] Thus, for example, Legg Mason assumes that a CLEC keeps taxes and 911 charges when, in fact, whatever sums that a CLEC collects for these items must in turn be paid to other parties. Nor is it appropriate to include the level of USF

[6] *See* Petition at 4 & n. 6, Att. B at 1 & n. 2, citing Legg Mason, *UNE-P Relief: Investors Expect Too Much* at 9 (December 19, 2002) ("Legg Mason Report").

[7] As its "local revenue," Legg Mason appears to have used the same per-line revenue data that NRRI utilized in its study of UNE prices and average revenue per line. Those revenue data were derived from the Commission's *Trends in Telephone Service*. Wireline Competition Bureau Industry Analysis and Technology Division, *Trends in Telephone Service*, Tables 8.1–8.9 (May 2002). *Compare* Legg Mason Report at 9 (column entitled "Local revenues only") *with* Billy Jack Gregg, *A Survey of Unbundled Network Prices in the United States (Updated July 1, 2002)* at Table 2 ("*2002 NRRI Survey").*

collections assumed by Legg Mason. Such universal service support is available to only targeted high-cost geographies. The Legg Mason Report also inflates available revenues by using urban area retail rates where rates tend to be higher rather than average retail revenues that reflect the geographic scope of CLEC services. The source for these rates is a 90-city survey, and some states are not represented at all and thus the rate Legg Mason uses comes from a city in another state.[8] Finally, the Legg Mason Report includes revenues associated with certain vertical features like voicemail and inside wire but omits the additional costs of providing those services.[9] That is a critical failure because the costs that a CLEC incurs for voicemail and inside wire are in addition to the costs of UNEs.

In addition, the costs of providing service using UNE-P are understated by Legg Mason. Legg Mason appears to have derived its data on rates for loops and the UNE-P for each state from NRRI's surveys of such rates.[10] NRRI data understate the true costs of UNE-P to the CLEC because they omit certain charges that CLECs must pay to the ILECs for their provision of service through the UNE platform. For example, NRRI fails to include the cost for transport and signaling, despite admitting that "in most instances it is necessary to also purchase

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[8] Legg Mason Report at 9. *Cf.* Wireline Competition Bureau, Industry Analysis Division, *Reference Book on Rates, Price Indices, and Household Expenditures for Telephone Service*, Tables 1.3 and 1.10 (July 2002), http://www.fcc.gov/wcb/stats/REF02.PDF; *2002 NRRI Survey* at 5 n. 12 ("most of the cities used in the FCC's rate surveys are larger cities").

[9] Legg Mason Report at 8-9. In contrast, the NRRI survey did not consider such additional features and revenues therefrom, because it did not consider the costs of providing those services. *2002 NRRI Survey* at 4 n. 8. The Legg Mason Report also improperly assumes that customers in every state will generate the same vertical features revenues. Legg Mason Report at 8-9.

[10] *Compare* Legg Mason Report at 9 (columns entitled "Average loop rates" and "Estimated UNE-P rates") *with 2002 NRRI Survey*, App. 3 at 1. For the Verizon region, the Legg Mason and NRRI reports differ only in New Jersey, where the UNE-P rate is listed as $12.89 in the NRRI survey and as $12.62 in the Legg Mason Report. Legg Mason Report at 9.

unbundled transport in order to have a basic UNE platform capable of supplying local service."[11] Nor do NRRI's data include estimates of charges for daily usage files or non-recurring charges ("NRCs"). This is a critical omission because the Commission has long recognized that NRCs can be sued as a barrier to entry and therefore cost-based pricing for NRCs is critical to making competitive local telephone entry economically feasible.[12]

NRRI also understates the true costs of UNE-P because of flawed usage assumptions. Specifically, because UNE-P prices are traffic-sensitive, determining the true costs of UNE-P requires an accurate estimate of CLEC traffic. Rather than use actual minutes of use ("MOUs") by state, however, NRRI's analysis simply estimates usage-sensitive rate components by assuming a constant 1,000 MOUs per line per month in each and every state.[13] Even assuming *arguendo* that NRRI's use of a one-size-fits-all average is otherwise proper, the 1,000-

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[11] Billy Jack Gregg, *A Survey of Unbundled Network Prices in the United States (Updated January 1, 2003)* at 3 n. 10 *("2003 NRRI Survey")*; *2002 NRRI Survey* at 2-3 & n. 7. NRRI explained that "state transport rates were too variable to reduce to monthly dollar figures." *Id.*

[12] *See, e.g.*, *AT&T Communications*, 103 FCC 2d 77, ¶ 37 (1985) ("[i]t is evident that nonrecurring charges can be used as an anticompetitive weapon to . . . discourage competitors"); Second Memorandum Opinion and Order on Reconsideration, *Expanded Interconnection with Local Telephone Company Facilities*, 8 FCC Rcd. 7341, ¶ 43 (1993) ("absent even-handed treatment, nonrecurring reconfiguration charges could constitute a serious barrier to competitive entry"). *See also* 47 C.F.R. § 51.507(e) ("[n]onrecurring charges . . . shall not permit an incumbent LEC to recover more than the total forward-looking economic cost of providing the applicable element").

[13] *See NRRI 2002 Survey* at 3; *NRRI 2003 Survey* at 3. In addition, NRRI fails to describe the basis for the various assumptions and allocations that it makes in connection with its assumption of a total of 1,000 minutes of use per line per month. For example, NRRI states that it allocated the 1,000 minutes on a 50/50 basis in states with on-peak/off-peak switching rates (or originating/terminating switching rates), and 50/30/20 in states with day/evening/switching rates. But NRRI fails to describe how it determined these particular allocations or why such allocations should be assumed to be the same for each state. Similarly, NRRI assumes 100 calls per month – *i.e.*, 10 minutes per call, a ridiculously high figure – in states with per-call or set-up rates, but does not provide any basis for its figure. *NRRI 2003 Survey* at 3; *NRRI 2002 Survey* at 3.

MOU figure is an understatement. For example, in performing a benchmarking analysis of Verizon's non-loop UNE rates in Pennsylvania, the Commission assumed 2,400 MOUs per month – 1,200 originating and 1,200 terminating – more than twice the level of demand assumed by NRRI.[14] This would be a more realistic assumption in calculating of the costs of UNE-P.

Lastly, the loop costs reported by NRRI are not representative. For virtually every state, NRRI determines average loop rates that are identical for both residential and business customers.[15] In reality, however, the average price of loops will be higher for the CLEC when it provides residential service, rather than business service, because businesses tend to be located in lower cost, more urban areas.[16] Similarly, NRRI's approach of providing prices for loops per zone and a weighted average loop price for each state assumes that the CLEC will provide service throughout each state.

But even if the Legg Mason Report accurately measured revenues and direct costs, that would merely demonstrate the "gross" margins available to CLECs and would provide no evidence at all as to whether CLECs could profitably offer local service. As Verizon CEO

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[14] *See* Memorandum Opinion and Order, *Application by Verizon Pennsylvania for Authorization to Provide In-Region Inter-LATA Services in Pennsylvania*, 16 FCC Rcd. 17419, ¶ 67 n. 252 (2001). In its survey with data updated to January 1, 2003, NRRI acknowledges that the national average is 1,400 MOUs per month, and that "several states have average MOU in excess of 2000 MOU per month." *NRRI 2003 Survey* at 3 n.9. NRRI attempts to address this problem by also computing UNE-P costs based on 2,000 minutes of use per line per month, which produces higher UNE-P rates than a scenario assuming usage of 1,000 MOUs. *See id.* at 3 n. 9 & App. 3 at 2. Like its original 1,000-MOU approach, however, NRRI's new alternative methodology fails to use actual MOU data and erroneously assumes no variations between states, even though NRRI effectively acknowledges that variations exist. In any event, NRRI used only the 1,000-MOU scenario to compute the price change percentages relied on by Verizon. *Id.*

[15] *See, e.g., 2003 NRRI Survey*, Tables 3 & 4.

[16] *Cf. 2003 NRRI Survey* at 5 n. 12 (acknowledging that "most of the cities used in the FCC's rate surveys are larger cities, typically falling in the lowest cost UNE loop zone in each state").

Ivan Seidenberg has acknowledged to the financial press, new entrants incur a host of additional costs beyond the leasing of network elements that provide only the necessary network connectivity. R. Krause, *Verizon's New York Fight Key to AT&T Challenge*, INVESTORS' BUSINESS DAILY, Aug. 15, 2000, at A6 (quoting Mr. Seidenberg). To provide finished retail services, CLECs must incur costs for marketing, advertising, and promotional inducements to "acquire" customers; labor and other customer care costs to respond to customer inquiries; labor, systems and related costs to bill customers; and bad debt expenses. These costs are substantial. AT&T has demonstrated that these "internal" costs are generally in excess of over $10 per month per line[17] – a level that eats up most of the "margin" that Legg Mason claims to be available to CLECs. And if Verizon's proposals were adopted, any existing margins would be eliminated completely, requiring AT&T and other CLECs to exit the market.

Apart from the Legg Mason Report, the only "proof" offered by Verizon of the allegedly lucrative margins from TELRIC pricing of UNE-P consists of promotional claims for "arbitrage opportunities" offered by "telecom consultants." Petition, Att. B at 18-19 & nn. 75-78. Entire "cottage industries" of "consultants," however, also promise lucrative returns from penny stocks, Ponzi schemes, and Nigerian advance-fee frauds; only the gullible take these offers seriously. If entry by UNE-P were as profitable as Verizon contends, Verizon would be rushing to expand outside its footprint via UNE-P instead of sinking tens of billions of dollars annually into its own network. *See* Steve Rosenbush, *Verizon's Gutsy Bet*, BUSINESS WEEK Aug. 4, 2003, at 53-55.[18] Verizon asks the Commission to accept fly-by-night sales pitches as a

[17] *See, e.g.*, Ex Parte Letter from Amy Alvarez to William Caton, CC Docket No. 02-7, Declaration of Steven Bickley ¶ 2, March 29, 2002.

[18] This announcement merely reflects Verizon's campaign of regulatory blackmail in which it threatened to withhold this investment until it got "broadband regulatory relief."

basis for jettisoning TELRIC rather than hard evidence regarding the actual costs of providing retail telecommunications services. The Commission should decline this invitation.

II. VERIZON HAS OFFERED NO CREDIBLE EVIDENCE THAT TELRIC-BASED RATES HAVE CAUSED OVERUSE OF UNE-P OR UNDERINVESTMENT IN LOCAL NETWORK ASSETS.

Verizon also fails to show any " causal link" between the decrease in UNE prices and a decline in investment in the local network. This is a fatal omission, for the courts have made clear that regulators cannot permit incumbent monopolists to earn "creamy" returns in order to "incentivize" them to make greater investments in their monopoly networks without a substantial showing of a causal relationship between higher rates and more investment. *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1503 (D.C.Cir. 1984). Of course, Verizon's inability to show a causal link is understandable because its thesis is contrary to basic economic theory and empirical evidence.

A CLECs has every incentive to deploy its own facilities where economically feasible to do so and to avoid dependence on the ILEC supplier that is also the CLEC's main competitor and thus has a strong incentive to give it inferior service. Furthermore, as the D.C. Circuit recognized, the availability of UNEs can act as a "bridge" mechanism that allows a CLEC to overcome sunk costs entry barriers, permitting a CLEC to first gain a customer base and then deploy facilities. *United States Telecom Association*, 290 F.3d 415, 423 (D.C.Cir. 2002). Likewise, as the Supreme Court found in *Verizon*, TELRIC-based rates give ILECs ample incentive to invest in network facilities. 535 U.S. at 517 n. 33. Indeed, the Supreme Court found this principle "commonsense" since the availability of cost-based UNEs induces competition, which in turn gives the ILECs strong incentives to make network investments necessary to attract or retain customers. *Id.*

In the Triennial Review Proceeding, several econometric studies tested this economic theory. All demonstrated that lower UNE rates *increased*, rather than *decreased*, investment incentives. As described in greater detail below, AT&T submitted studies employing standard econometric procedures, which showed that a 1% reduction in UNE-P rates corresponds with an approximately 2.1% to 2.9% increase in ILEC investment. Likewise, hard economic data contradicted Verizon's claim that the availability of UNE-P impairs CLEC investment incentives. Using a variety of established techniques, AT&T also provided a regression analysis to measure its own local facilities deployment in a state – controlling for the influence of leased facilities prices on these expenditures. In each case, the results show that the greater the use of leased facilities by AT&T, the greater the deployment of its own facilities. These findings have subsequently been confirmed by econometric studies conducted by an independent think tank.

Verizon's arguments to the contrary flunk Statistics 101. Verizon simply asserts that "because" investment has declined after UNE prices have decreased, the lower UNE prices must "cause" the decline in investment. Not only does this *post hoc ergo propter hoc* fallacy fail to prove causation, the very notion that investment has declined is entirely fabricated. Instead of looking at actual levels of investment, Verizon can show only that the rate of *growth* in investment has declined in recent years. And critically, in relying on this incorrect variable, Verizon ignores the fact that investment in the industry (including CLEC investment) remains at record levels. Indeed, Verizon itself has announced an ambitious plan to roll out fiber-optic connections to every home and business in its 29-state territory at the cost of tens of billions of dollars.

A. Verizon Has Provided No Support For Its Assumption That Changes In Investment Levels Are Caused Primarily By Changes In UNE Prices.

Verizon's entire argument is based on an invalid statistical premise. Verizon has simply *assumed* the existence of a causal relationship between downward trends in UNE prices and recent trends in investment growth and entry into local telephony.

For example, Verizon fails to recognize the typical boom-and-bust cycle that has occurred after every innovation in a network industry—a slowdown in investment after a speculative bubble. Other relevant factors include changes in demand; the underlying costs of telecommunications infrastructure; the effects of other state and federal regulation; the fallout from the Worldcom scandal; and "the sluggish economy experienced in the U.S. over the past few years."[19] With respect to business customers, other causal factors include the recent rash of CLEC bankruptcies (which has hampered both the ability of bankrupt and nonbankrupt CLECs to obtain credit).[20]

More fundamentally, Verizon's "analysis" likewise presumes that absent UNE-P, CLECs would serve customers using their own facilities (presumably by deploying their own switches and connecting them to leased loops). Again, this assumption founders on the facts. As

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[19] *See* Ex Parte Letter from C. Frederick Beckner III to Marlene Dortch, CC Docket No. 01-338, Oct. 22, 2002, M. Pfau, *Correcting the RBOCs' Empirical Analyses of the Linkage between UNE-P and Investment* at 20 ("Pfau Empirical Correction"); *Competition and Bell Company Investment in Telecommunications Plant: The Effects of UNE-P,* Phoenix Center Policy Bulletin No. 5 ("Phoenix Center Policy Bulletin No. 5") at 8 & n. 18; *cf.* R. O. Beil, G. S. Ford, and J. D. Jackson, *On the Relationship between Telecommunications Investment and Economic Growth in the United States* (June 2003) (www.telepolicy.com).

[20] Reply Comments of AT&T at 4, 106-07, 127, 137, 265-67, CC Docket 01-339, July 17, 2002 (summarizing evidence); FCC News Release, *FCC Chairman Michael Powell Appointed to President Bush's Corporate Fraud Task Force* (July 9, 2002). Furthermore, Verizon's analysis of facilities-based competition in business markets is based on data from only three states. Petition, Att. B at 17. Verizon has failed to show that this sample is representative of the larger universe.

demonstrated in the *Triennial Review* proceeding, it is generally unfeasible for CLECs to self-deploy switches to serve residential customers. That is because entry for switch-based service offered to mass-market customers requires new entrants to incur very significant costs that ILECs do not have. Thus, "higher" UNE rates would not increase investment by CLECs but merely cause them to exit the market – which, of course, is the real result that Verizon seeks.

CLECs cannot economically self-deploy their own switches to serve residential and small business customers because the way in which the ILECs have constructed their local networks prevents CLECs from gaining access to bottleneck loops at a cost comparable to the ILECs' costs. First, a CLEC seeking to use its own switches must incur significant sunk costs in order to extend its customers' loops from the ILEC's LSO to the building where the CLEC's switch is located.[21] These costs, which are sometimes collectively referred to as "backhaul" costs, are necessary because a CLEC seeking to serve residential and small business customers can expect to win only relatively small numbers of customers in a particular LSO. As a result, the CLEC must increase the geographic scope of its switches by employing a different type of network architecture than the ILEC's. Specifically, rather than deploying numerous switches located in close proximity to customers, as the ILEC does, the CLEC must deploy a single switch that serves a much broader geographic area than the ILEC's switch. This is usually the only way a CLEC can achieve scale economies comparable to those achieved by the ILEC. To accomplish

[21] *See generally* Ex Parte Letter from Joan Marsh to Marlene Dortch, CC Docket 01-338, Jan. 17, 2003 ("1/17/03 AT&T Cost Disparity Study"); Ex Parte Letter from Joan Marsh to Marlene Dortch, CC Docket 01-338, Oct. 4, 2003, *Comparing ILEC and CLEC Local Network Architectures* ("10/3/02 AT&T Network Architecture Presentation"); Ex Parte Letter From C. Frederick Beckner III to Marlene Dortch, CC Docket 01-338, Nov. 14, 2002, Robert D. Willig, *Determining "Impairment" Using the Horizontal Merger Guidelines Entry Analysis* ("Willig *Guidelines* White Paper"); Ex Parte Letter from Hon. Judge Bork to Chairman Michael Powell, CC Docket, 01-338, Jan. 10, 2003.

this, the CLEC must extend its mass-market customers' existing ILEC loops to the distant location where the CLEC switch is located.

In addition, the physics of the analog signals carried over copper-based loops—the most common means for connecting residential and small business customers to the network—limits the effective distance a customer may be located from a switch and still employ a copper-based loop.[22] As a result, a CLEC cannot use a geographically-distant switch to provide service to customers served by voice grade ILEC loops unless it also digitizes the signals carried over such loops. This requires the use of collocation and additional equipment that can digitize, concentrate, and multiplex the signals on voice-grade loops onto transport facilities connected to the competitor's switch. All these investments require substantial customer demand to minimize the disadvantage experienced in a particular wire center. Should the necessary minimum demand not materialize for the new entrant, much of the investment is sunk and therefore not recoverable.[23] Only after these arrangements are completed can a CLEC begin to use its switch to serve mass-market customers. And for each such customer, the CLEC must also incur the internal and external costs necessary to perform a "hot cut," which transfers the customer's loop to the CLEC collocation and arranges for number porting.[24]

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[22] *See* 1/17/03 AT&T Cost Disparity Study, Att. 2.

[23] *See* 1/17/03 AT&T Cost Disparity Study, Att. 2; Ex Parte Letter from Gil Strobel to Marlene Dortch, CC Docket 01-338, Jan. 27, 2003, *WorldCom Response to SBC and BellSouth Critique of Micra Model* at 9 ("1/27/03 WorldCom Cost Disparity Study Reply"); Ex Parte Letter from Gil Strobel to Marlene Dortch, CC Docket 01-338, Jan. 8, 2003, *Modeling the Costs of Serving Residential Customers Using UNE Loops* ("1/8/03 WorldCom Cost Disparity Study"). Notably, the ILECs' themselves have submitted cost studies that confirm these cost disparities. *See* Ex Parte Letter from James Smith to Marlene Dortch, CC Docket 01-338, Jan. 14, 2003; Ex Parte Letter from James Smith to Marlene Dortch, CC Docket 01-338, Feb. 4, 2003.

[24] *See generally* 1/17/03 AT&T Cost Disparity Study"; 10/3/02 AT&T Network Architecture Presentation"; Willig *Guidelines* White Paper; Ex Parte Letter from Joan Marsh to Marlene Dortch, CC Docket 01-338, Jan. 22, 2003, Laurence J. Kotlikoff, *Natural Monopoly and the Definition of "Impairment"* .

The unavoidable need to incur these hot cut and backhaul costs places the CLEC at a severe cost disadvantage relative to the ILEC. This disadvantage effectively precludes entry into the mass market unless there is access to UNE-P.[25] An ILEC can connect its copper loop directly to its switch by merely running a jumper wire across its main distribution frame in the central office for a trivial cost. In stark contrast, a CLEC must incur all of the costs discussed above, as well as the operational problems associated with hot cuts.[26] These are all additional, substantial costs (and operational problems) that *only* the CLEC incurs to serve small customers.[27] Overall, a CLEC that seeks to deploy its own switches to serve a typical mass market customer will generally incur over $10 per line per month more than the ILEC—a huge cost disparity that precludes competitive entry.[28]

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[25] Willig *Guidelines* White Paper at 17.

[26] There are serious operational problems caused by the ILEC's current closed network architecture, which requires manual-intensive work to sever the hardwire connection of the customer's loop to the ILEC's main distribution frame and to reconnect the loop to the CLEC's network. The hot-cut process is an inherently low-volume and manually-intensive migration process that is expensive and can result in service disruptions, particularly if the manual processes are stressed by substantial activity from a competitive market for residential and small business customers. In fact, evidence submitted by state commissions and CLECs demonstrates that hot cuts cannot be performed in the volumes needed to support mass-market competition. The record in the *Triennial Review Proceeding* overwhelmingly demonstrated that, although CLECs have used hot cuts to serve certain small segments of the market, no CLEC relies on hot cuts to offer service to significant numbers of customers served by voice-grade loops. *See, e.g.*, Comments of AT&T, *UNE Triennial Review*, CC Docket No. 01-338, at 212, 214-17, Apr. 5, 2002; Comments of New York State Department of Public Service, *UNE Triennial Review*, CC Docket No. 01-338, at 2-4, Apr. 5, 2002; Comments of BTI, *UNE Triennial Review*, CC Docket No. 01-338, at 11, Apr. 5, 2002; Comments of UNE-Platform Coalition, *UNE Triennial Review*, CC Docket No. 01-338, at 49-50, Apr. 5, 2002; Comments WorldCom, *UNE Triennial Review*, CC Docket No. 01-338, at 86-87, Apr. 5, 2002; Comments of Z-Tel, *UNE Triennial Review*, CC Docket No. 01-338 at 38-47, Apr. 5, 2002.

[27] 1/17/03 AT&T Cost Disparity Study, Att. 2; 1/8/03 WorldCom Cost Disparity Study, Att. A; Willig *Guidelines* White Paper at 17-20.

[28] *See* 1/17/03 AT&T Cost Disparity Study, Att. 2; *see also* 1/27/03 WorldCom Cost Disparity Study Reply at 9; 1/8/03 WorldCom Cost Disparity Study at 4.

To be sure, it is possible to use statistical methods to control for these and other factors and to test rigorously whether "low" UNE rates in fact increase or decrease investment by CLECs and ILECs.[29] By studying the investment decisions made in the various states with different UNE-P rates, it is possible to isolate the impact of the UNE-P rates from other factors. This analysis has, in fact, been undertaken, and the results—totally ignored by Verizon—directly refute Verizon's conclusions.

In a study by Drs. Willig, Lehr, Bigelow, and Levinson, these econometricians empirically tested two competing hypotheses: (1) the "Investment Deterrence hypothesis" (*i.e.*, UNE-P denies ILECs a fair return on their investment and thereby diminishes their incentives to make investments); and (2) the "Competitive Stimulus hypothesis" (*i.e.*, UNE-P creates competition, which brings about lower prices and better quality and induces ILECs to increase investment in their network facilities). The authors performed a state-by-state cross-sectional regression analysis of data, largely derived from the ARMIS reports submitted to the Commission by the ILECs, to test which of the two hypotheses had greater empirical support.[30] The first-step regression analysis compared UNE prices with ILEC investment. The authors found a statistically-significant negative relationship between these two factors, leading to the conclusion that lower UNE prices are associated with greater ILEC investment. The second-step regression analysis compared (1) UNE prices with CLEC competitive activity and (2) the effect of CLEC activity on ILEC investment. This analysis found a statistically significant negative relationship between UNE prices and CLEC activity (*i.e.*, higher UNE prices lead to less CLEC

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[29] "[A]n empirical question cannot be settled by non-empirical arguments." George Stigler, *The Organization of Industry* 115 (1968).

[30] Ex Parte Letter from C. Frederick Beckner to Marlene H. Dortch, CC. Docket No. 01-338, R. Willig, *et al.*, *Stimulating Investment and the Telecommunications Act of 1996*, Oct. 11, 2002.

activity), and a positive relationship between CLEC activity and ILEC investment (*i.e.*, *greater* CLEC activity leads to *greater* ILEC investment). The authors concluded:

> [B]oth the theoretical, and especially the empirical analysis provide a strong refutation of the ILEC argument that mandatory unbundling provisions deter ILEC and CLEC investment. Specifically, it is estimated that a 1% *reduction* in UNE rates corresponds with approximately a 2.1% to 2.9% *increase* in ILEC investment. Thus, the study concludes that unbundling of ILEC networks promotes competition, and thereby stimulates investment in telecommunications infrastructure by incumbents and entrants alike.[31]

This conclusion was confirmed by a recent study published on July 9, 2003, by the Phoenix Center, an independent think tank. Using publicly available FCC data, the study found that:

> [E]ach UNE-P access line increased BOC average net investment by $759 per year, or about 6.4% per year in the aggregate. While BOC net investment fell by about 7% in 2002, investment dollars were more heavily allocated to states with greater levels of UNE-P competition, and this additional investment offsets the total decline in investment by about 50% . . . .The empirical evidence is mounting against the claim that the pro-competitive unbundling policies of the 1996 Act have reduced investment . . . . So, while BOC net investment may be down relative to previous years due to economic conditions and other factors, *UNE-P itself exerts a positive influence on investment.*[32]

Hard economic analysis has also been undertaken to review the impact of "low" UNE rates on CLEC investment incentives. A recent empirical analysis focusing specifically on AT&T showed that its deployment of owned local facilities was strongly and positively related to its use of local network facilities leased from the ILEC. Reply Comments of AT&T, *UNE Triennial Review*, CC Docket No. 01-338, July 17, 2002, Reply Declaration of Richard N. Clarke

[31] *Id.* at 1 (emphasis in the original).

[32] Phoenix Center Policy Bulletin No. 5 at 1, 14.

¶ 13. "Indeed, these AT&T statistical results suggest that it is much more likely that . . . *greater* CLEC use of leased facilities is associated with *greater* deployment of their own facilities." *Id.* at ¶ 3; *see also* Pfau Empirical Correction at 2.[33]

In short, Verizon incorrectly assumes its conclusion – that "low" UNE prices have had the "effect" of reducing investment. Even if there has been a reduction in investment—and, as discussed below, there has not been such a reduction—the statistical studies of record demonstrate that "low" UNE prices are not the cause of the "problem". If anything, they are the cure.

B. Verizon's Analysis Of Investment Trends Confuses Changes In *Investment Flows* with Changes In The Net Level Of *Capital Stock.*

Verizon makes a second fundamental error in claiming that UNE-P has caused a decline in network investment. Verizon equates a decline in the rate of *investment flow* with a decline in the aggregate net level of *capital stock*. This "simple thinking ignores the basic relationship between the capital stock and investment." Phoenix Center Policy Bulletin No. 5 at 6.

The capital stock of a company or industry represents the aggregate value of the capital goods held at a given moment; an investment flow represents the *change* in the capital stock over a specified period of time. In mathematical terms, the latter is the first derivative of the former. *The MIT Dictionary of Modern Economics* 54, 219 (David W. Pearce ed., 4th ed.

[33] Indeed, the FCC's Report on Local Competition, released June 12, 2003, shows a steady increase in the CLECs' reliance on UNEs without switching as well as continued growth in CLEC facilities investment from December, 1999 to December, 2002. Wireline Competition Bureau Industry Analysis and Technology Division, *Local Telephone Competition: Status as of December 31, 2002* (June 2003). *See* Appendix 1 and Appendix 2 of this Attachment.

1992). The two values do not necessarily change in the same direction. A declining but positive net flow of investment will still produce an absolute increase in capital stock. Phoenix Center Policy Bulletin No. 5 at 7-9.

The telecommunications sector is a classic illustration of this phenomenon. An entrant building a network must invest substantial amounts in the early years, but after completing construction, its rate of investment slows down significantly. One would expect that in the period immediately after the 1996 Act, investment and capital stock would rise, followed by an eventual decline in investment while capital stock remained above pre-Act levels. In fact, this is exactly what happened. *Id.*

After passage of the 1996 Act, capital stock and investment in telecommunications rose sharply. For the fifteen years before the 1996 Act, investment by telecommunications firms grew at an annual rate of 2.8 percent, with an average annual investment level of $38.8 billion.[34] After the 1996 Act (from 1996 to 2001),[35] investment grew at an average annual rate of 22.3 percent, with an average annual investment level of $95.3 billion for a total of $572 billion for this period. The $572 billion in investment during the 1996-2001 post-Act period was $267 billion *higher* than the investment that would have been made during the same period if the post-1996 rate of investment had continued at pre-1996 rates.

This can also be demonstrated with the Commission's data on local competition. As set forth in Appendices 1 and 2, during the same period in which Verizon says that state

[34] *The Truth about Telecommunications Investment*, Phoenix Center Policy Bulletin No. 4 (June 24, 2003) ("Phoenix Center Policy Bulletin No. 4"). These figures are derived directly from data compiled by the U.S. Bureau of Economic Analysis, which is responsible for collecting massive amounts of economic data, including data on real investment and net capital stocks by industry sector. *Id*. at 2.

[35] Data for 2002 were unavailable at the time of writing of Phoenix Center Policy Bulletin No. 4.

commissions have been "ratcheting" down UNE rates, investment in local facilities by CLECs has dramatically increased. Specifically, from 1999 to 2002, CLECs have substantially and consistently increased the number of access lines served over their own facilities as well as "UNE-L" lines in which CLECs self-provide their own switching. The result is that facilities-based competition is at an all time high.

Verizon's entire presentation suffers from its confusion between changes in capital stock and investment flows. For example, Verizon repeatedly states that "the application of TELRIC to UNE-P has unquestionably contributed to a massive decline in telecommunications industry investment," (Petition at 6), but the reality, as explained above, is that there has been an over $200 billion increase in capital stock since 1996. And total investment capital stock in the telecommunications industry remains at record levels.[36]

Verizon's allegation concerning the decrease in the number of UNE loops connected by CLECs to their own switches rather than to ILEC switches (Petition, Att. B at 15-16) also suffers from the same fallacy. Verizon confuses the rate of *increase* in the number of CLEC switches employed with a decline in the *absolute* number of CLEC switches or the absolute level of CLEC investment. The reality is that there has been an increase in CLEC investment.

The same error infects Verizon's claim that, as TELRIC rates have decreased, the average number of business lines that CLECs have added monthly on their own switching facilities has declined (Petition, Att. B at 17). Again, Verizon confuses a declining rate of growth in the average number of business lines *added* with a decline in the *absolute* number of

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[36] There is "no evidence that the 1996 Act reduced investment"; to the contrary, "capital stock in the industry is at its historical peak." Phoenix Center Policy Bulletin No. 4 at 2.

such lines.[37] The overall number of lines served by CLEC facilities continues to increase, not decrease, as UNE-P prices have fallen.[38]

C. Verizon's Own Investment Plans Tell The Real Story About Investment Incentives.

Verizon also makes no attempt to reconcile the claims in its Petition regarding the impact of UNE-P on investment with its public statements—made under the penalties of the federal securities laws—regarding its own plans for capital spending. As noted above, Verizon recently announced plans to deploy fiber optics to virtually every business and household within Verizon's local footprint, a project whose enormous scale may be "compared with the construction of the Roman aqueducts":

> Verizon plans to roll out fiber-optic connections to every home and business in its 29-state territory over the next 10 to 15 years, a project that might reasonably be compared with the construction of the Roman aqueducts. It will cost $20 billion to $40 billion, depending on how fast equipment prices fall . . . . The company says it will pump $12.5 to $13.5 billion into capital expenditures this year, the third-largest capital budget in the world after DaimlerChrysler and General Electric Co. That's on top of the $3 billion a year it's paying in yearly interest because of its $54 billion debt load. How can Verizon pay for all this? Its business is one of the great cash machines of Corporate America. The largest local-phone operator and the largest wireless company, Verizon generates about $22 billion a year in cash from operations. That's 50% more than SBC, twice as much as BellSouth, and nearly three times as much as AT&T. . . . [Verizon CEO] Seidenberg expects to cover the fiber-optic initiative without raising the capital budget

[37] Verizon's contention that TELRIC pricing has caused an outright migration of CLEC customers from CLEC facilities to UNE-P (Petition, Att. B at 19-20) is unsupported in another respect. Verizon bases this conclusion on data from only four states and has provided no reason to believe that such a small sample—even if accurate—is representative of the other 46 states.

[38] Looking at investment flows would make sense if Verizon were attempting to rigorously determine through econometric techniques whether changes in UNE rates correlated with changes in investment. But Verizon eschewed such an approach in favor of a simplistic—and erroneous— "after this, therefore because of this" causation analysis.

> above the current level, while he continues to reduce the company's debt. "Funding is not an issue," he says.

Steve Rosenbush, *Verizon's Gutsy Bet,* BUSINESS WEEK, August 4, 2003, at 53-55. These massive investment plans make obvious that Verizon is crying wolf when it asserts that the TELRIC stifles ILEC investment incentives.

D. Verizon Has Assumed Without Proof That More Investment In Facilities-Based Entry Would Have Been Desirable In Recent Years.

Finally, Verizon simply assumes that despite significant investment by CLECs in their own facilities, even more investment by CLECs (and more investment by the local telephone sector generally) would have been desirable in recent years. One cannot assume, however, that more is always better.

In fact, "investment itself is not a valid policy goal; economic *performance* is the proper standard for measuring the success or failures of particular policies." Phoenix Center Bulletin No. 5 at 10 (emphasis in original). The test is whether economic performance in an industry is improved by increased investment, *i.e*., does the incremental benefit of the investment exceed its incremental cost? Stated otherwise, building new capacity is a better alternative for society than using existing ILEC assets more intensively if, *and only if*, the forward-looking cost of the former is expected to be lower than the forward-looking cost of the latter. Unless the potential new investment passes this test, a price standard that encourages CLECs to make use of existing ILEC network elements, rather than building redundant new assets, increases economic performance and is beneficial rather than harmful. *Local Competition Order* ¶ 378, *aff'd. on this point*, *Verizon*, 535 U.S. at 509-10.

The TELRIC standard provides the correct pricing signals for testing potential make-or-buy decisions by CLECs. TELRIC measures the forward-looking opportunity costs of obtaining UNEs from the existing facilities of the ILECs. TELRIC-based UNE prices foster efficient make-or-buy decisions by aligning the price signals received by CLECs with the opportunity costs of their decisions to society as a whole. *Local Competition Order* ¶ 630; *see Verizon*, 535 U.S. at 508-515.

In contrast, by deliberately setting UNE prices substantially above TELRIC—Verizon's goal in its Petition—the Commission would distort competition and harm consumer welfare in two ways. First, by raising the overall cost of competitive entry, inflated UNE prices would deter entry whose overall benefits to society will exceed its costs. Second, to the extent that some entry occurs anyway, inflated UNE prices would induce CLECs to waste social resources by building inefficient new capacity rather than using existing capacity more intensively, at a lower opportunity cost to society. *Local Competition Order* ¶ 378, *aff'd. on this point*, *Verizon*, 535 U.S. at 509-10. Thus, if the TELRIC price of using unbundled switching is lower than the forward-looking cost of building a new switch, construction of the new switch *should* be discouraged. Effectively competitive markets do not encourage new entrants to build redundant new capacity that can only be used at an inefficiently high cost. A regulatory pricing policy that artificially fosters the same result is both anti-competitive and wrongheaded.

For these reasons, Verizon's derisive use of recent statements from CLEC management about the economic advantages of entry via UNE-P rather than facilities-based investment (Petition, Att. B at 18 & n. 73) completely misses the point. That the price signals generated by the TELRIC standard encourage CLECs to act on appropriately cost-based preferences for UNE-P is evidence that TELRIC is working, not that it has failed.

III. VERIZON GROSSLY EXAGGERATES THE EXTENT AND EFFECTIVENESS OF INTERMODAL COMPETITION.

Verizon asserts that the recent growth in competition from intermodal sources has made the competitive pricing of UNEs unnecessary. Petition, Att. B at 20-29. Verizon bears a heavy burden in advancing this argument. First, Verizon must demonstrate that these other "platforms" are sufficient to constrain the ILECs' local market power and that the cost-based UNE-P provides only superfluous competition. In other words, Verizon must show that one of the principle vehicles Congress relied upon in the 1996 Act is no longer necessary in light of the ability of competitors to provide local exchange services using alternative, non-wireline facilities.

Verizon fails utterly to shoulder this burden. Verizon makes no attempt to demonstrate with hard evidence that wireless services are in the same market as local exchange services. That is because no such evidence exists. In reality, wireless services are viewed as an alternative to primary line local services only by a small minority of subscribers—most notably, teenagers and young adults who have not yet established permanent residences of their own (and, in many cases, would not buy local wireline service even if they did not subscribe to wireless services). Likewise, with regard to cable telephony, Verizon ignores both the limited geographic scope of these cable telephony services to date and the announced plans of the cable companies to curtail or delay rollout of telephony services. Moreover, neither wireless nor cable facilities are available to a "requesting telecommunications carrier" that seeks access to UNEs to provide local services. *See* 47 U.S.C. § 251(c)(3). Finally, Verizon's claims about potential IP-telephony and other alternative "broadband" platforms is exactly that – *potential* competition that may one day develop but today is far from reality.

In short, intermodal competition for local services is still in its earliest stages, and remains inadequate to ensure a fully effective and vigorously competitive local markets. The vast majority of consumers continue to obtain local exchange services over wireline facilities owned and operated by the ILECs. Although vigorous intermodal competition may develop in the future, such potential competition provides no basis for eliminating access regulation *today* that is essential if there is to be effective local exchange competition.

A. Wireless Telephony

Verizon asserts that "a large and growing number of customers are abandoning their wireline phone service for a wireless phone, and an even larger share of traffic minutes are migrating to wireless networks." Petition, Att. B at 20-22. In fact, wireless service remains a poor substitute for local wireline service, and the displacement of local wireline service by wireless service will remain limited for the foreseeable future.

Wireless telephony is not a viable alternative to unbundled loops in today's marketplace, for several reasons. Wireless services today still do not offer the same functionality or service quality as local wireline services,[39] and the data capabilities of wireless services are decidedly inferior.[40]

It is precisely because of these substantial quality differences that most consumers do not view wireless services as a substitute for primary line local wireline services.[41]

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[39] For example, during the August 14, 2003, power outage in six states, "the regular public telephone network generally kept working . . . but the cellular systems in affected areas were often unable to cope. . . . The cellular network is not yet fully up to the challenges of public emergencies." *People Turned to Land-Lines When Wireless Failed*, NEW YORK TIMES, August 15, 2003, at A18. *See also* A. Sorkin and M. Richtel, *Cellphone Failures Cause Many to Question Systems*, NEW YORK TIMES, August 16, 2003, at B7 ("[V]oices of concern were raised in Washington and elsewhere about the continued fragility of the nation's wireless networks . . . . [T]he industry has drawn criticism for its networks' performance after the blackout, particularly in comparison to the land-line telephone system, which generally stayed in service").

[40] AT&T Reply Comments, *UNE Triennial Review*, CC Docket No. 01-338, at 25-26, 162, July 17, 2002.

[41] *See, e.g.*, Vince Vittore and Glenn Biscoff, *Access Line Count Evaporating, Telephony*,

(continued . . .)

Displacement of wireline service by wireless competition has been overwhelmingly confined to the long distance market and to second lines.[42] The ILECs' own data submissions indicate that only "3 percent of wireless subscribers" – which is itself a subset of all telephone users – have "abandoned wireline in favor of wireless entirely."[43] The lion's share of these "wireless-only" subscribers are college students and other young adults that have yet to establish a residence. Finally, there is no real "competition" between Verizon incumbent and Verizon wireless operations, which is not an academic point in light of the fact that Verizon is the largest wireless carrier in the country.

B. Cable Telephony

Verizon's portrayal of cable telephony as effective competition for Verizon's wireline services (Petition, Att. B at 22-26) is equally absurd. Cable telephony is still in its infancy, serving only a tiny fraction of the local market.[44] By the end of December 2002, cable telephony lines still constituted only about two percent of nationwide switched access lines in service.[45] Moreover, cable offerings generally are limited to residential areas and therefore are not a legitimate alternative for most businesses.[46]

(. . . continued)
October 14, 2002 ("[w]ireless substitution remains statistically insignificant at the national level").

[42] *See, e.g.,* Further Notice of Proposed Rulemaking and Report and Order, *Federal-State Joint Board on Universal Service, et al.*, 17 FCC Rcd. 3752 (2002) (noting that the availability of wireless services has led to substantial erosion of traditional interexchange traffic and is increasingly a substitute for payphones and second lines, but in only a small number of cases is wireless a substitute for primary wireline services).

[43] Comments of Verizon, *UNE Triennial Review*, CC Docket No. 01-338, UNE Fact Report at IV-13, Apr. 5, 2002.

[44] Wireline Competition Bureau Industry Analysis and Technology Division, *Local Telephone Competition: Status as of June 30, 2001*, at Table 5 (Feb. 2002).

[45] Wireline Competition Bureau Industry Analysis and Technology Division, *Local Telephone*
(continued . . .)

There is no reason to believe that cable telephony is likely to significantly increase its market penetration in the foreseeable future. To the contrary, cable providers are generally scaling back or abandoning plans to provide local phone services.[47] Cable operators generally intend to use their limited capital to upgrade their video offerings rather than to fund entry into local telephone markets.[48] AT&T Broadband, for example, "posted strong telephony growth numbers" before the company's sale to Comcast; since then, however, Comcast "has limited investment here to stabilize its finances."[49] In any event, even if cable telephony were more widely available, cable telephony providers would have no legal obligation to unbundle their networks, *see* 47 U.S.C. § 251(c)(3), and there is no evidence that cable companies (or wireless providers) voluntarily provide CLECs with access to their networks.

C. Other Forms Of Intermodal Competition

Verizon also points to cable overbuilders, which have tried to differentiate their offerings by including voice telephony in their service offerings. *Cf.* Petition, Att. B at 26-29. None of these firms, however, has made significant inroads against the ILECs. Most are poorly capitalized, and several are bankrupt. The notion that the Commission should eliminate cost-

(. . . continued)
Competition: Status as of December 31, 2002, at 2 & Table 5 (June 2003).

[46] *See, e.g.*, AT&T Comments, *UNE Triennial Review*, CC Docket No. 01-338, April 5, 2002 & Willig Decl. ¶ 205; AT&T Reply Comments, *UNE Triennial Review*, CC Docket No. 01-338, at 161, July 17, 2002.

[47] Ellen Sheng, *Cable Companies Take Slow Road to Telephony Rollout*, Dow Jones News Service (December 24, 2002).

[48] *See* En Banc Hearing on Steps Toward Recovery in the Telecommunications Industry, *UNE Triennial Review*, CC Docket No. 01-338, October 7, 2002 (Lara Warner, Director, Credit Suisse First Boston) at 78-81.

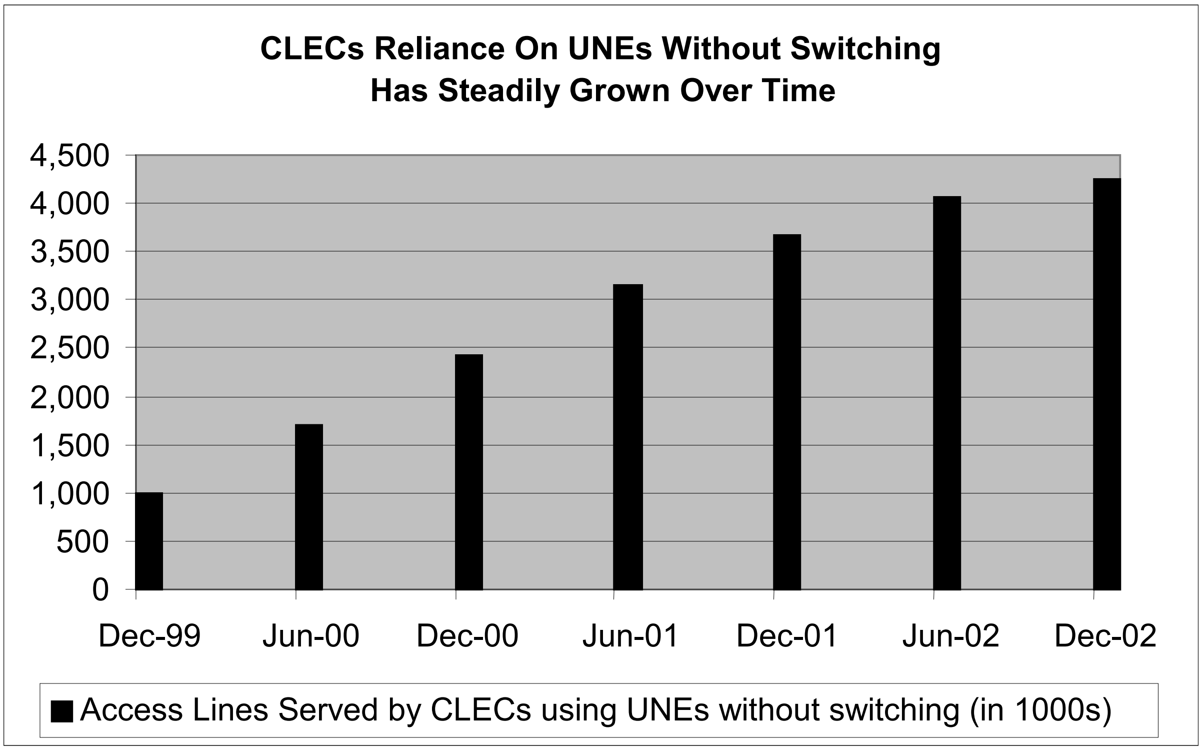
[49] David Reimer, T*elecommunications Services Industry*, VALUE LINE INVESTMENT SURVEY, July 4, 2003, at 721.

based pricing for UNE-P on the basis of "competition" from these entities does not even pass the red face test.

For example, on September 18, 2002, Knology's broadband subsidiary filed for bankruptcy. *Id*. at 3. RCN "has experienced trouble acquiring financing, and, as a result, has scaled back expansion plans." Ninth Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* 17 FCC Rcd. 26901, at ¶ 103 (2002). And WideOpen West, which operates in selected markets in only four states in the Midwest, "has delayed construction indefinitely because of funding problems." Andrea Ahles, *Cable Company's Area Plans on Hold,* FORT WORTH STAR-TELEGRAM, July 18, 2001.

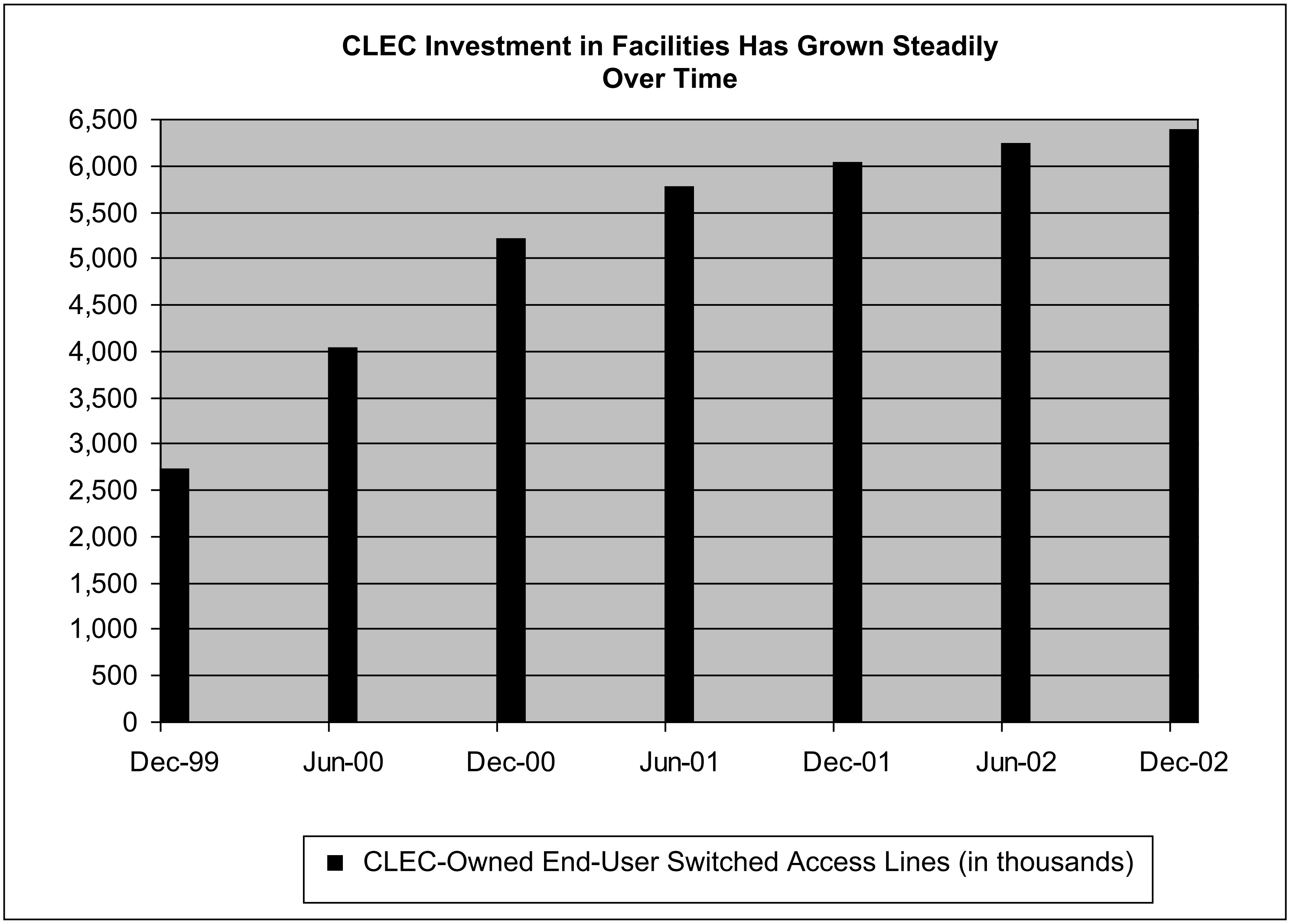
Finally, Verizon's reliance on potential next generation services such as IP-telephony and instant messaging is plainly misguided in this context. Such potential competition provides no basis for immediately eliminating regulation that is necessary to enable local competition today.

APPENDIX 1



Source: **Table 4 of FCC Wireline Competition Bureau Industry Analysis and Technology Division, *Local Telephone Competition: Status as of December 31, 2002* (June 2003).**

APPENDIX 2



Source: **Table 4 of FCC Wireline Competition Bureau Industry Analysis and Technology Division, *Local Telephone Competition: Status as of December 31, 2002* (June 2003).**

AT&T'S ATTACHMENT C

STATE-BY-STATE ANALYSIS OF UNE PRICING DECISIONS DISCUSSED IN VERIZON'S ATTACHMENT B

A. California

Verizon is correct that the California Public Utilities Commission ("California PUC") established interim UNE rates for Verizon in an arbitrated agreement with AT&T in January 1997, and prescribed new (and generally lower) interim rates in March 2003, based on Verizon's rates in New Jersey. The March 2003 decision, however, refutes Verizon's claim that the 1997 interim rates were "consistent with the FCC's rules."[1]

In its March 2003 decision, the California PUC explicitly found that new interim rates were necessary "due to the lengthy delays in this case and the fact that *current rates for Verizon were not set based on a forward-looking cost methodology*."[2] As the California PUC explained, the interim rates set in 1997 were "the product of a TSLRIC cost study that was filed [by GTE] in late 1995 and early 1996, rejected by the Commission in D. 96-08-021 as not adequately conforming to forward-looking cost principles, and then modified by the Commission in order to have UNE rates in effect for Verizon by the beginning of 1997."[3] Although the

[1] *Cf.* Attachment B to Verizon's Petition for Expedited Forbearance, filed July 1, 2003 ("Petition") at 12. Verizon's Attachment B is referred to herein as "Petition, Att. B."

[2] *See* Interim Opinion Establishing Interim Rates for Network Elements of Verizon California, Modifying Interim Price Floor Formula Adopted in Decision 99-12-018 and Adopting Nonrecurring Prices, *Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks*, CPUC No. 03-03-033, R. 93-04-003 and R. 93-04-002, March 13, 2003 at 2 (emphasis added) ("*CPUC Decision No. 03-03-033*"). *See also id.* at 23 ("Verizon's current rates are based on unsatisfactory, non-forward-looking cost studies that the Commission concluded 'do not adequately conform with the TSLRIC principles adopted in D. 95-12-016'") (citing CPUC Decision 96-08-021 at 91).

[3] *Id.* at 10. *See also id.* at 6, 67-68. The cost studies that the California PUC rejected were filed by GTE, Verizon's predecessor, in December 1995 and January 1996 – more than six months before this Commission adopted the TELRIC methodology in its *Local Competition Order*. *Id.* at 5.

California PUC had ordered Verizon to file new cost studies in 1997, more than *five years* elapsed without prescription of new rates by the California PUC. The delay was due in large part to the "uncertainty at that time regarding the future of the TELRIC methodology," which had been called into question by the decision of the U.S. Court of Appeals for the Eighth Circuit, setting aside the Commission's rules regarding TELRIC in 2000.[4]

Because of these delays, the non-TELRIC 1997 interim rates "avoided scrutiny or alteration" for years, even though the California PUC intended in 1997 that the rates "would apply only on an interim basis until replaced by new cost studies."[5] Thus, the California PUC concluded earlier this year that "the time has come to update those rates to reflect the most recent forward-looking cost information available for Verizon," rather than the 1997 rates, which were based on flawed cost studies and data that were at least eight years old.[6] In short, the California PUC prescribed new interim rates in 2003 because it recognized the need to promulgate forward-looking rates to replace rates that (1) failed to comply with TELRIC even when originally prescribed, and (2) were based on cost studies which (in addition to their inconsistency with TELRIC) were now outdated.

Even Verizon recognized that changes – including reductions – in the UNE rates were necessary. Although Verizon now criticizes the California PUC's decision to reduce the

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[4] *Id.* at 6-8.

[5] *Id.* at 11. The California PUC stated that it "never imagined that the rates it adopted [in 1997] based on 'approximate' conformance with costing principles, and ultimately on a flawed TSLRIC cost study, would still be in place over five years later." *Id.* *See also id.* at 23 ("Although the Commission attempted in 1996 to remedy the flaws that it found [in Verizon's 1995-1996 cost studies], this was a temporary measure and it is time to revisit Verizon's rates").

[6] *Id.* at 11. The California PUC noted that "[s]ince the time that GTEC performed its original TSLRIC analysis, the Commission and the entire country have moved to the TELRIC approach to UNE ratesetting. It is now time for Verizon's rates to be based on a TELRIC approach as well." *Id.* at 23. *See also id.* at 70-71 (Conclusions of Law 1 and 2).

originating per-minute switching rate by 60 percent, Verizon itself proposed to the California PUC that the 1997 switching rates be reduced by *35 to 52 percent*.[7] Furthermore, contrary to the assertion in Verizon's Petition, the California PUC prescribed the new, lower interim rates on the basis of evidence (produced in the California PUC's proceeding prescribing UNE rates for SBC) that the costs of loop and switching inputs had declined in the past few years. The California PUC noted that "Verizon *does not dispute that loop and switching equipment costs have declined*."[8] Indeed, Verizon's proposal to reduce switching rates by 35 to 52 percent was based on its own trend analysis finding reductions in switching costs in its Florida operations between 1996 and 2001.[9] Thus, the California PUC concluded that it was reasonable to assume "that equipment costs declines that were found to impact Pacific's forward-looking UNE costs . . . also impact Verizon's forward-looking UNE costs in the same manner."[10]

Although Verizon suggests that the California PUC acted arbitrarily in basing the new interim rates on the rates in New Jersey and in establishing a new pricing proceeding to establish permanent rates (Petition, Att. B at 12), the California PUC's approach was a reasonable temporary measure. The California PUC explained that, although it would examine "the multitude of cost modeling issues in the permanent phase of the case," it was "reluctantly" basing new interim rates on New Jersey rates "because we can no longer justify rates for Verizon

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[7] *See id.* at 13; Petition, Att. B at 12. Furthermore, despite its current criticism of the California PUC for reducing the statewide average rate for 2-wire analog loops by 31 percent, Verizon proposed to the California PUC last September that the UNE loop rates be reduced by 15.1 percent, for the purported reason of "bring[ing] this interim phase of the case to an expeditious conclusion so that the permanent phase involving review of cost studies can begin." *CPUC Decision No. 03-03-033* at 15.

[8] *Id.* at 12.

[9] *Id.* at 13-14.

[10] *Id.* at 71 (Conclusion of Law No. 3).

based on a 1996-era TSLRIC cost study."[11] The California PUC further explained that the New Jersey rates were an acceptable basis for setting new interim rates for Verizon in California because (1) the New Jersey rates "are among the most recent forward-looking, TELRIC-based UNE rates from another Verizon state," (2) the recently-adopted New Jersey rates reflected conditions after the merger of GTE with Bell Atlantic in mid-2000, and (3) the New Jersey rates, unlike those adopted in New York, were not the product of a settlement.[12]

Finally, the California PUC's new order makes clear that the California PUC has *not* found that even the reduced interim UNE rates that it adopted are TELRIC-compliant. The California PUC ruled that the interim rates would be subject to true-up, finding that "a true-up provision protect[s] against later claims that interim rates were not cost-based in compliance with Section 252(d) of the Federal Telecommunications Act."[13] Thus, when the California PUC sets permanent rates, the interim rates shall be adjusted, "either up or down, from the date the interim rates became effective through the date of adoption of a final rate."[14]

B. Delaware

As Verizon notes, the Delaware Public Service Commission ("Delaware PSC") initially prescribed UNE rates for Verizon in 1997. Petition, Att. B at 10. Verizon is also correct that the Delaware PSC ordered Verizon in August 2002, as a condition to approval of Verizon's 271 application for Delaware, to reduce its switching rates to levels consistent with this

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[11] *Id.* at 39.

[12] *Id.* at 31-32. The California PUC did not simply implement the same levels of UNE rates in California as those established in New Jersey, but instead used the Commission's Synthesis Model to adjust the New Jersey rates for regional and network differences between California and New Jersey. *Id.* at 32, 72 (Conclusion of Law Nos. 12-13).

[13] *Id.* at 41-42. *See also id.* at 75.

[14] *Id.* at 41-42.

Commission's 271 benchmarking standards. *Id.* Verizon has made no showing, however, that the reduced rates are below levels dictated by TELRIC. Moreover, such a claim would be flatly at odds with Verizon's representation to the Commission in support of the resulting rates:

> Because the reduced Delaware switching rates result in the Delaware non-loop rates benchmarking to the New York non-loop rates, which the long distance carriers have repeatedly championed, *there should be no question that the Delaware non-loop rates are within the range that a reasonable application of TELRIC would produce.*[15]

Finally, Verizon's current suggestion that the rate reductions were unwarranted is refuted by the evidence that prompted the Delaware PSC to demand the rate reductions. The evidence showed that Verizon's net switching prices had fallen by approximately 25 percent since 1996, and that an input error in the SCIS model used by Verizon to determine switching costs could allow Verizon to "over recover its switching investment by 126 percent."[16]

In sum, Verizon has offered no basis for challenging the Commission's finding, in approving Verizon's 271 application for Delaware, that Verizon's reduced UNE rates in that state were "just, reasonable, and non-discriminatory," and that the new non-loop rates, including switching rates, were "all within the range that reasonable application of TELRIC principles would produce."[17]

C. District of Columbia

Verizon is correct that the rates placed in effect in Washington, D.C., in December 2002 ($8.49 for an average two-wire loop and $0.003 per switching minute) are lower than

[15] Ex Parte Letter from Richard T. Ellis to Marlene H. Dortch, CC Docket No. 02-157, August 30, 2002, at 2 (emphasis added).

[16] Memorandum Opinion and Order, *Joint Application by Verizon, et. al., for Authorization to Provide In-Region InterLATA Services in Delaware and New Hampshire,* 17 FCC Rcd. 18660, ¶ 74 (2002).

[17] *Id.* at ¶¶ 68, 79-80.

the rates established in 1996. Petition, Att. B at 7-8. Any suggestion that the reduced rates are below levels justified by TELRIC, however, is both unsupported and contrary to Verizon's own representations to the Commission in support of the carrier's 271 application for the District.[18]

No possible claim can be made that the higher loop rates in effect from 1996 through 2002 ($10.81 for an average loop) complied with TELRIC or serve as any legitimate benchmark for judging the TELRIC-compliance of subsequent rates. The 1996-2002 rates were "interim" rates based on the proxy rates set by the Commission in its *Local Competition Order* in 1996; the proxy rates in turn were based on data of an even earlier vintage.[19] The DC PSC adopted the proxy rates without making any finding that they were TELRIC compliant, and the PSC has subsequently held that they are not. "Because the District of Columbia's interim rates are based on the FCC proxy rates, they must be replaced by the Commission with permanent TELRIC-compliant rates."[20] Even Verizon "concedes that the old rates have never been subject to a TELRIC analysis."[21]

Verizon has also made no showing that the reduced rates prescribed by the DC PSC on December 6, 2002, but stayed since then pending administrative review ($4.29 for an average loop and $0.00038 per switching minute), are below TELRIC levels. The newly prescribed rates are the product of five years of UNE rate litigation and reflect an extensive record before the DC

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[18] *See* Memorandum Opinion and Order, *Joint Application by Verizon, et. al., for Authorization to Provide In-Region InterLATA Services in Maryland, Washington, D.C., and West Virginia*, 18 FCC Rcd. 5212, ¶ 40 (2003) ("*Maryland/Washington D.C./West Virginia 271 Order*") ("In its application, Verizon relies on a benchmark comparison to its UNE rates in New York in order to demonstrate that its UNE rates in . . . Washington, D.C. . . . fall within the range that a reasonable application of TELRIC principles would produce").

[19] Order No. 12610, *In the Matter of the Implementation of the District of Columbia Telecommunications Competition Act of 1996 and Implementation of the Telecommunications Act of 1996*, DC PSC Formal Case No. 962, Dec. 6, 2002, ¶ 98 ("*DC PSC Order No. 12610*").

[20] *Id.*

[21] *Maryland/Washington D.C./West Virginia 271 Order* at ¶ 65.

PSC.[22] "We believe that District of Columbia ratepayers will be harmed by allowing any further delay" in replacing the interim rates with lower permanent rates, the DC PSC found. "[O]ur adoption of final UNE rates is critical to the future of local telecommunications competition in the District."[23]

The District is a geographically compact, densely populated, urban jurisdiction with exceedingly short loop lengths throughout. Unlike any other jurisdiction in the United States, every square inch of the District is Density Cell 1. Verizon's loop costs in the District are the very lowest in the nation.[24] Accordingly, the D.C. commission's approved UNE rates are precisely where one would expect them to be *vis-à-vis* the Density Cell 1 rates *approved* by state commissions in other jurisdictions. Indeed, the fact that this commission's loop rate is higher than the rate in effect in Chicago and just below Ohio's Density Cell 1 rate suggests a very rational – even conservative – pricing outcome.

D. Florida

As Verizon notes, the Florida Public Service Commission ("Florida PSC") initially established UNE rates for Verizon in January 1997, in arbitration proceedings involving AT&T and MCI.[25] It does not appear, however, that the Florida PSC applied the Commission's

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[22] *DC PSC Order No. 12610* at ¶¶ 1-14

[23] *Id.* at ¶ 21.

[24] Transcript, DC PSC Docket No. 962, at 373 (Oyefusi). The District is one of the densest population centers in the United States. *Id.* at 292-93 (Gansert). Population density lowers the cost of a provisioning a two-wire loop as a result of economies of scale. *Id.* at 373.

[25] *See* Petition, Att. B at 6; Final Order on Arbitration (Order Nos. PSC-97-0064, FOF-FP), *Petitions by AT&T Communications of the Southern States, Inc., MCI Telecommunications Corporation, and MCI Metro Access Transmission Services, Inc., for Arbitration of Certain Terms and Conditions of a Proposed Agreement with GTE Florida Incorporated Concerning Interconnection and Resale under the Telecommunications Act of 1996*, Florida PSC Docket Nos. 960847-TP and 960980-TP, January 17, 1997, at 24-38 ("*1997 PSC Order*").

TELRIC methodology in setting these rates. The Florida PSC found that the appropriate cost methodology to determine UNE prices was an "approximation of TSLRIC," rather than the TELRIC methodology itself.[26] Moreover, although the *Local Competition Order* required that UNE rates be geographically deaveraged, the Florida PSC declined to do so, both because it did not interpret the 1996 Act as requiring geographic deaveraging and because it believed that the record "does not contain sufficient cost evidence."[27]

On May 26, 1999, the Florida PSC opened a new generic UNE pricing docket for the three ILECs (BellSouth, GTE, and Sprint) to consider *inter alia* the geographic deaveraging of UNE pricing, and the pricing of UNE combinations and nonrecurring charges.[28] That proceeding was not initiated merely "to establish new rates," as Verizon alleges, but also to correct deficiencies that the Florida PSC recognized in its prior ratemaking decisions. The Florida PSC acted in response to a petition filed in December 1996 by a number of CLECs, who pointed out that: (1) the Florida PSC had not established rates for the UNE-P; (2) "Florida currently has the highest local switching rates in the Southeast, and some of the highest rates in

[26] *1997 PSC Order* at 25. *See also id.* at 34 (finding GTE's cost studies to be appropriate because "they approximate TSLRIC cost studies and reflect GTEFL's efficient forward-looking costs"). The Florida PSC acknowledged that although "[t]heoretically, there should not be a substantial difference" between the TSLRIC cost and the TELRIC cost of a particular UNE, "the methodology the FCC uses to implement TELRIC would not necessarily be used by this Commission in determining TSLRIC costs." *Id.* at 27. For example, the Florida PSC noted, its TSLRIC approach considered the physical architecture of the existing architecture used by the ILEC in its central offices and outside plant, whereas the "scorched node" approach of TELRIC only considered the current location of the ILEC's central offices. *Id.*

[27] *See id.* at 25; First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* 11 FCC Rcd. 15499, ¶¶ 764-765 (1996) ("*Local Competition Order*"); 47 C.F.R. § 51.507(f).

[28] *See* Order (Order No. PSC-99-1078-PCO-TP), *Petition of Competitive Carriers for Commission Action To Support Local Competition in BellSouth Telecommunications, Inc.'s Service Territory,* FPSC Docket No. 981834-TP, 1999 Fla. PUC LEXIS 934 (1999).

the country"; and (3) deaveraged pricing of local loops was necessary to remove the inequity between CLECs and the ILECs, whose costs of providing loops vary substantially among geographic regions.[29]

The Florida PSC agreed that institution of a generic proceeding was warranted for several reasons. First, the Florida PSC found that Supreme Court's 1999 decision in *AT&T* v. *Iowa Utilities Board*, which upheld this Commission's authority to require State commissions to follow a prescribed UNE pricing methodology, "gives great deference to the FCC and its national pricing rules."[30] Second, the Florida PSC concluded that important pricing issues – including the prices of the UNE-P – "should be examined on a more generic basis in light of the experience in the marketplace with . . . our previously ordered prices."[31] Third, in view of the Supreme Court decision reinstating this Commission's pricing rules, deaveraged pricing of local loops was necessary.[32] Last, but not least, the Florida PSC found that a generic proceeding was more likely to achieve "fair and equitable results," because there had been "little cooperation and agreement on . . . pricing issues" during the Florida PSC's three years of experience in conducting the negotiation and arbitration of individual interconnection agreements.[33]

On November 15, 2002, the Florida PSC issued a 363-page decision establishing UNE rates for Verizon, including geographically-deaveraged rates for loops.[34] Although, as

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[29] *Id.* at *3-*6.

[30] *Id.* at *11.

[31] *Id.* at *12.

[32] *Id.*

[33] *Id.* at *13-*14.

[34] *See* Final Order (Order No. PSC-02-1574-FOF-TP), *Investigation into Pricing of Unbundled Network Elements (Sprint/Verizon Track)*, FPSC Docket No. 990649B-TP, November 15, 2002 ("*FPSC 2002 Order*"). The Florida PSC established separate UNE rates for BellSouth and Sprint in separate orders issued in the same proceeding.

Verizon states, the Florida PSC ordered reductions in the average loop rate and the originating and terminating switching rate, Verizon *itself* proposed a substantial reduction in the switching rate.[35] Furthermore, the switching rate adopted by the Florida PSC was closer to the rate proposed by Verizon than to the rate proposed by the CLECs.[36]

The Florida PSC's decision to go beyond the rate reductions proposed by Verizon was fully warranted by TELRIC principles. In contrast to its 1997 decision, the Florida PSC's 2002 decision recognized that the applicable standards for determining UNE prices were Section 252(d)(1) of the Act and this Commission's regulations prescribing the TELRIC methodology.[37]

If the Florida PSC's decision can be criticized for *anything*, it is the PSC's failure to implement TELRIC to its full extent, as prescribed by this Commission. The Florida PSC based many of its pricing decisions on Verizon's existing network, rather than according to TELRIC methodology. For example, the Florida PSC found that it had "concerns as to whether [Verizon's cost model] in fact, is fully TELRIC-compliant," because "it appears that certain of

[35] The per-minute switching rate established by the Florida PSC in the 1997 arbitration proceeding was $.004 (originating) and $.00375 (terminating). *1997 FPSC Order* at Table 1. In the Florida PSC's generic UNE rate proceeding, Verizon proposed that the per-minute switching rate (both originating and terminating) be $.0029514 – a reduction of more than 25 percent. *See 2002 FPSC Order* at Appendix A-1. In addition, although the rates prescribed by the Florida PSC for 2-wire loops in 2002 are lower in two of the three newly-established geographic zones than the single $20.00 rate established in 1997, the new rate in the third zone is $27.54. *Id.*

[36] The Florida PSC ultimately adopted a per-minute switching rate of $.0022574, as opposed to the rate of $.0029514 proposed by Verizon and the rate of $.0007662 proposed by the CLECs. *Id.*, at Appendix A-1 and Appendix A-2.

[37] *Id.* at 13-14. For example, the Florida PSC stated that "UNE rates should be set using the forward-looking cost standards authorized by Section 252(d)(1) of the 1996 Telecommunications Act, the FCC's rules and orders implementing that section of the Act, and the court decisions that affect those rules and orders." *Id.* at 18.

the modeling assumptions . . . could be more reflective of Verizon's 'actual' costs than envisioned by either the FCC or the [Supreme] Court."[38]

Moreover, rather than assume the existing wire center locations (as the TELRIC methodology requires), the Verizon model arbitrarily placed certain DLC equipment where it did not otherwise exist to enable the cost model to reflect a feeder route on Verizon's existing network.[39] Yet, despite its skepticism that the Verizon model yielded costs consistent with TELRIC methodology, the Florida PSC *accepted* Verizon's model as the basis for setting UNE rates, for reasons that clearly are impermissible under TELRIC.[40] Moreover, rather than reject Verizon's approach to certain pricing issues as inconsistent with TELRIC, the Florida PSC repeatedly made a "50/50" split between the parties' positions. For example:

- On the issue of depreciation lives, the Florida PSC found that Verizon had "not provided sufficient evidence that its proposed inputs are appropriate." *FPSC 2002 Order* at 75. Yet the Florida PSC, stating that it was "hesitant" to rely solely on the life and salvage ranges previously approved by this Commission (and proposed by the CLECs), decided to use, as a "good compromise," the depreciation inputs that it had previously approved for BellSouth. *Id.*

- With respect to the cost of capital, the Florida PSC simply approved the cost of capital rate, cost of equity, cost of debt, and capital structure recommended

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[38] *Id.* at 66.

[39] *Id.* at 66-67

[40] The Florida PSC reasoned that the Verizon cost model should be used to set UNE rates because: (1) there was no viable alternative basis upon which rates could be set; (2) there was "some comfort" in the fact that the Verizon model did not fully replicate Verizon's existing network, because "it models fewer sheath feet of cable than currently exist"; and (3) other modifications made to the inputs by the Florida PSC produced rates that "on balance are reasonable." *Id.* at 67-68. No adjustments to the model, however, could remedy Verizon's arbitrary placement of DLC equipment – which was clearly contrary to TELRIC's "scorched-node" policy. Nor was this flaw remedied merely because the Verizon model reproduced less sheath. Finally, the Florida PSC's conclusion that there was no alternative to using Verizon's cost model ignored the Commission's regulations, which set proxy rates that state commissions may use when reliable cost information is unavailable. *See* 47 U.S.C. § 51.513(a).

by its own Staff witness. Although the 9.63 percent cost of capital rate was lower than the 12.95 percent rate proposed by Verizon, CLECs had presented evidence that the rate could be set as low as 8.5 percent and still be TELRIC-compliant. *Id.* at 87-88.

- Although the Florida PSC agreed with the CLECs that an Integrated Digital Loop Carrier ("IDLC") configuration should be used to calculate the rate for the UNE platform, it nonetheless ruled that rates for stand-alone loops should be based on the Universal Digital Loop Carrier ("UDLC") configuration assumed in Verizon's cost study. *Id.* at 128-131.

In addition, the Florida PSC adopted critical inputs in Verizon's cost study, even though the CLECs had submitted evidence showing that those inputs were erroneous. For example, the Florida PSC adopted, with only a few exceptions, the fill factors proposed by Verizon, despite evidence that those fill factors were too low to be TELRIC-compliant.[41] Moreover, the Florida PSC accepted Verizon's approach of including the GTD-5 switches that are currently deployed in its Florida territory in the determination of switch costs, even though – as the Florida PSC had previously found – the GTD-5 is not forward-looking for the purposes of determining the cost of basic local service.[42] In computing switching rates, the Florida PSC also accepted Verizon's approaches of using a "mix" of "new" and "growth" switch discounts, and a wholesale

[41] *See 2002 FPSC Order* at 92-106.

[42] *Id.* at 141-143. In yet another instance of using its embedded network to calculate UNE rates, Verizon placed the same type of switch (such as the GTD-5) in its cost model in the same locations as those in its current embedded network. The Florida PSC acknowledged in its November 15, 2002, order that the GTD-5 switch "is not used by any other ILEC" and "may not be a forward-looking technology for other LECs." *Id.* at 143. Although the Florida PSC conceded that it had found in a previous order (Order No. PSC-99-0068-FOC-TP) that the GTD-5 switch was not forward-looking, it found that the previous order was not applicable because it was issued in a "generic proceeding" involving the Universal Service Fund "where the outcome was applicable to every ILEC." *Id.* The distinction drawn by the Florida PSC, however, is without a difference, because the UNE proceedings that culminated in its November 2002, order were generic as well. Moreover, the only "generic" aspect of the USF proceeding was the use of the same modeling methodology for each ILEC for more than 100,000 access lines. The forward-looking costs determined in the Florida PSC's USF proceeding for Verizon, including those attributable to switching costs, were specific to Verizon.

pricing structure that assesses a charge for each switching feature used by the CLECs, even though the evidence showed that these approaches were inappropriate.[43]

In short, Verizon's criticisms of the rate reductions mandated by the Florida PSC are wholly unwarranted. Had the Florida PSC properly applied the TELRIC methodology, UNE rates would have been even *lower* than those that it actually prescribed.[44]

E. Maine

Verizon's criticism of the reductions in rates on loops and switching rates ordered by the Maine Public Utilities Commission ("Maine PUC") in early 2002 is equally misplaced. *See* Petition, Att. B at 6-7. As Verizon admits, the Maine PUC's decisions of February and March 2002 represented the first time the PUC had established UNE rates for all CLECs. *Id.* at 7. More importantly, those decisions marked the first occasion on which the Maine PUC attempted to apply the TELRIC methodology in calculating such rates.

Between 1996 and the issuance of the Maine PUC's 2002 decisions, Verizon offered UNEs in Maine under "interim" rates established by the PUC in December 1996 in an arbitration proceeding between Verizon and AT&T.[45] Those rates, however, were not based on the TELRIC methodology. Although AT&T and Verizon had filed cost models in the arbitration proceeding, the Maine PUC concluded that time constraints and deficiencies in the record precluded determining the validity of those models under either the TELRIC methodology or

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[43] *Id.* at 143-150.

[44] Like Verizon, AT&T has appealed the Florida PSC's order to the Supreme Court of Florida. The Florida PSC has stayed the effectiveness of the rates adopted in its November 2002 order pending the outcome of judicial review.

[45] *See* Commission Decisions on Arbitrated Issues, *AT&T of New England, Inc., New England Telephone and Telegraph Company d/b/a NYNEX – Requests for Arbitration Pursuant to Section 252(B) of the Telecommunications Act of 1996*, Maine PUC Docket No. 96-510, December 4, 1996 ("*Maine PUC 1996 Decision*"); Petition, Att. B at 7.

under Section 252(d)(1).[46] Instead, the PUC simply set rates at the "mid-point" between those proposed in the two cost studies, as adopted in a previous arbitration proceeding in New Hampshire based on New Hampshire-specific cost inputs. Because the parties had agreed that any rates determined by the Maine PUC should be adopted on an interim basis, the PUC found it unnecessary to determine "the Maine-specific depreciation rates and cost of capital for use with Maine TELRIC costs."[47] The Maine PUC also declined to require that rates be deaveraged by geographic location, and instead permitted rates to be calculated on a state-wide average basis.[48]

The Maine PUC made clear in its arbitration decision that it intended to replace the interim rates it was prescribing with permanent, Maine-specific rates.[49] In fact, eight months after it issued the arbitration order, the PUC initiated a new proceeding "to review all TELRIC cost issues, evaluate TELRIC studies and models, and develop TELRIC-based pricing of unbundled network elements."[50] After the submission of pre-filed testimony, two technical conferences, and several days of hearings, the Maine PUC issued a procedural order in February

[46] *Maine PUC 1996 Decision* at 105.

[47] *Id.* at 104-107.

[48] *Id.* at 105, 107.

[49] *Id.* at 106.

[50] *See* Procedural Order Opening New Docket, *Investigation of the Entry of New England Telephone and Telegraph Company d/b/a NYNEX into In-Region InterLATA Services Pursuant to 47 U.S.C. § 271* and *Investigation of Total Element Long-Run Incremental Cost (TELRIC) Studies and Pricing of Unbundled Network Elements*, Maine PUC Docket Nos. 96-781 and 97-505, August 4, 1997, at 1 ("*Maine PUC Procedural Order*"). *See also* Order, *Investigation of Total Element Long-Run Incremental Cost (TELRIC) Studies and Pricing of Unbundled Network Elements*, Maine PUC Docket No. 97-505, February 12, 2002, Att. A at 1 ("*Maine PUC TELRIC I Order*"); Memorandum Opinion and Order, *Application by Verizon New England Inc., et. al., for Authorization to Provide In-Region InterLATA Services in Maine*, 17 FCC Rcd. 11659, ¶ 10 (2002) ("*Maine 271 Order*"). By suspending the proceedings, the PUC split off the issue of TELRIC pricing from the non-cost issues in its Section 271 proceeding, which the PUC had instituted in December 1996 – the same month in which it issued interim UNE rates in the AT&T-Verizon arbitration proceeding. *Maine PUC Procedural Order* at 1.

1998 that suspended its proceedings after this Commission had released its universal service model platform – which, the Maine PUC hoped, would provide additional guidance on cost model issues.[51] In June 2000, after this Commission had issued the USF model, the Maine PUC issued a procedural order stating that it wished to move the investigation forward. This order was followed by evidentiary submissions of the parties regarding Verizon's cost model, discovery, and hearings.[52]

On February 12, 2002, the Maine PUC issued a 91-page order establishing permanent rates for UNEs and interconnection. The Maine PUC issued its order in an atmosphere of uncertainty, because the Commission's TELRIC rules had been set aside by the U.S. Court of Appeals for the Eighth Circuit, and the Supreme Court had not yet issued an opinion on review of the Eighth Circuit's decision. Nonetheless, the Maine PUC's order makes clear that the PUC was attempting to prescribe rates – including the lower loop and switching costs cited by Verizon – on the basis of the TELRIC methodology. As this Commission found in its *Maine 271 Order*:

> In determining the appropriate UNE rates, the Maine Commission demonstrated a commitment to basic TELRIC principles, and *we applaud the Commission's efforts to establish TELRIC-compliant rates based on the information available to it*. Indeed, the *Maine TELRIC Order* contains an extensive discussion concerning the proper application of the TELRIC standard and the challenges presented by its application. The record demonstrates that the Maine Commission carefully examined the cost studies submitted by Verizon and concluded, in many instances, that such studies did not yield TELRIC-compliant rates. For these rates, as discussed above, the Maine Commission recalculated the rates using modified inputs or assumptions, or, alternatively, adopted a different cost model that complied with the TELRIC standard, *as it did for switching rates*. In other instances, the Maine Commission looked

[51] *Maine PUC TELRIC I Order*, Att. A at 1-2; *Maine 271 Order* at ¶ 10.

[52] *Maine PUC TELRIC I Order*, Att. A at 1-2; *Maine 271 Order* at ¶ 12.

> to other state jurisdictions to establish rates within a range that a reasonable application of TELRIC principles would produce.[53]

Verizon itself vigorously argued that the Maine PUC had adhered to TELRIC principles in the carrier's Section 271 application for Maine one month after the Maine PUC issued its *TELRIC I* order. In contrast to its current position that State commissions such as the Maine PUC "set rates without regard to costs" and reduced rates as a result of "pressure to produce the appearance of competition," Verizon flatly stated in its Section 271 application that "with respect to the assumptions regarding each of the inputs used to establish Verizon's rates, the PUC conducted an extensive investigation and applied principles that are consistent with what this Commission has found TELRIC-compliant in the past."[54] And, in contrast to its current attack on the rate reductions required by the Maine PUC, Verizon emphasized in its Section 271 application that no party – including itself – had sought judicial review of that order.[55]

Even leaving aside Verizon's previous defense of the Maine PUC's order, the order itself demonstrates that the new loop and switching rates prescribed by the Maine PUC were the product of the Maine PUC's attempt to apply TELRIC principles. In determining rates

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[53] *Maine 271 Order* at ¶ 20 (emphasis added).

[54] Application by Verizon New England for Authorization to Provide In-Region InterLATA Services in Maine, CC Docket No. 02-61, March 21, 2002, at 44 ("Verizon Application in *Maine 271*"). *See also id.* at 43 ("the Maine PUC applied TELRIC principles in establishing Verizon's rates"); *id.* at 45 ("the Maine PUC conducted an extensive pricing proceeding to establish rates based on TELRIC principles"); *id.* at 47 ("the loop and non-loop rates established by the PUC were based on the use of core inputs and assumptions that are fully consistent with what this Commission has found TELRIC-compliant in the past").

[55] *Id.* at 43, 47. *See also Maine 271 Order* at ¶ 14 (noting that "No party filed for reconsideration of the Maine Commission's TELRIC orders and no party is seeking judicial review at this time").

for 2-wire loops, for example, the Maine PUC adopted Verizon's cost model but rejected certain key inputs used by Verizon because they were inconsistent with TELRIC.[56] Thus:

- The Maine PUC found that Verizon had not shown that its assumption of 100 percent fiber feeder cable in the network used the most efficient cost-minimizing technology currently available, as required by the TELRIC methodology. As a result, the PUC found that Verizon's assumption over-stated the cost of 2-wire analog loops by 96 cents per month.[57]

- The Maine PUC rejected Verizon's proposed weighted average cost of capital (13.18 percent) and capital structure, and instead recalculated recurring rates – including rates for 2-wire loops and switching – using a weighted average cost of capital of 9.79 percent. In an extensive analysis, the PUC correctly found that Verizon had overstated the level of risk involved in providing UNEs, included too much equity in its proposed capital structure, and had not proposed a "reasonably comparable group of companies" for purposes of calculating the cost of equity.[58]

- The Maine PUC rejected the short depreciation lives proposed by Verizon because it had failed to show that those lives "are realistic or appropriate for Maine, but rather relies on speculative projections that are unsupported by recent history." Instead, the PUC adopted the depreciation lives previously prescribed by this Commission, not only because they were based on the economic lives of equipment that is currently being placed in service in Maine, but also because they contained a prospective analysis that appropriately considered technological change and obsolescence.[59]

- The Maine PUC found that Verizon's proposed feeder and distribution fill rates were "unacceptably low," and its proposed cable sizes were "over-stated," resulting in a "significant overstatement of Verizon's costs."[60] This

[56] *See Maine 271 Order* at ¶ 18; Joint Declaration of Edward B. Dinan, Patrick A. Garzillo and Michael J. Anglin, CC Docket No. 02-61, March 21, 2002, at ¶ 26 ("Dinan/Garzillo/Anglin Decl.").

[57] *See Maine PUC TELRIC I Order* at 33; Dinan/Garzillo/Anglin Decl. at ¶ 42.

[58] *Maine PUC TELRIC I Order* at 11-21.

[59] *Id.* at 10-11.

[60] *Id.* at 27. For example, the PUC adopted a 50% fill factor for the distribution portion of the network (which had also been adopted by the New York and Vermont commissions and cited approvingly by this Commission in the past), rather than the far lower rates proposed by Verizon. *Id.* at 28; Dinan/Garzillo/AnglinDecl. at ¶ 45 (stating that Verizon had proposed average distribution fill factors of 35% for urban areas, 27% for suburban areas, and 31% for rural areas). The PUC also found that "the cable sizes used in Verizon's model are unreasonable given the (continued . . .)

> error required reductions in Verizon's proposed recurring rates, including rates for 2-wire analog loops and switching, to eliminate the "upward bias" caused by Verizon's assumptions.[61]

The Maine PUC similarly attempted to apply TELRIC principles in determining switching rates. The PUC rejected Verizon's model as a basis for computing those rates because its cost study "does not provide cost estimates that are appropriate for setting local switching rates in Maine."[62] The PUC found that the outputs in Verizon's cost study were "unreasonably high" because they were more than *twice* those that Verizon had previously used to test the reasonableness of AT&T's model, and nearly *six* times the investment values adopted by this Commission.[63]

More importantly, the Maine PUC adopted switching prices that were far lower than those proposed by Verizon because the evidence showed that switching costs had declined significantly. The PUC also rejected Verizon's model because the evidence showed that –

(. . . continued)
anticipated level of demand," and that Verizon had ignored "the less expensive, lower capacity cables even though it is reasonable to assume that smaller cables could satisfy the needs of the network." *Maine PUC TELRIC I Order* at 28.

[61] *Id.* at 29. The loop rates proposed by Verizon were further reduced due to other aspects of its cost study that the Maine PUC found to be inconsistent with TELRIC. For example, the PUC found that Verizon had overstated loop costs by improperly adjusting its conduit utilization rate downward to 50 percent. The PUC adjusted the utilization rate to 100 percent to reflect that the development of the conduit cost per sheath began with the level of demand, not (as Verizon had erroneously assumed) the level of capacity. *Id.* at 40-41. The PUC also rejected the outside plant costs proposed by Verizon, which were higher than those determined by its own consultants. The PUC found, *inter alia*, that Verizon's explanation that it might have higher supply expense loadings than those used by smaller firms was "contrary to the FCC's TELRIC pricing rules," which "require that we model the cost of an efficient operator." *Id.* at 42. The PUC further found that many of Verizon's proposed cable input values were so unreasonable that it replaced them with those adopted by this Commission where Verizon's inputs were "considerably higher." *Id.* at 43.

[62] *Id.* at 57.

[63] *Id.* at 58-59.

contrary to the price increases described in the model – the cost of digital switches had declined *by 43 percent* during the period in question. The PUC concluded that accepting "prices that are totally out-of-line with the national trend in prices" would be "contrary to TELRIC pricing principles" and "an impediment to competition."[64] Instead, the PUC established switching and port rates using the Commission's USF model, incorporating the switching costs developed by the PUC's outside consultants, who had used information from the depreciation reports of the BOCs.[65] The information used by the PUC was subsequently adopted by this Commission, with slight modifications, for use in calculating universal service support.[66]

The Maine PUC further demonstrated its intention to promulgate TELRIC-compliant switching rates when, less than a month after issuing its original pricing order, the PUC issued a new order reconsidering, *sua sponte*, its February 2003 determination concerning such rates.[67] The PUC explained that it had conducted a further review of the Verizon inputs used to determine switching costs after AT&T pointed out, in the PUC's separate Section 271 proceeding, that the switching rates prescribed in *TELRIC I* not only were 28 percent higher than those recently adopted in New York, but also contributed to an anticompetitive price squeeze.[68] Upon its further review, the PUC concluded that the rates it had prescribed in *TELRIC I* were overstated, because it had "incorrectly assumed" that Verizon's input represented all minutes of

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[64] *Id.* at 59.

[65] *Id.* at 59-60.

[66] *Id.* at 59; *Maine 271 Order* at ¶ 26.

[67] *See* Order, *Investigation of Total Element Long-Run Incremental Cost (TELRIC) Studies and Pricing of Unbundled Network Elements,* Maine PUC Docket No. 97-505, March 8, 2002 ("*TELRIC II Order*").

[68] *TELRIC II Order* at 1.

use reported during 1996.[69] In addition, the PUC reconsidered its earlier decision to adopt a zero rate for night and weekend switching, deciding instead to assign a rate for those periods to recover the "getting started" cost pursuant to this Commission's model. Finally, the PUC determined that, rather than establish separate rates for day, night, and weekend switching, it would establish a single switching rate for all 24 hours of the day.[70] As Verizon stated to this Commission in its Section 271 application, the PUC's actions in the *TELRIC II Order* resulted in "decreasing the [switching usage] rate during some times and increasing the rate during others, resulting in an overall reduction in the rates."[71] This Commission concluded that the Maine PUC's approach "demonstrated a commitment to basic TELRIC principles in establishing switching rates."[72]

Although Verizon filed a letter with the Maine PUC on March 14, 2002, citing a number of non-substantive clerical errors in the PUC's *TELRIC II* order, it raised no further challenge to the rates prescribed by the PUC. *See Maine 271 Order* at ¶ 14. Verizon's failure to challenge the rates, together with its defense of the PUC's actions before this Commission in the *Maine 271* proceeding, belie its current suggestion that the PUC simply ignored costs and bowed to pressures to "produce the appearance of competition." This Commission concluded in the *Maine 271 Order* that the UNE rates prescribed by the PUC "fall within a range of rates that a reasonable application of TELRIC would produce." *Id.* at ¶ 33.

In short, Verizon's criticisms of the rate reductions required by the Maine PUC are unwarranted, since the PUC attempted to prescribe rates based on the TELRIC methodology.

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[69] *Id.* at 1-2.

[70] *Id.* at 2.

[71] Verizon Application in *Maine 271* at 47 n.46.

[72] *Maine 271 Order* at ¶ 28.

If anything, the UNE rates prescribed by the PUC were too *high*, because the PUC's application of TELRIC methodology did not fully comply with the Commission's requirements. For example, the switching rates prescribed by the PUC were overstated, because the PUC misallocated switching costs as between the line port rate element and the minutes-of-use rate element.[73] In addition, rather than apply the TELRIC methodology in a uniform manner to all UNE rates, the PUC utilized different methodologies to compute different rates.[74]

The Maine PUC itself has effectively recognized that the new UNE rates did not fully reflect TELRIC methodology. The PUC promulgated its February 2003 and March 2003 orders before the Supreme Court upheld the Commission's TELRIC methodology, and reversed the Eighth Circuit's decision, in *Verizon Communications v. FCC*. In its February 2003 order, the PUC, citing the "tortuous path" which the TELRIC standard had taken, "acknowledged a degree of uncertainty surrounding the proper application of the TELRIC standard" and concluded that determining the precise UNE price required by TELRIC "would be a futile exercise even with a full record based on recent data."[75] It was for that reason that the PUC expressed its commitment in the "relatively near term to revisit the UNE rates it was prescribing

[73] Specifically, the switching rates prescribed by the Maine PUC currently reflect a ratio of fixed to usage-sensitive cost of 30%/70%, while the appropriate ratio based on cost causation principles is actually 59%/41%. This "mismatch" allows over-recovery of switching costs by Verizon and deters CLEC entrants from serving high-use customers. *See* Comments of AT&T Corp. (at 7-14) and Declaration of Catherine Pitts on Behalf of AT&T Corp. (¶¶ 4-15), CC Docket No. 02-61, April 10, 2002; *Maine 271 Order* at ¶¶ 26-30 (finding that the PUC "did not commit any clear error" when it used the 30%/70% allocation, which is the allocation contained in the Commission's own Synthesis Model).

[74] For some recurring charges, the Maine PUC adopted Verizon's cost model but rejected Verizon's inputs and recalculated the rates using corrected inputs. As previously stated, the PUC established switching and port charges by adopting the Commission's USF model. For all other recurring charges, the PUC simply compared Verizon's proposed rates with those found in other Verizon jurisdictions and adopted the lower of the proposed rate or the average of the comparable rates in these jurisdictions. *See Maine 271 Order* at ¶ 18; *TELRIC I Order* at 7.

[75] *See Maine 271 Order* at ¶ 12; *TELRIC I Order* at 6.

based on more recent cost studies and with the benefit of at least some further clarification of the legal issues surrounding TELRIC at the national level."[76] Furthermore, the PUC acknowledged that the multiple-method approach that it had used in prescribing UNE rates this year "may seem 'rough' justice."[77] In view of the PUC's own statements, the PUC cannot reasonably have been found to have reduced the UNE rates to the full extent required by TELRIC methodology.

F. Maryland

As Verizon notes, the Maryland Public Service Commission ("Maryland PSC") initially prescribed UNE rates for Verizon in 1998. Petition, Att. B at 9. Verizon is also correct that the Maryland PSC ordered Verizon, as a condition to approval of Verizon's 271 application for Maryland, to reduce both its loop and switching rates in December 2002 to levels consistent with the Commission's 271 benchmarking standards. *Id.* Verizon's suggestion that the reduced rates are below levels justified by TELRIC, however, is both unsupported and contrary to Verizon's own representations to the Commission in support of the carrier's Maryland 271 application. *See Maryland/Washington D.C./West Virginia 271 Order* ¶ 40 ("In its application, Verizon relies on a benchmark comparison to its UNE rates in New York to demonstrate that its UNE rates in Maryland . . . fall within the range that a reasonable application of TELRIC principles would produce.").

The Maryland PSC's recent decision in its second-generation UNE pricing case[78] also provides no support for the notion that the recent rate reductions were unwarranted. After receiving extensive prefiled testimony, several days of oral testimony, and two rounds of briefs,

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[76] *See TELRIC I Order* at 7. *See also Maine 271 Order*, ¶ 12.

[77] *TELRIC I Order* at 7.

[78] Order (Order No. 78552), *In the Matter of the Investigation into Rates for Unbundled Network Elements Pursuant to the Telecommunications Act of 1996*, MD PSC Case No. 8879, July 1, 2003 ("Order No. 78552").

the PSC issued its final decision on July 1, 2003.[79] AT&T, Verizon and other parties filed cross-petitions for reconsideration of various aspects of the decision on July 30, 2003. Replies to the petitions are expected to be filed at the end of August.

Although the Maryland PSC's July 30 decision established only input values, and final rates await the PSC's action on the parties' petitions for rehearing and subsequent compliance runs, the decision makes clear that the higher rates sought by Verizon were well above forward-looking economic costs. For example, the PSC found that the weighted average cost of capital proposed by Verizon—12.95 percent—was riddled with flaws. It resulted from a DCF analysis of "subjectively selected companies that have little financial or structural resemblance to Verizon" and assumed that their currently project rates of earnings growth would continue "into the indefinite or nearly indefinite future." Order No. 78552 at 24-25. Verizon's cost of capital assumptions greatly overstated the competition, and competitive risk, that Verizon can realistically expect to face in Maryland for the foreseeable future. *Id.* at 25. And the PSC found that Verizon's proposed methodology for determining the discounted price of switching investment included "significant embedded costs" and overstated the discounted prices that Verizon could realistically expect to pay going forward. *Id.* at 63. Although the PSC failed to purge all of Verizon's embedded and short-run costing assumptions from its cost models,[80] there is clearly no basis for Verizon's unsupported assumption that the interim rates prescribed by the Maryland PSC in December 2002 fall below TELRIC levels.

G. Massachusetts

The Massachusetts Department of Transportation and Energy ("Massachusetts DTE") first established UNE rates in its *Consolidated Arbitrations* proceeding, which it insti-

[79] Order No. 78552.

[80] AT&T Petition for Rehearing and Reconsideration, MD PSC Case No. 78552, July 30, 2003.

tuted after several CLECs requested arbitration with Verizon in July 1996. The parties to the DTE's proceeding agreed in October 1996 that the rates ultimately approved by the DTE would be designated as "interim," in view of the Eighth Circuit's stay of the TELRIC rules issued by this Commission in its *Local Competition Order*.[81]

In an order issued in Phase 4 of the *Consolidated Arbitrations* proceeding in December 1996, the Massachusetts DTE accepted, for the most part, the cost model submitted by Verizon and ordered Verizon to determine the cost of UNEs based on that model.[82] In June 1997, the DTE issued an order approving the compliance filing that Verizon had made pursuant to the DTE's December 1996 order, including the UNE prices therein.[83] In March 1999, two months after the Supreme Court had vacated the Eighth Circuit's stay and upheld this Commission's jurisdiction to design nationwide pricing rules for interconnection and UNEs, the DTE made the "interim" rates permanent.[84]

While making the UNE rates permanent, the Massachusetts DTE nonetheless advised the parties that it would revisit – and possibly revise – those rates in 2001. The DTE found that "a five-year period between Department reviews is reasonable," and therefore the

[81] *See* Order Granting BA-MA's Motion to Adopt Permanent UNE Rates, *Investigation by the Department on Its Own Motion into the Propriety of the Resale Tariff of New England Telephone and Telegraph Company d/b/a Bell Atlantic-Massachusetts, filed with the Department on January 16, 1998, to Become Effective February 14, 1998*, DTE 98-15, March 19, 1999, at 11 ("*Permanent Rates Order*").

[82] *See* Order, *Consolidated Petitions of New England Telephone and Telegraph Company d/b/a NYNEX, Teleport Communications Group, Inc., Brooks Fiber Communications, AT&T Communications of New England, Inc., MCI Communications Company, and Sprint Communications Company, L.P., Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration of Interconnection Agreements Between NYNEX and the Aforementioned Companies*, DPU 96-73/74, 96-75, 96-80/81, 96-83, 96-94–Phase 4, December 4, 1996 ("*Consolidated Arbitrations*").

[83] *See* Order Approving NYNEX's Compliance Filing, *Consolidated Arbitrations*, June 27, 1997.

[84] *Permanent Rates Order* at 11-16.

"permanent" UNE rates would be in effect only "until December 2001."[85] In establishing a five-year review cycle, the DTE cited Verizon's position that a five-year period would be appropriate.[86]

In accordance with its five-year cycle, the DTE instituted a new investigation into UNE rates in January 2001, stating that "Because the UNE rates and avoided cost discounts were first set in 1996, the five-year deadline for evaluating wholesale rates is now upon us." The DTE announced its objective to complete the investigation by the end of 2001.[87]

Thus, contrary to the impression created by Verizon in its Petition, the DTE's decision to institute a "second-generation pricing proceeding" in 2001 was neither arbitrary nor surprising to Verizon. Verizon had *agreed* in 1998 that such a five-year review was appropriate, and it surely recognized that the initial UNE rates set in 1996-1997 might be substantially revised based on the evidence submitted in the new proceeding.

Verizon's Petition is similarly misleading and inaccurate in its depiction of the rate decreases that have occurred in Massachusetts since initial rates were approved by the DTE

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[85] *Id.* at 15-16. The DTE stated that it might review these rates at intervals even shorter than five years upon a "convincing demonstration that technological or regulatory change has affected Bell Atlantic's costs to such an extent that, unless the rates are modified, carriers will be improperly disadvantaged." *Id.*

[86] *Id.* at 15 (citing statement in Verizon's brief that "the five-year period is co-terminous with the terms of many of its existing contracts with CLECs"); Initial Brief of Bell-Atlantic-Massachusetts, DTE 98-15, Phase III (Part I), October 14, 1998, at 18 ("BA-MA agrees with this five-year time frame" for "subsequent Department investigations into UNE pricing based on newly available information or regulatory changes").

[87] *See* Vote and Order to Open Investigation, *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*, DTE 01-20, January 12, 2001.

in 1996 and 1997. *First*, although Verizon argues that switching rates have decreased 79 percent from the level of the switching rates originally adopted in 1997, Verizon itself reduced (or offered to reduce) its switching rates – substantially -- on three occasions *before* the Massachusetts DTE issued its July 2002 order establishing new UNE rates:

- In mid-2000,Verizon negotiated with certain CLECs "promotional discounts" of 30 to 50 percent less than the preexisting switching rates and made those discounts available to all CLECs until the Massachusetts DTE completed its reevaluation of UNE rates in 2001.[88]

- In October 2000, Verizon reduced its rates for switching, transport, and switch ports to the levels of the rates then in effect in New York.[89]

- In April 2002, Verizon filed a tariff that would have further reduced switching rates, subject to a true-up against whatever new rates the Massachusetts DTE ultimately adopted in its ongoing review of the UNE rates. The proposed tariff rates were identical to those that Verizon had proposed in the DTE's then-pending UNE rate proceeding.[90] The tariffed rates included a rate of $0.002888 per originating end office minute – less than one-third of the average originating per-minute rate that, according to Verizon, the DTE approved in the *Consolidated Arbitrations.*[91] Although the DTE suspended Verizon's tariff (on the ground that it rarely allowed "interim" rates to take effect when the DTE was on the verge of

[88] *See* Memorandum Opinion and Order, *Application of Verizon New England Inc., et al., for Authorization to Provide In-Region InterLATA Services in Massachusetts*, 16 FCC Rcd. 3988, ¶ 18 (2001) ("*Massachusetts 271 Order*"); Application by Verizon New England for Authorization to Provide In-Region InterLATA Services in Massachusetts, CC Docket No. 00-176, September 22, 2000 at 69 ("First Verizon 271 Application").

[89] *Massachusetts 271 Order*, ¶ 18; Reply Declaration of Steven E. Collins, CC Docket No. 00-176, November 3, 2000, ¶ 4.

[90] *See* Formal Complaint, *WorldCom, Inc. v. Verizon New England, Inc.*, File No. EB-02-MD-017, ¶ 30 & Exh. 5 (April 24, 2002) ("WorldCom Complaint").

[91] Order, *Investigation by the DTE on Its Own Motion into the Appropriate Pricing Based upon Total Element Long-Run Incremental Costs for Unbundled Network Elements*, DTE 01-120, July 11, 2002, at 263 ("*DTE UNE Rate Order*"). Verizon filed its tariff after it previously refused WorldCom's request that Verizon reduce its switching rate in Massachusetts to the rates recently prescribed in New York, negotiations between the parties had failed to resolve their dispute, and WorldCom made clear to Verizon that it intended to file a complaint requesting that this Commission revoke or suspend Verizon's Section 271 authority in Massachusetts because its switching rates in that State did not mirror those in New York. WorldCom Complaint at ¶¶ 25-29.

issuing a new UNE rate order), Verizon then offered to agree that the switching rates ultimately set by the DTE would be effective retroactively to March 1, 2002 -- the effective date of the new switching rates adopted in New York in January 2002.[92]

In fact, the switching rates that Verizon proposed in the DTE's recent UNE rate proceedings were *lower* than those which, according to Verizon, were adopted in the *Consolidated Arbitrations*. Verizon proposed originating and terminating end office MOU costs of $0.002888 and $0.002533, respectively. The average switching rate approved in *Consolidated Arbitrations* was $0.003637 per minute.[93]

Second, Verizon made these rate reductions *voluntarily* – not because it "had" to do so to meet the Commission's benchmarking standard.[94] As previously stated, Verizon negotiated its "promotional" discounts in switching rates with other CLECs in mid-2002. Furthermore, as Verizon has acknowledged – and the Commission has recognized – the reductions in

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[92] *See* Memorandum Opinion and Order, *WorldCom, Inc.* v. *Verizon New England Inc.*, File No. EB-02-MD-017, ¶¶ 11-14, July 23, 2002 ("*WorldCom Complaint Order*"). The switching rates in Verizon's tariff were lower than the previous New York rates, but higher than the new switching rates adopted by the New York Public Service Commission in its January 2002 order. *Id.* at ¶ 11.

[93] Petition, Att. B at 6; *DTE UNE Rate Order* at 297.

[94] Verizon's assertion that it reduced the switching rates "to satisfy the FCC's benchmark test" is disingenuous, because the Commission did not adopt such a test until three months later, in the *Kansas/Oklahoma 271 Order*. Memorandum Opinion and Order, *Joint Application by SBC Communications Inc., et al., for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, 16 FCC Rcd. 6237, ¶ 82 (2001)("*Kansas/Oklahoma 271 Order*"). *See Massachusetts 271 Order* at ¶ 22. Furthermore, once it filed the rate decrease in October 2000, Verizon relied heavily on the New York rate as a "benchmark" – and on the Commission's "benchmarking" test after it was adopted – as the basis for its argument that the switching rates, as so reduced, were TELRIC-compliant. *See* Reply Comments of Verizon, CC Docket No. 01-09, February 28, 2001, at 32 (arguing that because its switching rates are equivalent to those in New York, "that is the end of the matter" under the test adopted in the *Kansas/Oklahoma 271 Order*); *id.* at 38 (stating that loop rates are comparable to those previously approved in the *New York 271 Order*); Reply Comments of Verizon, CC Docket No. 00-176, *supra*, at 18 (arguing that reductions in rates to levels of rates in New York, which Commission had already found to be in compliance with TELRIC, "should put to rest any arguments that UNE rates in Massachusetts are not TELRIC-compliant") (quoting DTE Evaluation).

switching rates that Verizon filed with the DTE in October 2002 were voluntary.[95] Similarly, as previously noted, the tariff that Verizon filed in April 2002 was not an attempt to "benchmark" its switching rates to those recently adopted in New York, since the tariff rates were *higher* than the New York rates.[96]

Third, even leaving aside Verizon's own substantial reductions in switching rates since the DTE's *Consolidated Arbitrations* proceedings, Verizon's attacks on the reductions in loop and switching rates resulting from the DTE's newly-concluded UNE rate proceedings are without merit. This Commission found last year that the DTE's new UNE rate order "thoroughly analyzes the competing cost arguments made by Verizon and the CLECs" and "was the culmination of a comprehensive eighteen month investigation," the primary objective of which was "to assess 'whether Verizon ha[d] substantiated the reasonableness of its many UNE and interconnection cost components.'"[97] The sheer length of the DTE's order (519 pages) belies Verizon's assertions that the DTE simply "ignored costs" to "produce the appearance of competition." In any event, the DTE's own discussion of its objective shows the baselessness of Verizon's contention. The DTE stated:

> *The Department's objective in this order is to set UNE rates that most accurately reflect the TELRIC costs of particular UNEs. It is not to reach a biased outcome promoting either investment or UNE based competition through either "high" or "low" UNE rates.*

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[95] *See, e.g.*, Reply Comments of Verizon, CC Docket No. 00-176, *supra*, at 18 ("on October 13, 2000, Verizon voluntarily filed and the DTE approved a new tariff" to levels "virtually identical" to those in New York); Supplemental Filing of Verizon New England, CC Docket No. 01-9, January 16, 2001, at 37 ("Verizon voluntarily reduced its switching rates to the same levels to the same levels that the Commission approved in New York"). *See also Massachusetts 271 Order* at ¶¶ 21, 25. Verizon stated in the *Massachusetts 271* proceeding that it proposed these reductions "to eliminate pricing issues" in the proceeding. Reply Declaration of Steven Collins, *supra*, ¶ 4.

[96] *See WorldCom Complaint Order* at ¶ 11.

[97] *Id.* at ¶ 14 (quoting DTE's July 2002 UNE Rate Order at 4).

> Incremental cost-based rates, designed and implemented correctly, send the appropriate signals to both ILECs and CLECs about their investment and market entry decisions. *We will not conclude that UNE rates are "wrong" or "illegal" if they do not provide a sufficient margin for market entry when compared to retail rates (which are not cost-based). Nor will we conclude that rates are wrong if CLECs decide that it is more efficient for them to enter the market using UNEs instead of building their own facilities.* In addition, appropriately cost-based rates should compensate Verizon for its forward-looking costs, so that Verizon will have incentives to continue to invest in its network facilities.[98]

Although the Massachusetts DTE asserted in its *UNE Rate Order* that the UNE rates established in the *Consolidated Arbitrations* were TELRIC-based based on the record before it at that time, it recognized those rates were not immutable, since the passage of time had increased the availability of relevant information and the DTE's experience: "While the Department will rely on its earlier findings in *Consolidated Arbitrations* about what constitutes TELRIC, additional guidance from the FCC about TELRIC since 1996, as well as the parties' and the Department's actual experience since that time, may lead us to develop our precedent in view of the issues presented here."[99] Again and again in its order, and in its subsequent orders resolving requests for reconsideration of that order, the Massachusetts DTE made clear that it was attempting to apply the TELRIC methodology (as interpreted by the DTE) to establish the new UNE rates and resolve the myriad of price-related issues before it.[100]

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[98] *DTE UNE Rate Order* at 20 (emphasis added).

[99] *Id.* at 23-24.

[100] *See, e.g., id.* at I ("The rates were developed by applying a Federal Communications Commission ('FCC') cost standard, known as Total Element, Long-run Incremental Cost ('TELRIC'), which calculates the cost for an efficient carrier to provide UNEs and interconnection in a competitive wholesale market"); *id.* at 4 (new UNE proceeding was "a comprehensive review of [Verizon's] TELRIC-based rates for UNEs and interconnection (both recurring and nonrecurring), with the primary objective of assessing whether Verizon has substantiated the reasonableness of its many UNE and interconnection cost components"); *id.* at 20 ("the proper method for setting UNE rates is the FCC's TELRIC methodology"). *See also* Order Granting Verizon and AT&T Motions for Reconsideration, in Part, and Requesting (continued . . .)

In reality, Verizon's complaint about the reduction in rates on loops and switching stems from its belief that the Massachusetts DTE should simply have rubber-stamped the agency's rulings in the *Consolidated Arbitrations*, while ignoring both the TELRIC standard and the evidence submitted by the parties in the DTE's new UNE rate proceeding. In its *UNE Rate Order*, the DTE found that Verizon's position on a number of issues simply reflected its disagreement with TELRIC as adopted by this Commission:

> AT&T and WorldCom correctly observe that some of Verizon's arguments and interpretations represent Verizon's view of what Verizon wants TELRIC to be, rather than the FCC's requirements or guidance (WorldCom Brief at 6-7; AT&T Brief at 6-7). For example, Verizon criticizes the "scorched node" and "dropped in place" characteristics of a network modeled under TELRIC, but those characteristics are part of the FCC's description of its TELRIC method. In this Order, the Department is guided by the FCC's rules and statements about what constitutes TELRIC.[101]

(. . . continued)
Additional Evidence, *Investigation by the DTE on Its Own Motion into the Appropriate Pricing Based on TELRIC for Unbundled Network Elements,* DTE 01-20, September 24, 2002, at 8 ("*First DTE Reconsideration Order*") ("the point here is to come as near as we can to the right answer – the answer most correct under TELRIC – and not to shrink from a second look at the record, where, as here, one is warranted by the importance of the issue"); Order on Motions by Verizon Massachusetts, AT&T Communications of New England, Inc., and CLEC Coalition for Partial Reconsideration and Clarification and on Motions by WorldCom, Inc. and Z-Tel Communications for Partial Reconsideration, *Investigation by the DTE on Its Own Motion into the Appropriate Pricing Based on TELRIC for Unbundled Network Elements,* DTE 01-20, January 14, 2003, at 1 ("*Second DTE Reconsideration Order*") (stating that the DTE's *UNE Rate Order* used this Commission's TELRIC standard to develop recurring and nonrecurring rates for UNEs); *id.* at 14 ("in this proceeding we seek the most relevant data concerning the costs that would best apply in the theoretical TELRIC construct"); *id.* at 56-57 ("our intent is that the TELRIC studies we approve in this proceeding will lead to cost-based rates that encourage economically efficient demand for Verizon's telecommunications network and the economically efficient deployment of rival networks"); Order on Verizon Massachusetts/Compliance Filing, *Investigation by the DTE on Its Own Motion into the Appropriate Pricing Based on TELRIC for Unbundled Network Elements,* DTE 01-20, May 29, 2003, at 1 (*UNE Rate Order* used TELRIC standard of this Commission to develop recurring and nonrecurring rates); Letter and Order Approving Verizon's Revised Compliance Filing, DTE 01-20, July 14, 2003, at 2 (same).

[101] *DTE UNE Rate Order* at 20-21 (footnotes omitted).

Similarly, the DTE frequently rejected Verizon's position on particular cost issues because the evidence compiled in the new proceeding called for a contrary finding. Although the DTE repeatedly gave Verizon the opportunity to supplement its evidentiary submissions to correct what the DTE regarded as a failure of proof, Verizon declined to do so.[102]

In any case, the Massachusetts DTE's reduction of rates for switching and 2-wire loops should have come as no surprise to Verizon, because many of the bases underlying the DTE's prescription of rates for those UNEs in the *Consolidated Arbitrations* were fundamentally flawed and inconsistent with TELRIC methodology. For example, the switching and related usage rates prescribed in the *Consolidated Arbitrations* were grossly inflated because they were based on numerous inputs and assumptions that were both unreasonable and erroneous (and were contrary to the standards set by this Commission, the positions taken by other ILECs, and even the representations made by Verizon in other proceedings). The numerous flawed inputs and assumptions in Verizon's cost studies included:

- The use of a switch discount rate that failed to account for the full discount that Verizon receives for new switch purchases;
- Overstated installation costs;
- A significant understatement of the number of minutes that switches will be in use;
- An understated utilization factor applied to switch port costs;
- An overstated cost of capital;
- An improper calculation of the cost of buildings required to provide switching and transport; and

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[102] *See, e.g., DTE UNE Rate Order* at 316-318; *DTE First Reconsideration Order* at 3-4, 7-8, 11-12; *DTE Second Reconsideration Order* at 12-13 (RTU fees), 25-26 (ratio of "new" to "growth" switches), 40-41 (Verizon's use of 251 days in calculation of Busy Hour to Annual Conversion factor), 61 (IOF portion of UNE rates).

- The use of an overstated factor to estimate the cost of power equipment associated with switching plant.

Correcting these errors in Verizon's studies has the combined effect of reducing local usage rates by 63-67%, analog port rates by more than 77%, local switching usage rates in the range of 63% to 67%, trunk port rates by 79.76%, and common transport rates by 62.2%.[103] Thus, the preexisting rates were 150 to 200 percent above properly calculated TELRIC levels.

Although the rate adjustments that Verizon filed with the DTE on October 13, 2000, reduced these rates somewhat, they effectively eliminated only about half of these overages, thus still leaving the switching and related usage rates well above TELRIC levels.[104] For example, the evidence showed that the switching usage rates filed in October 2000 still exceeded Verizon's forward-looking economic costs by *70 percent* or more, due to such factors as: (1) the failure of Verizon's cost model to use the aggressive new switch purchase discounts offered by its vendors; (2) the inability of Verizon's Switch Cost Information System ("SCIS") model (on which Verizon relies to support its claimed switching costs) to calculate reasonable estimates of the switch prices for the switch configurations that Verizon uses in its study; and (3) Verizon's overstatement of proposed engineering and installation factors.[105]

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[103] *See* Comments of AT&T Corp. in Opposition to Verizon New England Inc.'s Section 271 Application for Massachusetts, CC Docket No. 01-9, February 6, 2001, at 7-9 ("AT&T Massachusetts II Comments"); Initial Comments of WorldCom, Declaration of Mark T. Bryant, CC Docket No. 00-176, October 16, 2000, at ¶¶ 4-75 ("Bryant Initial Decl.").

[104] *See* AT&T Massachusetts II Comments at 8; Reply Comments of WorldCom, Reply Declaration of Mark T. Bryant, CC Docket No. 00-176, November 3, 2000, at ¶¶ 3-8 ("Bryant Reply Decl.").

[105] *See* AT&T Massachusetts II Comments at 9 & Att. 1 at 10-11, 37, 109-150. As discussed below, even the switching rates prescribed by the New York Public Service Commission in 1997, which Verizon adopted in Massachusetts in October 2000, fell far short of meeting TELRIC standards, due to misstatements that Verizon had made to the NYPSC (and the DTE) regarding the future availability of large discounts for purchases of "new" switches. However, unlike the NYPSC, the Massachusetts DTE made no commitment to order refunds in the event that it found that Verizon's switching rates were not TELRIC-compliant in its forthcoming reevaluation of Verizon's UNE rates.

The loop rates adopted in the *Consolidated Arbitrations* also failed to comply with TELRIC. The unverifiable cost model that Verizon presented in that proceeding produced clearly inflated estimates of loop costs by assuming (1) an unreasonably high cost of capital; (2) unrealistically long drop lengths in urban and suburban areas; (3) unreasonably low fill factors for fixed plant, digital loop carrier line cards and equipment; and (4) excessive spare conduit capacity.[106] Correcting these errors has reduced Verizon's loop costs by approximately 30 percent.[107]

Although the Commission's *Massachusetts 271 Order* found that Verizon's switching and loop rates met the requirements of Section 271 (largely because of their similarity to the rates previously adopted in New York, where the Commission had already granted Section 271 authority), the Commission nonetheless expressed reservations about the compliance of those rates with TELRIC methodology. For example, the Commission found that a future decision by the NY commission to revise switching rates in New York "may undermine Verizon's reliance on those rates in Massachusetts and its compliance with the requirements of section 271, depending on the New York commission's conclusions."[108] Furthermore, the Commission found that commenters "had raised legitimate concerns" regarding: (1) the 12.16 percent cost of capital adopted by the DTE, which was "higher than the cost of capital that the [DTE] has used in setting Verizon's local rates and substantially higher than the cost of capital employed by any of the other states in Verizon's region"; and (2) the "substantially low fill

[106] *See* Reply Comments of AT&T, CC Docket No. 00-176, at 12-19, 23-24, 32-33, and Declaration of Baranowski at 3-9. *See also* Bryant Reply Declaration at ¶¶ 19-23 (Verizon's loop rates are overstated by at least 9% due to its use of an inflated cost of capital and unduly low utilization factors).

[107] AT&T Reply Comments at 23-24; Baranowski Decl. at 3.

[108] *Massachusetts 271 Order* at ¶ 30.

factors" that the DTE had used in calculating rates for loops, including a fill factor of only 40 percent for copper distribution cable for metro, urban, and suburban zones.[109]

The Massachusetts DTE's 2002 *UNE Rate Order* resulted in reductions in rates on switching and loops because the DTE corrected some (but not all) of the errors it made in prescribing inflated UNE rates in the *Consolidated Arbitrations* proceeding. For example:

- In lieu of its previous acceptance of Verizon's heavy reliance on "growth" switches for purposes of switching rates, the DTE directed Verizon to use a blend of 90 percent new switches and only 10 percent growth switches. The DTE concluded that, because of the "dropped in place" nature of a TELRIC-modeled network, the "more appropriate foundation for a TELRIC analysis" assumes that in the first year, the model deploys all new switches and then, in subsequent years, growth is added to accommodate forecast demand.[110] Citing statements by this Commission in the *Massachusetts 271 Order* and the *Rhode Island 271 Order* (which approved a presumption of 90 percent new switches and 10 percent growth additions), the DTE concluded that "the FCC has recently and clearly directed the use of a network that includes some new switches."[111]

- For the Engineering, Furnishing, and Installation ("EF&I") factor for switching, the DTE allowed Verizon to use 24 percent, as increased by the ratio of Verizon's proposed switch investment to the switch investment that corresponded to the DTE's order, plus 5 percent for sales tax. This factor was lower than that adopted in the *Consolidated Arbitrations* and lower than the 40 percent factor proposed by Verizon, which the DTE found to be unsupported by the evidence.[112]

- The DTE rejected Verizon's attempt to understate the number of minutes that switches will be in use by counting only business days (251 days) – the same approach that Verizon had successfully proposed in the *Consolidated Arbitrations*. The DTE found that, because traffic patterns have likely

[109] *Id.* at ¶¶ 38-39. The Commission found that these deficiencies were not sufficient to require denial of Verizon's application, because the DTE was reviewing these inputs in its current UNE rate case and because, even as calculated by the DTE, the loop rates in Massachusetts were not significantly different from those in New York. *Id.* at ¶¶ 38-40.

[110] *DTE UNE Rate Order* at 300-302.

[111] *Id.* at 299-300 (citing *Massachusetts 271 Order* at ¶ 35 and *Rhode Island 271 Order* at ¶ 34).

[112] *Id.* at 317-321; *Second DTE Reconsideration Order* at 29-32.

evolved since 1997, it was reasonable to include at least some portion of weekend days and holidays.[113]

- The DTE adopted a cost of capital of 11.45 percent, which was lower than the 12.16 percent approved by the DTE in the *Consolidated Arbitrations.*[114]

- The DTE directed Verizon to adjust its forward-looking costs to account fully for the beneficial impact of the Bell Atlantic/GTE merger (which occurred after the *Consolidated Arbitrations*) on its productivity.[115]

- The DTE assumed that the average distribution loop length in a particular distribution area ("DA") is one-half of the longest distribution portion of the loop of each DA, rather than simply assume a 125-foot distribution drop length in all density zones (as Verizon's cost study had done in the *Consolidated Arbitrations*).[116]

- In contrast to its acceptance of Verizon's assumption in the *Consolidated Arbitrations* that fiber should always be used in the feeder portion of the loop, the DTE adopted thresholds that, the DTE estimated, would result in an over-all "mix" of 41.2 percent copper and 58.8 percent fiber for the feeder portion of the network. In addition, for purposes of fiber feeder, the DTE required that the ratio of Integrated Digital Loop Carrier ("IDLC") to Universal Loop Digital Carrier ("UDLC") be 2:1 – not 4:1, as proposed by Verizon. The DTE found not only that Verizon had failed to support its proposed ratio, but also that the ratio of IDLC (which it found to be the least cost technology) to UDLC in Verizon's current network was already 2:1, and it was "reasonable to assume" that this ratio would continue in the future. Finally, the DTE directed Verizon to adjust to 4:1 the loop/port concentration ratio for lines served by IDLC with GR-303 equipment (from the 3:1 ratio proposed by Verizon) to recognize the opportunity for Verizon to take advantage of differing residential and business patterns.[117]

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[113] *DTE UNE Rate Order* at 326-327. The DTE originally determined that each weekend day and holiday should be counted as a half-business day, resulting in a total of 308 days (251 days plus one-half of 114 days). *Id.* On reconsideration, the DTE reiterated that Verizon had not provided sufficient evidence to support its proposed 251-day figure, but revised its originally-adopted figure of 308 days to 270 days (the figure in the CLECs' cost study) because of concern that the use of 308 days might lead to an understatement of Verizon's actual traffic. *Second DTE Reconsideration Order* at 39-43.

[114] *DTE UNE Rate Order* at 69-80.

[115] *Id.* at 104-113.

[116] *Id.* at 135-137. The new average distribution loop length was proposed by Verizon. *Id.* at 133-134.

[117] *Id.* at 143-145, 159-160, 162-163. The DTE estimated that its requirement that Verizon change its cost study to use copper/fiber breakpoints of 9,000 feet (rather than the 4,000 and

(continued . . .)

- Many of the fill factors adopted by the DTE were higher than those adopted in the *Consolidated Arbitrations*. Although Verizon had proposed the same previous fill factors (or factors 10 percent higher than the previous fill factors), the DTE found that "a new cost driver (*i.e.*, increasing competition in the markets that TELRIC envisions) warrants some adjustment of Verizon's proposed fill factors, which were achieved under a price cap regime" that did not necessarily reflect the most efficient carrier.[118] *Inter alia*, the DTE increased the copper distribution factor (which had been 40 percent in metro, urban, and suburban density zones), finding that Verizon had failed to substantiate a number of the bases for its proposed 40 percent figure and to take other factors (such as demand growth) into account.[119] The DTE also found that the appropriate fiber feeder fill factor was 75 percent (rather than the previously-approved 60 percent), because the fiber feeder factor already includes inherent spare capacity (the assignment of two redundant pairs to every two fibers for emergency use).[120]

The Massachusetts DTE's prescription of new UNE rates was deficient only to the extent that it failed to *fully* apply TELRIC methodology to certain issues – and therefore did not require even *lower* UNE rates than those actually prescribed. For example, the 11.75 percent cost of capital approved by the DTE far exceeded the appropriate rate (9.54 percent), because it overstates the risk that Verizon faces from competition in the retail market – and, thus, overstates the cost of equity. In addition, although the DTE adopted a blend of 90 percent "new" and 10

(. . . continued)
5,000-foot breakpoints used by Verizon) wold decrease the monthly UNE loop costs (unloaded) for the urban and suburban zones by $3.10 and $1.72 per loop, respectively, where UDLC is assumed. Where IDLC was assumed, the corresponding estimated decreases for urban and suburban loops (which constitute approximately 88 percent of the loops affected by the DTE's order) are $0.96 and $0.42, respectively. *Id.* at 56-57.

[118] *Id.* at 172.

[119] *Id.* at 181-185.

[120] *Id.* at 190. The DTE also increased the conduit (duct) utilization factor and channel units fill factor to 55 percent and 88 percent, respectively, from the 50 percent and 80 percent fills approved in *Consolidated Arbitrations*. *Id.* at 192-195 In the case of the conduit utilization factor, the DTE concluded that Verizon had not shown that its proposed 44 percent factor complied with engineering guidelines or that spare inner ducts and spare ducts have mutually exclusive functions requiring separate adjustments. The DTE found Verizon's proposed 80 percent fill factor for channel units to be inadequate because it failed to account for the "high flexibility for capacity adjustment". *Id.*

percent "growth" switches, the amount of the "new switch" discounts used by the DTE was too low, and thus overstated switching costs. The DTE also overstated the percentage of UDLC that would be used in a forward-looking network; the evidence showed that the IDLC/UDLC ratio in a forward-looking network likely would be between 8:1 and 9:1, rather than the 2:1 ratio adopted by the DTE. Furthermore, the DTE did not require Verizon to calculate per-unit costs associated with the loop based on a reasonable projection of the actual total usage of the loop element.[121]

On a number of other issues, the Massachusetts DTE overstated UNE rates because it made a "split" between the parties' positions to accommodate Verizon's interests, rather than apply TELRIC methodology fully and reject Verizon's position altogether. For example, as stated above, the DTE decided to use a figure of 308 days, and then 270 days (rather than the 251 days proposed by Verizon and the 365 days proposed by the CLECs) for purposes of the Busy Hour to Annual Conversion Factor. Although the DTE rejected Verizon's proposal to recover $1.88 million in "right-to-use" fees because Verizon had failed to provide sufficient evidence to support it, the DTE nonetheless allowed initial RTU fees of a "considerably smaller magnitude" based on evidence in the record concerning competitively-bid switches.[122] Similarly, the DTE found that Verizon had failed to substantiate its feature port additive costs for features that rely on "product management," but ultimately decided simply to reduce those costs by 40 percent, based on its "administrative judgment."[123] After initially deciding that Verizon should assign all "getting started" and Equivalent POTS Half Calls ("EPHC") to the non-traffic sensitive category, the DTE decided that Verizon should allocate 50 percent of the costs to that

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[121] *See* AT&T's Motion for Partial Reconsideration and Clarification, DTE 01-20, August 14, 2002, at 1-22.

[122] *See Second DTE Reconsideration Order* at 11-21.

[123] *Id.* at 50-52.

category and the remaining 50 percent to traffic-sensitive UNEs, on the basis of the DTE's "subjective weighting" in "the absence of direct evidence to support any specific allocation."[124]

H. New Hampshire

Verizon (then Bell Atlantic) first proposed UNE rates in New Hampshire in a Statement of Generally Available Terms ("SGAT") that it filed with the New Hampshire Public Utilities Commission ("NHPUC") in July 1997. To avoid delaying the implementation of the SGAT tariff, the NHPUC ordered that the rates in the SGAT take effect immediately, as "the equivalent of temporary rates," until the rates could be reviewed.[125]

On July 6, 2001, the NHPUC issued an order resolving UNE rate issues and certain non-cost issues, and requiring Verizon to file revised tariffs with UNE rates in compliance with the rulings in its order.[126] However, in June 2002 – only 11 months after the NHPUC issued its order and only three weeks before Verizon filed a Section 271 application for New Hampshire with this Commission – Verizon reduced its UNE rates below those prescribed by the NHPSC. Verizon's current claim that it was "required" to make these rate reductions "in order to meet the FCC's benchmarking" standard is nothing more than revisionist history. *See* Petition, Att. B at 8.

First, Verizon's reductions occurred because of the NHPUC's own recognition that the rates that it had approved in the *SGAT Order* were too high – not because of this Commission's benchmarking standard. On March 1, 2002 (seven months after issuing the *SGAT*

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[124] *Id.* at 54-58; *DTE UNE Rate Order* at 308-311.

[125] *See* Order Granting in Part and Denying in Part (Order No. 23,738), *Petition for Approval of Statement of Generally Available Terms Pursuant to the Telecommunications Act of 1996*, NHPUC Docket No. DE-171, July 6, 2001, at 6-9 ("*NHPUC SGAT Order*"); *New Hampshire/Delaware 271 Order* at ¶ 25.

[126] *See NHPUC SGAT Order* at 174.

Order), after reviewing the evidence submitted in its Section 271 proceeding, the NHPUC found that because it had "several areas of concern about several checklist items," Verizon would be required to satisfy certain conditions before the NHPUC could recommend approval of Verizon's Section 271 application.[127] One of the NHPUC's conditions was that Verizon must: (1) recalculate the rates in its CLEC tariff using an 8.42 percent cost of capital, based on Verizon's current debt to equity ratio, Verizon's current cost of debt and 10 percent return on equity as used in New Jersey; and (2) in addition, reduce *all* such rates by 6.43 percent to "account for merger and process re-engineering savings."[128] That condition "would have resulted in lower UNE rates." *New Hampshire/Delaware 271 Order* at ¶ 31 n.109. Verizon, however, objected to this condition, stating that the NHPUC should institute a new proceeding if it "desire[d] to conduct a fresh examination of UNE rates."[129]

The NHPUC then ordered discussions between Verizon and the NHPUC Staff about possible alternatives to the conditions to which Verizon objected. On June 5, 2003, after the NHPUC Staff filed a report containing alternative proposals for addressing Verizon's concerns, Verizon filed a letter with the NHPUC that summarized its position on the NHPUC's

[127] Letter from NHPUC to J. Michael Hickey, *Application of Verizon New England Inc., d/b/a Verizon New Hampshire, for a Favorable Recommendation to Offer InterLATA Service under 47 U.S.C. § 271*, DT 01-151, March 1, 2002, at 2-3 ("NHPUC March 1 Letter").

[128] *Id.* The 8.42 percent cost of capital rate that the NHPUC attached as a condition of its Section 271 approval would have replaced the 10.46 rate that the NHPUC had approved seven months earlier in its *SGAT Order*. *See* Letter from J. Michael Hickey to Thomas B. Getz, *et al.*, *Application of Verizon New England Inc., d/b/a Verizon New Hampshire, for a Favorable Recommendation to Offer InterLATA Service under 47 U.S.C. § 271*, DT 01-151, March 15, 2002, at 3 ("Verizon March 15 Letter"). Although the NHPUC's letter also conditioned its approval of Verizon's application on, *inter alia*, revision of Verizon's tariff to apply the local switching charge only once on a call that originates and terminates to the same switch, the NHPUC later eliminated that condition after receiving information that no double charging occurred when Verizon billed for both originating and terminating portions of calls within the same switch. *New Hampshire/Delaware 271 Order* at ¶ 32.

[129] Verizon March 15 Letter at 2-4.

conditions and offered an alternative to the NHPUC's UNE pricing condition. Specifically, as an alternative to the UNE pricing changes described in the NHPUC's conditions, Verizon agreed to: (1) reduce switching and transport rates by approximately 17-18 percent; (2) reduce monthly rates for 2-wire and 4-wire analog loops in the rural density zone to $25 and $50, respectively; (3) reduce all DS1 loop rates by 20 percent; and (4) reduce daily usage file rates by approximately 70 percent.[130] Verizon stated in its letter that it was making the reductions so that the NHPUC "will be able to make a favorable recommendation" to this Commission regarding its application. Verizon's letter to the NHPUC made no reference to "benchmarking."[131] The NHPUC accepted Verizon's proposal on June 14, 2002, and Verizon promptly modified its SGAT to reflect the reduced rates.[132] Verizon filed its application with this Commission less than two weeks later.

Second, Verizon's argument that it was "required to meet" the Commission's benchmark test is bogus. Both before and after Verizon filed its Section 271 application for New Hampshire, the Commission made clear that the use of a benchmark test is necessary *only* when the applicant has failed to show that the State commission did not apply TELRIC principles properly.[133] In its Section 271 application, Verizon argued at length that the NHPUC *had*

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[130] Letter from J. Michael Hickey to Thomas B. Getz, *Application of Verizon New England Inc., d/b/a Verizon New Hampshire, for a Favorable Recommendation to Offer InterLATA Service under 47 U.S.C. § 271*, DT 01-151, June 5, 2002, at 2 ("Verizon June 5 Letter"); *New Hampshire/Delaware 271 Order* at ¶ 31 & n.112.

[131] Verizon June 5 letter at 1.

[132] Letter from NHPUC to J. Michael Hickey, *Application of Verizon New England Inc., d/b/a Verizon New Hampshire, for a Favorable Recommendation to Offer InterLATA Service under 47 U.S.C. § 271*, DT 01-151, June 14, 2002, at 2-3 ("NHPUC June 14 Letter"); *New Hampshire/Delaware 271 Order* at ¶ 32.

[133] *See, e.g., New Hampshire/Delaware 271 Order* at ¶ 37 & n.138; Memorandum Opinion and Order, *Application of Verizon for Authorization to Provide In-Region InterLATA Services in New Jersey,* 17 FCC Rcd. 12275, ¶ 49 (2002); *Kansas/Oklahoma 271 Order* at ¶¶ 81-82.

properly applied TELRIC methodology in establishing UNE rates.[134] Indeed, Verizon asserted in its Application that it was *not* required to satisfy the benchmark test and stated that it had *agreed* to those rate reductions.[135]

Despite its position that its UNE rates were not required to satisfy the benchmark test to satisfy the competitive checklist, Verizon's Section 271 application nonetheless chose to rely on the benchmark test as further support for its argument the reduced UNE rates in New Hampshire satisfied the competitive checklist, emphasizing the similarity of those rates to the rates recently adopted in New York.[136] Indeed, in its reply comments, Verizon relied *entirely* on the benchmarking test, arguing that because the reduced rates met the benchmark requirement, there was "no need to address" the issue of whether the NHPUC adhered to TELRIC principles. That is why this Commission concluded that, rather than rely on the rates established by the NHPUC, Verizon had "relie[d] on its reduced UNE rates to support its application and demonstrates that these rates pass a benchmark analysis."[137]

In reality, Verizon relied on the benchmark test in its application because it was undoubtedly aware that the NHPUC had *misapplied* TELRIC methodology in several respects in

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[134] Application by Verizon New England and Verizon Delaware for Authorization to Provide In-Region, InterLATA Services in New Hampshire and Delaware, WC Docket No. 02-157, June 27, 2002, at 57-64 ("Verizon NH Application").

[135] *See* Verizon NH Application at 60 (stating that Verizon has "agreed to implement" the four types of rate reductions described in its June 5, 2002 letter); *id.* at 63 ("Verizon has voluntarily reduced the switching rates that were initially adopted by the New Hampshire PUC"); *id.* at 75 ("Verizon is not required to demonstrate that the rates established by the New Hampshire PUC and the Delaware PSC are comparable (relative to cost levels) to the newly adopted rates in New York, [but] the facts here nonetheless demonstrate that they are with respect to both the loop and non-loop rates in New Hampshire").

[136] *Id.* at 74-79 & Joint Declaration of J. Michael Hickey, Patrick A. Garzillo and Michael J. Anglin, ¶¶ 58-64.

[137] Reply Comments of Verizon New England and Verizon Delaware, WC Docket No. 02-157, August 12, 2002, at 16; *New Hampshire/Delaware 271 Order* at ¶ 37 & n.137.

determining UNE rates in its 2001 order, resulting in rates that were well *above* TELRIC levels. The Commission recognized this fact in the *New Hampshire/Delaware 271 Order*, stating that it had "serious concerns as to whether the New Hampshire Commission applied the proper interpretation of the TELRIC methodology in its SGAT proceeding."[138] Only by resorting to its benchmarking standard was the Commission able to find that the UNE rates, as reduced by Verizon *after* the NHPUC issued the *SGAT Order* (*i.e.*, the rates which Verizon now describes as "ratcheted down") were "within the range that a reasonable TELRIC-based rate proceeding would produce."[139]

As the Commission indicated, the NHPUC's *SGAT Order* failed to apply 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. Instead, the NHPUC's interpretation of TELRIC appeared to be based on *Iowa Utilities Board v. FCC*, 219 F.3d 744 (8th Cir. 2000) ("*Iowa Utilities II*"), which had set aside the Commission's requirement—but which had been recently reversed by the Supreme Court.[140] The Commission expressed particular concern about the technology and cost assumptions required by the NHPUC, Verizon's methodology for calculating switching rates, and evidence that some of the cost inputs adopted by the NHPUC "were established via a stipulation between Verizon and [NHPUC] Staff, rather than through an examination of Verizon's costs."[141]

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138 *New Hampshire/Delaware 271 Order* at ¶ 37.

139 *Id.* at ¶¶ 37, 44-55.

140 *See id.* at ¶¶ 27 & n.88, 37 & n.136; *NHPUC SGAT Order* at 5-6.

141 *New Hampshire/Delaware 271 Order* at ¶ 37 & n.135.

The rate reductions made by Verizon in June 2002 did not cure the NHPUC's failure to apply TELRIC methodology to its full extent in the *SGAT Order*. The NHPUC has never judged whether the reduced rates (or even rates approved in the *SGAT Order*) comply with the Commission's TELRIC methodology.[142] In fact, the NHPUC effectively found that those rates were *not* TELRIC-compliant when, in March 2002, it required reductions in those rates before it could recommend that Verizon be found in compliance with the competitive checklist of Section 271 – Item 2 of which requires compliance with Section 252(d)(1). Furthermore, the NHPUC held no evidentiary proceedings after Verizon proposed its rate reductions to determine whether the reduced rates were TELRIC-complaint. Instead, the NHPUC simply accepted Verizon's proposal to reduce the rates only nine days after Verizon submitted it. Nor did Verizon's June 5, 2002, proposal to the NHPUC provide any evidence that the reduced rates that it was proposing were TELRIC-complaint. Finally, notwithstanding Verizon's attempt to show that the reduced rates meet the "benchmarking" test, AT&T has previously shown that even as reduced, the switching rates in New Hampshire substantially exceed those in New York on a cost-adjusted basis.[143]

The NHPUC's institution of a new rate proceeding is further evidence that the NHPUC recognizes that, even as reduced, Verizon's UNE rates are inconsistent with TELRIC methodology. On June 18, 2002, only four days after finding Verizon's reduced UNE rates to be

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[142] In its June 14, 2002, letter accepting Verizon's proposal, the NHPUC made no determination as to whether the rates, as reduced, were TELRIC-compliant. *See* NHPUC June 14 letter at 3-4. The NHPUC also did not determine whether the switching rates approved in the *SGAT Order* were, in fact, TELRIC-compliant. Those original switching rates were the product of a bilateral side deal ("stipulation") between Verizon and the NHPUC Staff, and were not based on costs. *See New Hampshire/Delaware 271 Order* at ¶ 25; Comments of AT&T, WC Docket No. 02-157, July 27, 2002, at 14-16 ("AT&T NH Comments").

[143] AT&T NH Comments at 6-8. Even Verizon's Petition describes its current rates for loops and switching as significantly higher in New Hampshire than in New York. Petition, Att. B at 3, 9.

acceptable for purposes of recommending approval of its Section 271 application, the NHPUC opened a new proceeding to determine whether recurring UNE rates should be modified to reflect changes in the cost of capital, or cost inputs, since 1998.[144] Although that proceeding is still ongoing, its institution suggests a commitment by the NHPUC to implement the TELRIC methodology required by this Commission based on the most recent data available.

I. New Jersey

The history of UNE price litigation in New Jersey is in large part a history of ratcheting rates up, not down. The Commission will gain little understanding of it, however, from Verizon's selective and one-sided account. *Cf.* Petition, Att. B, at 3-4.

AT&T requested an interconnection agreement with Verizon's predecessor, Bell Atlantic, shortly after the 1996 Act was passed. Unable to agree on rates, the parties arbitrated those and other issues before Judge Paul Thompson, the arbitrator appointed by the New Jersey Board of Public Utilities ("BPU"). After extensive evidentiary filings and a twelve-day trial, the arbitrator set TELRIC-based UNE prices in November 1996. Judgment of Arbitrator, Docket No. TO96070519, Nov. 8, 1996.

The rates never took effect. Bell Atlantic first delayed completion of the interconnection agreement and then refused to sign any interconnection agreement that included the arbitrated rates. Bell Atlantic also waged a vociferous public campaign to have the rules of the game changed retroactively through replacement of the arbitrated rates with rate determinations from a generic rate-setting proceeding that the BPU had already expressly ruled would not be used as between AT&T and Bell Atlantic.

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[144] *New Hampshire/Delaware 271 Order* at ¶ 33; Order of Notice, NHPUC Docket No. DT-011, June 18, 2002. As AT&T stated in its comments in the *New Hampshire/Delaware 271* proceeding, Verizon based its switching cost study on 1994 or 1995 switch discount percentages and technology that were already obsolete even in 1998. AT&T NH Comments at 16-18.

The gambit worked. By the time interconnection agreements were finally submitted to the BPU for its review—and two were ultimately submitted, one that contained the arbitrated rates and one that contained the rates that Bell Atlantic contended should replace them—the BPU had reversed field. Reneging on its earlier commitment that the rates AT&T and Bell Atlantic arbitrated would govern their contractual interconnection relationship, the BPU retroactively substituted a different set of rates prescribed by the BPU in its separate "generic" proceeding. Generic Order, NJ BPU Docket No. TX95120631, Dec. 2, 1997. These rates were much higher than the arbitrated rates:

New Jersey UNE Rates – 1996 vs. 1997			
	November 1996	**April 1997**	**Increase**
2-wire analog loop (statewide average)	$ 11.76	$14.52	23.5%
Local switching (average rate/min.)	$0.002	$0.00315	57.5%

The newer rates did not begin to comply with the TELRIC standard. Rather than make "real choices on what an efficient network would look like if constructed today," the Board resorted to a crude political compromise: it placed the competing rate proposals of AT&T/MCI and Verizon side by side, assigned a 60 percent weighting to Bell Atlantic's and a 40 percent weighting to AT&T/MCI's, and dubbed the weighted average TELRIC. *AT&T Communications of New Jersey, Inc. v. Bell Atlantic-New Jersey, Inc.*, Civ. No. 97-5762, slip op. at 27-30 (D.N.J. June 2, 2000). On review, the District Court overturned this split-the-baby approach as arbitrary and capricious:

> [W]hen the Board has the expertise and resources it does, adopting a fallback position like splitting the difference is in the end, a simplistic way of resolving a complex problem. The assignment of percentage ratios to the models as a whole is nothing more than a rough estimate of which model was "more wrong" than the other. The Board gave no articulated, rational connection between the problems with the models and its decision to weight them on a

> 60/40 basis, as opposed to, say, a 50/50, a 30/70, or a 45/55 basis. Nor does the Board explain why weighting was applied evenly to all elements collectively. Inevitably, as AT&T and MCI have argued, this approach creates uneven, even harsh consequences.

AT&T Communications of New Jersey, Inc. v. Bell Atlantic-New Jersey, Inc., Civ. No. 97-5762, slip op. at 27 (D.N.J. June 2, 2000). To illustrate further the arbitrariness of the BPU's approach, the Court singled out the BPU's decisions to adopt a 40/60 weighting of new and add-on switch discounts, and to accept a 30 percent fill factor for distribution cable based on Verizon's embedded capacity utilization. *Id.* at 29, 33-34.

On remand from the District Court, the BPU finally attempted to apply TELRIC principles in earnest. Verizon identifies nothing inconsistent with TELRIC in the assumptions and methodology underlying the reduced rates adopted by the BPU in its 2001 and 2002 decisions on remand from the District Court. Nor could Verizon do so. Even a cursory review of the BPU decisions makes clear that Verizon's challenges to the BPU-adopted rates were little more than efforts to recover embedded or short-run costs, or recycled versions of Verizon's unsuccessful attacks on the TELRIC standard itself on judicial review of the *Local Competition Order* in the Supreme Court. *See, e.g.*, Decision and Order, NJ BPU Docket No. TO00060356, March 6, 2002, at 9-10, 33-34.

J. New York

Verizon's description of the reduction of UNE rates in New York is both simplistic and highly incomplete. *See* Petition, Att. B at 2-3. The new rates for 2-wire loops and local switching that the New York Public Service Commission ("NYPSC") prescribed in January 2002 reflected an increasing adherence by the NYPSC to TELRIC methodology, as well as new evidence demonstrating that certain previous rulings by the NYPSC were inconsistent with TELRIC.

In November 1995 – three months before the 1996 Act became law – the NYPSC instituted a proceeding to establish resale rates for Verizon's telephone service and rates for unbundled links and ports.[145] In July 1996, the NYPSC established temporary rates for Verizon's wholesale service and unbundled links.[146] Although briefing and hearings had been concluded by the NYPSC at the time this Commission issued its *Local Competition Order* in August 1996, the presiding Administrative Law Judge of the NYPSC ruled in September 1996 that the record of the NYPSC's proceeding needed reopening with respect to links and the UNEs required under the *Order*. The ALJ authorized all parties to revise their previous cost studies with respect to links to satisfy this Commission's requirements – and ordered Verizon to submit cost studies with respect to the other UNEs required by this Commission.[147]

On April 1, 1997, the NYPSC issued an order establishing permanent prices for UNEs.[148] Although the NYPSC made some adjustments in the rates proposed by Verizon, it

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[145] Opinion Considering Loop Resale and Links and Ports, *Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market,* NYPSC Case Nos. 94-C-0095, *et al.*, November 1, 1995.

[146] Opinion and Order Concerning Temporary Resale and Links Rates (Opinion No. 96-18), *Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market,* NYPSC Case Nos. 94-C-0095, *et al.*, July 18, 1996.

[147] Ruling Reopening Record for Limited Purposes, NYPSC Cases 95-C-0657, *et al.*, September 9, 1996. As a result of the ALJ's ruling, ports were subsumed within the broader switching network element under this Commission's rules.

[148] *See* Opinion and Order Setting rates for First Group of Network Elements (Opinion No. 97-2), *Joint Complaint of AT&T Communications of New York, Inc., MCI Telecommunications Corporation, WorldCom, Inc., d/b/a LDDS WorldCom and the Empire Association of Long Distance Telephone Companies, Inc. against New York Telephone Company Concerning Wholesale Provisioning of Local Exchange Service by New York Telephone Company and Sections of New York Company's Tariff No. 900,* NYPSC Cases 95-C-0657, 94-C-0095, and 91-C-1174, April 1, 1997 ("*1997 NYPSC UNE Pricing Order*"). As will be described below, although the NYPSC intended that all of the rates that it prescribed in the April 1997 order be made permanent, it ruled in September 1998 that the switching rates which it prescribed would

(continued . . .)

nonetheless accepted numerous assumptions and assertions in that study that were inconsistent with TELRIC methodology. For example, the NYPSC approved Verizon's assumption of a network with *only* fiber-optic cable in the feeder portion of the plant, even though Verizon had not demonstrated that fiber was always less expensive than copper cable, regardless of loop length.[149] In approving switching prices, the NYPSC accepted Verizon's use of only "growth discounts," rather than the deeper discounts that Verizon was actually receiving on new digital switches from its vendors, on the basis of Verizon's representation that it would not continue to receive such large discounts in the future.[150] Finally, notwithstanding Verizon's assumptions that all loops would be provisioned on modern fiber feeder, the NYPSC developed its switching costs assuming that most DLC lines would be terminated at the switch using older DLC technology (and even some analog copper line terminations), rather than using the more modern—and significantly less expensive—GR-303 compliant DLC equipment.[151]

Approximately one year after the NYPSC issued its order, through discovery of Verizon's switch contracts during a later phase in the cost proceeding, AT&T discovered that – contrary to Verizon's previous claim – Verizon would continue to receive substantial "new"

(. . . continued)
be temporary, subject to true-up, in light of new evidence showing that certain representations by Verizon regarding switch discounts – on which the NYPSC had relied in prescribing switching rates – were not true.

[149] *Id.* at 82-84.

[150] *Id.* at 84-86. Thus, the NYPSC stated that its calculation of switching costs did not take into account the "atypically large discounts" that Verizon had received from its vendors after 1994 in connection with a major switch replacement program. *Id.* at 85 n.1.

[151] *See* Memorandum Opinion and Order, *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*, CC Docket No. 99-295, December 22, 1999 at ¶ 248 ("*New York 271 Order*") (discussing AT&T's arguments regarding the inconsistencies in Verizon's approach).

switch discounts in the future. As detailed in a motion filed by AT&T and other CLECs with the NYPSC in June 1998, Verizon's failure to take these continuing discounts into account in its cost study substantially overstated forward-looking switching costs. For this reason, AT&T and other CLECs requested the NYPSC to re-open the UNE pricing proceeding.[152] Verizon, in response to the motion, admitted that its prior claim regarding the availability of large switch discounts was incorrect, but attributed the error to "intra-company miscommunication or misunderstanding."[153]

In an order issued in September 1998, the NYPSC agreed that Verizon had made a "careless error" that "changes the state of the record with regard to vendor discounts," and that the NYPSC's 1997 "analysis also made judgments that relied on assumptions regarding the level of vendor discounts."[154] Despite these statements, the NYPSC declined to re-open the UNE pricing proceeding on the ground that adjusting the switching price to reflect the availability of discounts would also require re-evaluation of a number of other judgments that it and its Staff had made in setting rates.[155] Nonetheless, the NYPSC *rejected* Verizon's argument that the "discount that should be contemplated in a forward-looking analysis" is the one "associated with growth purchases," pointing out that a TELRIC analysis "of the sort used in these proceedings contemplates the construction of a new system."[156]

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[152] *See* Joint Motion of AT&T, MCI, Sprint and WorldCom To Reopen Phase 1 For the Purpose of Predetermining Switch Costs, filed June 10, 1998, in NYPSC Cases 94-C-0095, 95-C-0657, and 91-C-1174, at 4-5.

[153] *See* Order Denying Motion To Reopen Phase 1 and Instituting New Proceeding, *Joint Complaint of AT&T Communications of New York, Inc., MCI Telecommunications Corporation, WorldCom, Inc., d/ba LDDS WorldCom and the Empire Association of Long Distance Telephone Companies, Inc. against New York Telephony Concerning Wholesale Provisioning of Local Exchange Service by New York Telephone Company and Sections of New York Telephone's Tariff No. 900,* September 30, 1998, at 7 n.1.

[154] *Id.* at 9.

[155] *Id.* at 9-10.

[156] *Id.* at 9.

More importantly, although the NYPSC declined to re-open its cost proceeding, it announced that – in view of the various adjustments to the switching costs that would be necessitated by the new evidence regarding switch discounts – it intended to institute a *new* "comprehensive reexamination of the network element rates that have been set," beginning in January 1999. The NYPSC explained its reexamination as a natural part of the ratemaking process:

> Such a review will certainly be needed at some point, for *the rates set in Phase I,* though sound and worthy of being left in place at least for now, *were not regarded as an eternally valid last word. Costs change continually, as they always have; and, perhaps even more importantly here, the continuing evaluation of the telecommunications industry may warrant revisiting certain premises of the Phase 1 decision.* Although there is no clearly correct time to undertake a comprehensive review of the network element rates that have been set, January 1999 appears to be a reasonable time for beginning that process. Nearly two years will have elapsed since issuance of the Phase 1 opinion, providing a reasonable amount of experience with the rates there set. The interval, as noted, has seen continued evolution of the telecommunications industry, including, among many other things, very substantial growth in demand for additional lines and in Internet usage. Moreover, the Federal Communications Commission may by then have completed its review of New York Telephone's application, pursuant to §271 of the Telecommunications Act of 1996, for authority to provide long-distance service. And several matters related to the switching costs immediately at issue, such as rebundling of network elements, also should have been resolved by then.[157]

Furthermore, the NYPSC held that in view of the new evidence regarding switch discounts, the switching rates would remain as temporary rates subject to a true-up after completion of the new proceeding.[158]

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[157] *Id.* at 11 (emphasis added).

[158] *Id.* at 12. In view of the misrepresentations made by Verizon to the NYPSC regarding switch discounts, and the NYPSC's 1998 decision to make the switching rates subject to a true-up (continued . . .)

Thus, far from being the inexplicable action that Verizon suggests, the NYPSC's decision to institute a new UNE rate proceeding in January 1999 was a recognition of the need to revise prices periodically in response to changes in costs, changes in the telecommunications industry generally, and new evidence that had come to light since its 1997 decision. The NYPSC's action was particularly warranted in view of the new evidence concerning switch discounts that had emerged since its April 1997 order, and the increasingly stale nature of other evidence on which the NYPSC had relied in resolving critical decisions in 1997. For example, even leaving aside the misrepresentations previously made by Verizon concerning switch discounts, the data regarding the "actual cost of switches" that the NYPSC used in its calculations of switching rates were for the years 1993 and 1994. Similarly, in approving Verizon's assumption of all-fiber feeder, the NYPSC had relied on a study prepared in 1991.[159] The age of the data that formed the basis for the UNE rates—as much as seven years old—amply justified the NYPSC's desire to reexamine UNE rates in light of more recent evidence.

(. . . continued)
pending the outcome of the new UNE rate proceeding that it decided to initiate, the court decisions cited by Verizon and the Commission's *New York 271 Order* provide no support for Verizon's equivocal assertion that the 1997 UNE rates have been "affirmed," "upheld," or "found to be TELRIC-compliant." *See* Petition, Att. B at 2-3 & nn. 5-7. In its *New York 271 Order*, the Commission based its finding that the UNE rates complied with the competitive checklist of Section 271 in great part on the "active review and modification" of Verizon's UNE prices by the NYPSC, including the NYPSC's stated intention to reexamine those rates (including the issue of switch discounts) in its then-forthcoming UNE rate case. *New York 271 Order* at ¶¶ 238, 247. In affirming the *New York 271 Order*, the D.C. Circuit also relied on the NYPSC's statement that "it will reexamine switching discounts, ordering refunds if appropriate." *AT&T Corp.* v. *FCC*, 220 F.3d 607, 618 (D.C. Cir. 2000). In the District Court decision cited by Verizon (which was an appeal from the NYPSC's arbitration of an interconnection agreement between MCI and Verizon), the District Court granted the NYPSC's motion for summary judgment regarding the lawfulness of the 1997 switching rates. However, in its analysis the District Court simply presumed as correct Verizon's statements to the NYPSC that it would not continue to receive switch discounts, even though those representations turned out to be untrue. *See MCI Telecommunications Corp.* v. *New York Tel. Co.*, 134 F.Supp. 2d 490, 501-503 (N.D.N.Y. 2001).

[159] *See 1997 NYPSC UNE Pricing Order* at 83, 85.

Following the conclusion of evidentiary proceedings and briefing in the new UNE rate proceeding, an Administrative Law Judge issued a decision in May 2001 recommending new UNE rates that, in general, were substantially lower than those adopted in 1997.[160] On January 28, 2002, the NYPSC issued an order establishing UNE rates. Although the NYPSC modified the ALJ's decision in some respects, the rates resulting from the NYPSC's order also represent a substantial reduction from the preexisting rates.[161]

The NYPSC made clear in its decision that, in determining the new UNE rates, it was attempting to apply Section 252(d)(1) of the 1996 Act, the TELRIC methodology adopted by the Commission in the *Local Competition Order,* and the Commission's regulations. The NYPSC stated that it had "a responsibility under the 1996 Act to set proper UNE rates and avoid allowing unwarrantedly high UNE rates to impede the development of competition."[162]

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[160] *See* Recommended Decision on Module 3 Issues by Administrative Law Judge Joel A. Linsider, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, NYPSC Case No. 98-C-1157, May 16, 2001 ("ALJ Decision"). As the NYPSC later stated, the UNE prices resulting from the ALJ's rulings "were, in general, well below not only Verizon's proposals but also the prices currently in effect." Order on Unbundled Network Element Rates, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, NYPSC Case 98-C-1357, January 28, 2002, at 15 ("*2002 NYPSC UNE Rate Order*").

[161] *See 2002 NYPSC UNE Rate Order*, Appendix C (summarizing NYPSC's modifications to the recommended decision of the ALJ). The NYPSC's Administrative Law Judge originally scheduled initial testimony regarding UNE rates to be filed in the new UNE rate proceeding in December 1999, and hearings to begin February 2000. Ruling on Scope and Schedule, *Proceeding on Motion of the Commission To Examine New York Telephone Company's Rates for Unbundled Network Elements*, NYPSC Case 98-C-1357, June 10, 1999, at 19-20. However, the schedule was extended on several occasions for "a variety of reasons, including the broad scope of the proceeding, the need to take account of actions by the FCC and of a federal court decision, and the strike by Verizon employees during August 2000." *2002 NYPSC UNE Rate Order* at 2. Verizon urged that the proceedings be suspended in view of the Eighth Circuit's decision in *Iowa Utilities II* "and the uncertainty it was said to create with regard to the proper costing standard," but the Administrative Law Judge denied both Verizon's request and its motion for reconsideration of that denial. *Id.* at 2-4.

[162] *2002 NYPSC UNE Rate Order* at 8.

However, the NYPSC emphasized that the proceeding had been litigated on the basis of the Commission's TELRIC standard "despite the legal cloud cast over the standard" by the Eighth Circuit's decision in *Iowa II*.[163] Citing the Administrative Law Judge's statement that "the TELRIC rules remain in force" despite the Eighth Circuit's decision, the NYPSC unequivocally stated that "TELRIC remains the standard that must be applied," regardless of its "future fate" in the Supreme Court's review of the *Iowa II* decision.[164] This Commission, after reviewing the *2002 UNE Rate Order*, found that the NYPSC's January 2002 order "demonstrate[s] an admirable commitment to accurate, cost-based rate making."[165]

As Verizon notes, the *2002 NYPSC UNE Rate Order* resulted in a substantial reduction in rates for local switching and loops. *See* Petition, Att. B at 3. Those reductions, however, occurred because the NYPSC more closely applied TELRIC methodology to the evidence presented in the record than it did in 1997 (although, as described below, the NYPSC's application of TELRIC did not go far enough, and overstated UNE rates as a result). The NYPSC reduced switching rates, for example, because it more closely followed TELRIC principles in its treatment of switch discounts and in its allocation of costs between usage and non-usage sensitive elements.

With respect to switch discounts and switch material costs, the NYPSC gave greater recognition to the fact that under the TELRIC rules, which examine the "long run" costs

[163] *Id.* The Supreme Court had not yet issued a decision on its review of *Iowa II* at the time of the NYPSC's January 2002 decision. The Supreme Court issued its decision, which reversed the Eighth Circuit, four months later.

[164] *Id.* at 13.

[165] Memorandum Opinion and Order, *Application of Verizon New England for Authorization to Provide In-Region InterLATA Services in Rhode Island,* 17 FCC Rcd. 3300, ¶ 52 (2002).

of a "reconstructed local network" using the "lowest-cost network configuration,"[166] the efficient, forward-looking long-run costs of switches would measure the costs of new, optimally sized switches for all current demand – with the correspondingly steep discounts that carriers receive on such switch prices. The NYPSC acknowledged that its acceptance of Verizon's use of "growth-only" switch discounts in 1997 "rested, in large part" on Verizon's representation that these deep discounts would not continue -- a representation that was subsequently discredited by new evidence presented by the CLECs.[167]

Thus, although the NYPSC was reluctant to assume that a network consisting of all-new switches "would be purchased and installed in a single transaction," it rejected Verizon's position (and its own previous position) that exclusive reliance on the growth discount was proper: "For one thing, it has been clear since [1998] that relatively deep new-switch discounts are not limited to full-scale switch replacements, and *there is no basis for agreeing with Verizon that incremental replacement of the system over time would entail growth discounts only.*"[168] For these reasons, and because of the difficulties it encountered in computing the amount of switch discounts in a forward-looking environment, the NYPSC agreed with the ALJ's calculation of switching costs on the basis of a "surrogate analysis." That analysis, in addition to using as its perimeters the respective per-line switching costs recommended by Verizon and the CLECs, looked to various estimates in two studies that had been presented in this Commission's *Universal Service Proceeding* by Commission staff and the majority of the State members of a Commission/State joint board. Combining these factors, the ALJ and the NYPSC determined a

[166] *Local Competition Order* at ¶ 685; 47 C.F.R. § 51.505(c).

[167] *2002 NYPSC UNE Rate Order* at 21-22.

[168] *Id.* at 28 (emphasis added).

per-line switching costs of $105, which was well below both the $128 cost proposed by Verizon and the $192.67 cost determined by the NYPSC in its *1997 UNE Rate Order*.[169] This result, the NYPSC found, was reasonable "on the basis of the record in this proceeding."[170] This Commission has described the NYPSC's approach as a "reasonable, downward adjustment to switching rates" in response to "new evidence that Verizon continues to receive deep discounts on its new switches."[171]

Switching costs were also reduced because the NYPSC correctly found that relatively more switching costs should be recovered from non-traffic sensitive rates and less from traffic-sensitive costs (such as per-minute usage rates). The NYPSC found that only 34 percent of the switching costs should be treated as usage-sensitive (not the 64 percent proposed by Verizon) because Verizon's witness had presented a study in the NYPSC's previous rate proceeding that would warrant allocating only 34 percent to usage. This decision was plainly proper, since the record showed that most switching costs are non-usage sensitive.[172] Similarly, the NYPSC appropriately found that the cost of switch investment should be spread over 308 days in a year, to account fully for demand and avoid overstating per-minute switching costs (as would have been the case if the NYPSC had accepted Verizon's proposal of using only 251 business days).[173]

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[169] *Id.* at 24-32; ALJ Decision at 137-139; *1997 NYPSC UNE Rate Order* at 85-86.

[170] *2002 NYPSC UNE Rate Order* at 32.

[171] *Rhode Island 271 Order* at ¶ 50.

[172] *2002 NYPSC UNE Rate Order* at 34-36.

[173] *Id.* at 36-39. *See also New Hampshire 271 Order* at ¶ 37 (expressing concern over Verizon's use of only 252 days to derive a per-minute rate).

The NYPSC's greater application and understanding of TELRIC methodology in other areas further contributed to reductions in loop and switching rates. For example, in contrast to its *1997 UNE Rate Order*'s acceptance of the assumption that most DLC lines would be terminated at the switch using older DLC technology (despite the use of 100 percent fiber feeder), the NYPSC recognized in 2002 that the use of IDLC and GR-303-compliant technology was more consistent with forward-looking principles. Thus, the NYPSC found that beginning in June 2002, rates should be adjusted downward to reflect IDLC connections unless Verizon could establish that such an adjustment would be unreasonable.[174]

Finally, Verizon's criticisms of the rate reductions required by the NYPSC's *2002 UNE Rate Order* ring particularly hollow because Verizon *agreed* to those reductions less than two weeks after the NYPSC issued its *Order*. On February 8, 2002, Verizon and the Staff of the NYPSC filed a "Joint Proposal Concerning Verizon Incentive Plan" (ultimately approved by the NYPSC on February 28, 2002) which specifically provided that until March 1, 2004, the rates for UNEs and the UNE-P would be those established by the NYPSC in its *Order*.[175] Those rates include precisely the same rates adopted by the NYPSC for 2-wire analog loops and local switching which Verizon now characterizes as too low in its Petition.[176] Furthermore, as part of the Joint Proposal, Verizon agreed not to appeal the NYPSC's *2002 UNE Rate Order*.[177] In view of its own agreement to the UNE rates and its waiver of any right to appeal, Verizon's

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[174] *2002 NYPSC UNE Rate Order* at 93-95.

[175] *See* Order Instituting Verizon Incentive Plan, *Proceeding on Motion of the Commission to Consider Cost Recovery by Verizon and to Investigate the Future Regulatory Framework*, NYPSC Cases 00-C-1945 and 98-C-1357, February 27, 2002, at 7 & Appendix at 1-2 ("*NYPSC Settlement Order*"). The only rate in the *2002 NYPSC UNE Rate Order* that was not adopted in the "Joint Proposal" was the non-recurring charge for 2-wire and 4-wire hot cuts, which was reduced to $35.00. *Id.*

[176] *Compare id.* at 1 & Appendix, App. A *with* Petition, Att. B at 3.

[177] *NYPSC Settlement Order* at 7 & Appendix at 14.

attempt to portray New York as an example of excesses by the state commissions is totally illegitimate.

Like other state commission decisions, the NYPSC's *2002 UNE Rate Order* can be fairly criticized only for its failure to prescribe even *lower* UNE rates. Many of the rates actually prescribed by the NYPSC are above TELRIC levels, due to the NYPSC's failure to fully apply TELRIC principles. On a number of issues, the NYPSC simply split the differences between the parties even when Verizon's position was flatly inconsistent with TELRIC methodology. For example, although the NYPSC's treatment of the issue of switch discounts was more consistent with forward-looking principles than its 1997 decision, the NYPSC nonetheless computed switching costs essentially by determining the "mid-point" of the competing estimates proposed by Verizon and the CLECs, rather than calculate the costs of a network using "new" switch discounts.[178] In determining the weighted cost of capital, the NYPSC computed a rate of 10.5 percent, which is between the 9.19 percent rate proposed by AT&T and the 12.6 percent rate proposed by Verizon.[179] As a result of these approaches, the new rates prescribed by the NYPSC are overstated.

K. Pennsylvania

Verizon is correct that the UNE rates prescribed by the Pennsylvania PUC in 1999 are generally lower than the rates prescribed by the PUC in 1997 (Petition, Att. B, at 4-5).

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[178] *Id.* at 24, 27.

[179] *Id.* at 79-87. The NYPSC also accepted a number of aspects of Verizon's cost study that were contrary to forward-looking cost principles and overstated TELRIC costs. These included a "forward-looking to current factor" that was simply an attempt by Verizon to recoup its embedded costs, and an "environmental factor" that improperly allocated costs among geographic zones. *See id.* at 56-61, 105-111.

But there is no basis for Verizon's suggestion that the reductions were unsupported by TELRIC principles, or that the reduced rates are unreasonably low.

The 1997 rates, and the inputs and assumptions underlying them, have been under judicial review since their inception, and AT&T and MCI's challenges to the TELRIC-compliance of those rates are currently pending in district court. *See MCI Telecomms. Corp. v. Bell Atlantic-PA*, 271 F.3d 491 (3d Cir. 2001), *cert. denied*, 123 S.Ct. 340 (2002), *on remand*, *MCI Telecomms. Corp. v. Bell Atlantic-Pennsylvania, Inc.*, Civil Action No. 03-685 (E.D. Pa.) (pending).

Moreover, the PUC, in setting lower rates in 1999, expressly found that the rates set by the PUC in 1997 exceeded TELRIC. *Nextlink Pennsylvania, Inc.*, P.U.R.4th 172, 210 (Pa. PUC 1999) ("*Global Order*") ("The empirical evidence indicates that the existing rates in Pennsylvania are not set at the TELRIC level."). In particular, the PUC repudiated the following inputs underlying the 1997 rates:

(1) Next Generation Digital Loop Carrier ("NGDLC"), the most costly and important equipment used to transmit digital information over local loops, was almost certainly much less costly than claimed by Bell Atlantic (and assumed by the PUC in its 1997)—as recently unearthed internal documents from Bell Atlantic confirmed. *Id.*, 196 P.U.R.4th at 210-11.

(2) The 11.9 percent cost of capital proposed by Bell Atlantic and adopted by the PUC in 1997 was excessive. The lower value advocated by AT&T and other parties, 9.83 percent, was more realistic, and was also consistent with Bell Atlantic's own representations to the Securities and Exchange Commission. *Id.*, 196 P.U.R.4th at 212.

(3) The fill factor assumed by the PUC for Verizon's loop feeder cable in 1997—70 percent—was unrealistically low. *Id.*, 196 P.U.R.4th 213.

AT&T believes that the 1999 rate reductions did not go far enough to reduce Verizon's rates to TELRIC-compliant levels, and the two companies' appeals from the 1999 decision (and the 1997 input assumptions left unchanged by the decision) is currently pending in District Court.[180] Verizon, by contrast, withdrew its appeals from the 1997 and 1999 decisions, and subsequently represented to this Commission that the UNE prices set by the PUC in 1999 were just, reasonable, and nondiscriminatory—a finding that this Commission relied on in approving Verizon's 271 application. *Pennsylvania 271 Order* at ¶ 55. Under the circumstances, Verizon should not be heard to complain now that the reduced rates are unreasonably low.

L. Rhode Island

Verizon's assertion that it "was required" to reduce its switching rates in Rhode Island while its Section 271 application was still pending before this Commission to meet the Commission's benchmarking standard borders on the frivolous. *See* Petition, Att. B at 11. Throughout the *Rhode Island 271* proceeding, Verizon defended the UNE rates originally adopted by the Rhode Island PUC in May 2001 as TELRIC-compliant. Moreover, Verizon not only emphasized that its reductions were voluntary, but also relied on "benchmarking" in support of its Section 271 application.

The Rhode Island PUC ("RI PUC") instituted a proceeding to establish UNE rates in 1997. However, the RI PUC did not establish permanent rates for UNEs until 2001.[181] In

[180] *Bell Atlantic-Pennsylvania, Inc.* v. *Pennsylvania PUC*, Civil Action Nos. 99-5391 (E.D. Pa.).

[181] *See Rhode Island 271 Order* at ¶ 21.

August 1999, the RI PUC adopted interim UNE rates that were the product of a stipulation between Verizon and the Rhode Island Division of Public Utilities and Carriers, finding that the adoption of these rates would not delay "the setting of permanent, cost-based rates" for the provisioning of UNEs.[182]

Although briefing was completed in June and July 2000, the RI PUC took no action to establish permanent rates until Verizon indicated that it would be seeking a positive recommendation from the PUC with respect to its Section 271 application. On May 18, 2001, the RI PUC issued a two-page order requiring that the interim rates be reduced downward by 7.11 percent to reflect the economic efficiencies from the Bell Atlantic/GTE – and ordered that these rates (as so reduced) be the permanent UNE rates. The PUC's order did not address any of the numerous substantive issues that AT&T and other parties had raised in the proceeding.[183]

On November 18, 2001, the Rhode Island PUC issued a new order in the UNE pricing proceeding that finally addressed the substantive issues raised by the parties.[184] The new order, however, left in place the permanent rates that the PUC had previously adopted six months

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[182] *See* Order, *Total Element Long Run Incremental Cost Interim Rates for Bell Atlantic – Rhode Island*, RI PUC Docket No. 2681, July 15, 1999, at 2.

[183] *Id.* at 1-2. The PUC's order also followed a resolution passed by the Rhode Island State Senate in April 2001 which called upon the PUC to enhance the prospects of a successful Section 271 application to this Commission. In addition, two weeks before it issued its order, the PUC received a letter from the majority leader of the Rhode Island House majority leader, urging the consumers in the State be offered the "same benefit that consumers in Massachusetts have for long-distance choice." On the day before it issued its two-page order establishing UNE rates, the PUC issued an order reversing its prior course with respect to the scope of OSS testing that it had intended to request KPMG to perform, citing the Rhode Island General Assembly's "policy directives" to "move forward with Verizon's 271 application for Rhode Island.". *See* Comments of AT&T Corp. in Opposition to Verizon Section 271 Application for Rhode Island, CC Docket No. 01-324, December 17, 2001, at 2-3 ("AT&T RI Comments")

[184] Report and Order, *Review of Bell Atlantic – Rhode Island TELRIC Study*, RI PUC Docket No. 2681, November 18, 2001 ("*RI PUC UNE Rate Order*").

earlier. The order provided that the substantive rulings therein would not be reflected in new rates until 30 days after Verizon received Section 271 authority from this Commission or on May 1, 2002, whichever was earlier.[185]

The UNE rates approved by the RI PUC in its May 2001 and November 2001 orders were overstated because – as this Commission has effectively recognized – the RI PUC did not properly apply TELRIC methodology and determined UNE rates that exceeded TELRIC levels. In the *Rhode Island 271 Order*, the Commission based its finding that Verizon's reduced switching rates and loop rates satisfied the competitive checklist only on the basis of its benchmark test, because it concluded that it could not find that Verizon's UNE rates "were adopted through a proceeding which correctly applied TELRIC principles in all instances."[186] Specifically, the Commission "strongly question[ed]" the PUC's assumption of only growth additions for switches – an assumption that the PUC itself has disavowed for purposes of its new UNE rate proceeding.[187] The Commission also found that the RI PUC's 2001 decision did not provide sufficient evidence to conclude that Verizon's switch installation factor "accurately reflects cost recovery of an efficient, forward-looking network pursuant to TELRIC principles." The RI PUC expressed concern about this factor in its 2001 order, but simply required Verizon to submit substantial additional evidence of its installation costs in the new UNE proceeding.[188] Finally, although the RI PUC has maintained that the rates it prescribed in 2001 were TELRIC-complaint, it has also acknowledged that the rates "represent a reasonable compromise between

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[185] *Id.* at 76.

[186] *Rhode Island 271 Order* at ¶ 32.

[187] *Id. at* ¶ 34. The RI PUC held that in the new UNE rate proceeding that it was instituting, it would establish a rebuttable presumption of 90 percent new switches and 10 percent growth additions. *RI PUC UNE Rate Order* at 35.

[188] *Rhode Island 271 Order* at ¶ 35; *RI PUC UNE Rate Order* at 36-37 (stating *inter alia* that the RI PUC "is concerned that Verizon RI may not be as efficient in this matter as it could be").

the rates proposed by VZ-RI and AT&T" – a statement indicating that the RI PUC simply "split the difference" in determining the proper level of rates.[189]

Verizon itself apparently recognized that the RI PUC's rate prescriptions could not be defended as TELRIC-compliant. Although the PUC's *UNE Rate Order* addressed the issue of the switching rates that it had declared to be permanent in May 2001, Verizon had already *reduced* its switching rates by the time the PUC issued its order. As Verizon stated in its Section 271 application to this Commission, Verizon made a "supplemental filing" in the PUC's Section 271 proceeding on October 5, 2001, "in which it *voluntarily* agreed to reduce" its rates for unbundled switching in Rhode Island in order "to ensure that they did not become an issue in reviewing Verizon's long-distance application." The newly-filed switching rates, Verizon claimed, were consistent with the levels of its proposed switching rates in Massachusetts.[190] The PUC approved the new switching rates in an order issued on November 28, 2001, finding that the reduced switching rates compared favorably with those in effect in Massachusetts at the time this Commission approved Verizon's 271 application for that State. The PUC refused to take into account the decision issued in May 2001 by the NYPSC's ALJ finding that Verizon's switching rates in New York failed to comply with TELRIC.[191]

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[189] Reply Comments of the Rhode Island Public Utilities Commission, CC Docket No. 01-324, January 11, 2002, at 3 ("RI PUC Reply Comments").

[190] Application by Verizon New England for Authorization to Provide In-Region InterLATA Services in Rhode Island, CC Docket No. 324, November 26, 2001, at 89 (emphasis added) ("Verizon RI Application"). *See also Rhode Island 271 Order* at ¶ 23 (noting that the "discounted" switching rates approved by the PUC in November 2001 were "voluntarily proposed" by Verizon "in seeking the Rhode Island Commission's approval of its section 271 application").

[191] *See* Report and Order, *Unbundled Local Switching Rates – Verizon Rhode Island's Section 271 Compliance Filing*, RI PUC Docket No. 3363, November 28, 2001, at 4-6.

In its application, filed one month after the PUC approved the new switching rates, Verizon nonetheless asserted that the Rhode Island PUC had established TELRIC-compliant rates, and properly applied TELRIC methodology, in establishing the permanent UNE rates adopted in its May 18, 2001 order – including the switching rates adopted therein.[192] Although acknowledging that it had voluntarily "offered to reduce" the switching rates in November 2001 to remove them as an issue in the 271 proceedings, Verizon asserted that it still "believed that its previous [switching] rates complied fully with the FCC's [TELRIC] rules."[193]

Moreover, far from complaining about the Commission's benchmarking standard, Verizon argued in its application that its rates on switching and loops in Rhode Island were entitled to "a strong presumption of TELRIC compliance" under that standard, because they were lower than the then-existing rates in Massachusetts and New York, where the Commission had previously granted Section 271 authority. Verizon described the similarity of its Rhode Island UNE rates to those in Massachusetts and New York as an additional reason why the Commission should find its UNE rates to be in compliance with Section 271.[194]

As previously stated, however, on January 28, 2002, the New York PSC prescribed new UNE rates, including substantially lower loop and switching rates. Because of the NYPSC's new rate prescriptions, Verizon could no legitimately defend the Rhode Island UNE rates on the ground that they were comparable to the New York rates (and, therefore, the Massachusetts rates which had reflected those in New York) that had been in effect at the time Verizon filed its application in December 2001.[195] Thus, on February 14, 2002, only 10 days

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[192] *See* Verizon RI Application at 4, 85-89.

[193] *Id.* at 89.

[194] *Id.* at 91-92.

[195] Verizon's reliance on Massachusetts rates for a benchmark comparison was inappropriate,
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before the Commission was required to render a decision on its Section 271 application, Verizon filed tariffs that substantially reduced its port and switching usage rates in Rhode Island, citing the recent reduction of UNE rates in New York.[196]

Verizon's letter of February 14, 2002 advising this Commission of the new rate reductions totally belies its current claim that it was "required" to reduce the rates to meet the benchmarking standard. Verizon emphasized in the letter that the reductions were "voluntary" measures.[197] In fact, Verizon took the position that the reductions were *not* required, because the UNE rates originally prescribed by the Rhode Island PUC in May 2001 were TELRIC-compliant.[198]

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because the Commission had approved Verizon's application for Section 271 authority in Massachusetts based on a benchmark analysis comparing Massachusetts rates to New York rates. Moreover, the Commission had warned in the *Massachusetts 271 Order* that even the then-existing New York rates would likely be unsuitable as a benchmark if the New York PSC revised those rates in its UNE rate proceeding, which had not been completed at the time the *Massachusetts 271 Order* was issued. *See Rhode Island 271 Order* at ¶¶ 42-44; *Massachusetts 271 Order* at ¶¶ 23, 29-30. The Commission found in the *Rhode Island 271 Order* that the "old" New York rates were particularly inappropriate for use in benchmarking because (*inter alia*) the NYPSC had previously indicated that it would redetermine the switching rates subject to true-up, the parties had questioned Verizon's preexisting switching rates in New York during the *New York 271* proceedings, the NYPSC's new UNE rate order had "expressly rejected Verizon's discredited claim of no further new switch discounts," and the preexisting New York switching rates were considerably higher than rates in other States for which the Commission had granted Section 271 approval subsequent to the *New York 271 Order*. *See Rhode Island 271 Order*, ¶¶ 45-53.

[196]*See* Ex Parte Letter from Dee May to William Caton, CC Docket No. 01-324, February 14, 2002, ("Verizon May 14 Ex Parte"). *See also Rhode Island 271 Order* at ¶¶ 9-11.

[197] *See* Verizon May 14 Ex Parte at 1. Verizon used the words "voluntary" or "voluntarily" to describe its actions *four times* in its two-page letter to the Commission. *Id.* This Commission similarly found that Verizon had made the rate reductions voluntarily. *Rhode Island 271 Order* at ¶¶ 26, 29.

[198] Specifically, Verizon stated:

> Verizon previously demonstrated in its application in this proceeding that Verizon has satisfied the requirements of section

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Despite Verizon's assertions to the Commission, there is no basis for finding that even the reduced switching rates actually comply with TELRIC standards. Verizon's February 14, 2002 filings with the Commission and the RI PUC simply stated the new rates, without providing any data to support them or any explanation as to have they were derived. As previously stated, the Commission based its finding that the reduced rates satisfied the competitive checklist solely by using a benchmark analysis, because Verizon had filed the reduced rates only days before the Commission's decision.[199] But Verizon provided no analysis to support a finding that the reduced rates were comparable, for benchmarking purposes, to the new New York rates.[200] The RI PUC held no formal evidentiary proceedings on the reduced rates before it approved them only six days after they were filed (and only two days before this Commission issued the *Rhode Island 271 Order*). Moreover, the reasons given by the RI PUC for approving

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> 271 of the Act, and the Rhode Island Public Utility Commission (PUC) and the United States Department of Justice have agreed based on the results of their own extensive investigations. Likewise, the RI PUC previously has adopted a full suite of rates for unbundled elements that it has concluded are TELRIC compliant. Consequently, *the voluntary measures that Verizon is implementing are not in any way necessary to demonstrate compliance with section 271, other sections of the Act or the Federal Communications Commission's (FCC) rules.*

Verizon May 14 Ex Parte at 1 (emphasis added). Thus, the Commission found in its *Rhode Island 271 Order* that Verizon still asserted that the switching rates originally adopted by the RI PUC were TELRIC-complaint, but now "alternatively" relied on the rates it filed in February 2002 in seeking Section 271 approval. *Rhode Island 271 Order* at ¶ 29.

199 Similarly, the Commission based its finding that Verizon's loop rates (which Verizon had not reduced since the RI PUC issued its *UNE Rate Order*) were in compliance with the competitive checklist on the basis of a benchmark analysis. The Commission declined to decide whether the loop rates were fully consistent with TELRIC methodology. *Rhode Island 271 Order* at ¶ 57.

200 As described in Verizon's Petition, the current rates for 2-wire analog loops and switching in Rhode Island are substantially higher than those in New York. *See* Petition, Att. B at 3, 11.

the reduced rates cannot reasonably be regarded as a finding that the rates are TELRIC-compliant.[201]

Finally, the RI PUC's pending review of UNE rates lends no support to Verizon's overall position here that State commissions are seeking to "ratchet down" UNE rates to present "the appearance of competition." In fact, Verizon's suggestion in its Petition that the new proceeding is improper or unusual is disingenuous, because Verizon *relied* on the new RI PUC proceeding in its Section 271 application as support for the benchmark analysis that it was presenting.[202] In any event, the new RI PUC proceeding is plainly a proper attempt by the PUC to determine whether the existing UNE rates are TELRIC-complaint. The PUC has stated that it

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[201] *See* Order, *Unbundled Local Switching and Analog Line Port Rates – Verizon Rhode Island's Section 271 Compliance Filing*, RI PUC Docket No. 3363, February 21, 2002. The PUC approved the rates on the grounds that lower rates "will be in the best interest of the ratepayers and will further the development of local telephone competition," no CLEC had opposed the adoption of the reduced rates, and the reduced rates were "well below" the "comparable" rates in Massachusetts when the Commission approved Verizon's Section 271 application for that State. *Id.* at 2-3. The reasons cited by the RI PUC, however, beg the question of whether the reduced rates are set at TELRIC levels. A reduction in rates will not foster competition if, even as reduced, the rates remain well above TELRIC levels. Moreover, the CLECs would not be expected to oppose a reduction in switching rates, particularly in view of the unreasonably high level of the preexisting rates. Finally, the RI PUC's reliance on the Massachusetts rates was inappropriate because, as this Commission recognized, those rates were based on the preexisting New York rates – which had been superseded by the NYPSC's January 2002 order. *Rhode Island 271 Order* at ¶ 42.

[202] *See* Verizon RI Application at 93 (describing new proceeding as "additional comfort" that Commission can take in performing benchmark analysis). The Rhode Island PUC announced its intention to institute the new proceeding in 2001, due to its desire to receive and review more recent evidence. *Rhode Island 271 Order* at ¶ 22 & n.64. Since this Commission approved its Section 271 application for Rhode Island, however, Verizon has shown little cooperation in the RI PUC's new proceeding. Although Verizon filed a cost study in the new proceeding on the deadline (May 1, 2002) established by the RI PUC's *UNE Rate Order*, the PUC subsequently found that Verizon's new cost model used a methodology different from that required by the *Order*. *See* Report and Order, *Verizon – Rhode Island TELRIC Cost Studies Filed May 1, 2002*, RI PUC Docket No. 2681, March 12, 2003, at 8-10. Not surprisingly, Verizon's new cost studies produced "significantly higher" UNE rates for Rhode Island than those currently in effect. *Id.* at 11 n.25. The PUC found that Verizon's failure to file cost studies consistent with its *UNE Rate Order* had caused "unnecessary confusion and delay in this proceeding," and required Verizon to re-file cost studies that comply with the *Order*. *Id.* at 9-11.

instituted the proceeding in order "to receive and review more recent evidence on [cost] inputs," because "some of the evidence regarding these inputs that was presented during the TELRIC hearings in 1998 and 1999 could be considered out of date."[203] As the Commission has found, the new proceeding is evidence of the RI PUC's desire to implement TELRIC principles correctly, particularly in view of the PUC's own doubts about some of the evidence that Verizon submitted in support of the current UNE rates.[204]

M. Virginia

As Verizon states, the Virginia State Corporation Commission ("SCC") first established permanent UNE rates in April 1999.[205] Verizon is also correct that Verizon reduced its switching rates in October 2002. *See* Petition, Att. B at 11. However, Verizon's assertion that it was "required" to reduce these rates to meet the Commission's benchmarking standard is flatly wrong.

First, in the Commission's proceedings involving its Section 271 application, Verizon consistently maintained that the permanent switching rates prescribed by the SCC were TELRIC-compliant, and that the SCC had used TELRIC principles to determine those rates.[206]

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[203] *See Rhode Island 271 Order* at ¶ 22; RI PUC Reply Comments at 3.

[204] *See Rhode Island 271 Order* at ¶ 54.

[205] *See* Memorandum Opinion and Order, *Application by Verizon Virginia Inc., Verizon long Distance Virginia, Inc., Verizon Enterprise Solutions Virginia Inc., Verizon Global Networks Inc., and Verizon Select Services of Virginia Inc., for Authorization to Provide In-Region InterLATA Services in Virginia,* WC Docket No. 02-214, October 30, 2002, at ¶¶ 64-69 ("*Virginia 271 Order*") (describing establishment of interim rates by SCC in November 1996 and subsequent proceedings leading to SCC's final order, issued April 15, 1999, which established permanent UNE rates).

[206] *See, e.g.,* Application by Verizon Virginia for Authorization to Provide In-Region InterLATA Services in Virginia, WC Docket No. 02-214, August 1, 2002, at 3 ("Application") ("The Virginia SCC established TELRIC-complaint rates for the vast majority of network elements . . . including unbundled loops, switching, and transport. . . . [T]he switching rates set by the SCC comply fully with this Commission's TELRIC rules"); *id.* at 48-50; Letter from Ann D. (continued . . .)

Verizon maintained that position even when it reduced its switching rates only four weeks before the Commission issued the *Virginia 271 Order*.[207]

Second, when it reduced the switching rates in October 2002, Verizon emphasized to this Commission that the reductions were a purely *voluntary* action on its part.[208] Verizon, in fact, asserted that the reductions were "in no way necessary to demonstrate compliance with Section 271, other sections of the Act, or the Commission's rules," because it continued to maintain that the original permanent rates were TELRIC-compliant.[209] Verizon's position was fully consistent with its Section 271 application, which described as "irrelevant" the fact that "switching rates do not benchmark to the recently adopted rates in New York," given the SCC's findings that the permanent switching rates comply with TELRIC.[210]

AT&T has shown that neither the permanent switching rates adopted by the SCC, nor the reduced rates that Verizon filed in October 2002, are TELRIC-complaint.[211] The Commission itself expressed "serious concerns as to whether the [permanent] rates established by the Virginia Commission in its state rate proceeding are TELRIC-compliant," and only found the reduced switching rates to be in compliance with Section 271 on the basis of its

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Berkowitz to Marlene H. Dortch, WC Docket No. 02-214, October 3, 2002, at 1 ("Verizon October 3 Ex Parte").

[207] Verizon October 3 Ex Parte at 1 ("the Virginia commission has adopted unbundled switching rates that it has concluded are TELRIC-compliant").

[208] *Id.* at 1-2 & Att. 1.

[209] *Id.* at 1.

[210] Application at 52. This Commission similarly (and repeatedly) found in its *Virginia 271 Order* that the rate reductions were voluntary. *See Virginia 271 Order* at ¶¶ 82, 86, 100 n.347, 115, 121.

[211] *See* Comments of AT&T, WC Docket No. 02-214, August 21, 2002, at 3-11; Supplemental Comments of AT&T Corp. on Verizon's Revised Switching Prices, WC Docket No. 02-214. October 9, 2002.

benchmarking analysis of all non-loop elements together.[212] However, even if Verizon's reduced switching rates are TELRIC-complaint (and they are not), Verizon's previous assertions that its reduction of switching rates were voluntary – and unnecessary – belies its current posture that those reductions were "required." In any event, Verizon certainly has not shown that the reductions, whether voluntary or otherwise, brought its rates below levels consistent with TELRIC.

N. West Virginia

As Verizon notes, the West Virginia PSC initially prescribed UNE rates for Verizon in 1997. Petition, Att. B at 9-10. Verizon is also correct that it entered into a stipulation with the staff of the PSC in October 2002, as a condition to approval of Verizon's 271 application for West Virginia, to reduce its switching rates to levels consistent with this Commission's 271 benchmarking standards. *Id.* Verizon has made no showing that the reduced rates—*to which it agreed*—are below levels dictated by TELRIC. To the contrary, Verizon repeatedly stated in its 271 application that the UNE prices resulting from the rate reductions "comply with the Act and this Commission's prior orders,"[213] are "consistent with this Commission's well-settled precedent," and "satisfy the requirements of the Act."[214]

[212] *See Virginia 271 Order* at ¶¶ 89, 96-121. *See also id.* at ¶ 86 (noting that "substantial questions have been raised in the record about whether Verizon's Virginia UNE rates were adopted through a proceeding which correctly applied TELRIC principles in all instances" and that in response to those allegations "Verizon voluntarily reduced some of its UNE rates to meet a benchmark comparison to non-loop rates in New York").

[213] Application by Verizon Maryland, Verizon Washington, D.C., and Verizon West Virginia for Authorization to Provide In-Region InterLATA Services in Maryland, Washington, D.C., and West Virginia, Dec. 19, 2002, at 47.

[214] *Id.* at 49.

O. States Outside Verizon's Region

Verizon also contends that UNE rates in States outside of its region "also have systematically ratcheted down." *See* Petition, Att. B at 12-13 & nn. 56-57. However, the analyses that it cites do not support its claim.

The primary basis offered by Verizon for its assertion is a survey of UNE rates collected by the National Regulatory Research Institute ("NRRI"), which purportedly "show that from January 2002 to January 2003, the national average UNE-P rate dropped 15 percent, while the average loop rate dropped more than 8 percent." *Id.*, Att. B at 12-13 & n.57. The NRRI survey, however, is not a reliable measure of UNE-P or loop rates. First, NRRI's data alone cannot be used to estimate UNE-P prices, because traffic data are also required to estimate the cost of usage-sensitive elements. Rather than use actual minutes of use ("MOUs") by State, however, NRRI's analysis simply estimates usage-sensitive rate components by assuming a constant 1,000 MOUs per line per month.[215] Such an assumption is unreasonable because minutes of use vary substantially from state to state, and over time.

Even assuming *arguendo* that NRRI's use of an average would otherwise be proper, the 1,000-MOU figure that it uses is understated. For example, in performing a bench-

[215] *See* Billy Jack Gregg, *A Survey of Unbundled Network Prices in the United States – Updated July 1, 2002*, at 3 (*"NRRI 2002 Survey")*; Billy Jack Gregg, *A Survey of Unbundled Network Prices in the United States – Updated January 1, 2003,* at 3 ("*NRRI 2003 Survey*"). In addition, NRRI fails to describe the basis for the various assumptions and allocations that it makes in connection with its assumption of a total of 1,000 minutes of use per line per month. For example, NRRI states that it allocated the 1,000 minutes on a 50/50 basis in States with on-peak/off-peak switching rates (or originating/terminating switching rates), and 50/30/20 in States with day/evening/switching rates. But NRRI fails to describe how it determined these particular allocations, or why such allocations should be assumed to be the same for each State. Similarly, NRRI assumes 100 calls per month in States with per-call or set-up rates, but does not provide any basis for its figure. *NRRI 2003 Survey* at 4; *NRRI 2002 Survey* at 3.

marking analysis of Verizon's non-loop UNE rates in Pennsylvania, the Commission assumed 2,400 MOUs per month – 1,200 originating and 1,200 terminating.[216]

Second, the NRRI data understate the true costs of UNE-P to the CLEC, because they omit certain charges that CLECs must pay to the ILECs for their provision of service through the UNE platform. These charges include, for example, a cost for transport, despite NRRI's admission that "in most instances it is necessary to purchase unbundled transport to have a basic UNE platform capable of supplying local service."[217] Nor do NRRI's data include estimates of charges for daily usage files or non-recurring charges. Finally, NRRI's data fail to take into account the costs that a CLEC generates *internally* in providing service to end-users through the UNE-P – including administrative, personnel, and capital costs.

Third, the NRRI data understate the costs of loops (and therefore the costs of the UNE-P) for a CLEC's residential customers. For virtually every State, NRRI determines average loop rates that are identical for both residential and business customers.[218] In reality, however, the price of loops will be higher for the CLEC when it provided residential service, rather than business service. Similarly, NRRI's approach of providing prices for loops per zone,

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[216] *See Pennsylvania 271 Order* at ¶ 67 n.252. In its most recent survey, NRRI acknowledges that the national average is 1,400 MOUs per month, and that "several states have average MOU in excess of 2000 MOU per month." *NRRI 2003 Survey* at 4 n.11. NRRI attempts to address this problem by also computing UNE-P costs based on 2,000 minutes of use per line per month, which produces higher UNE-P rates than a scenario assuming usage of 1,000 MOUs. *See id.* at 3 n.9 & App. 3 at 2. Like its original 1,000-MOU approach, however, NRRI's new alternative methodology fails to use actual MOU data and erroneously assumes no variations between States, even though NRRI effectively acknowledges that variations exist. In any event, NRRI used only the 1,000-MOU scenario to compute the price change percentages cited by Verizon. *Id.*

[217] *2003 NRRI Survey* at 2-3 & n.8; *2002 NRRI Survey* at 2-3 & n.7. NRRI explained that "state transport rates were too variable to reduce to monthly dollar figures." *Id.*

[218] *See, e.g., 2003 NRRI Survey*, Tables 2-4.

as well as a weighted average loop price, for each State assumes that the CLEC will provide service throughout each State. To date, however, CLECs have been generally unable to provide service outside of large metropolitan areas, because the costs of providing such service (including the higher UNE rates) make it highly uneconomical to provide such service on a Statewide basis even if – as in AT&T's case – the CLEC would prefer to offer service to any customer, regardless of location.

Because of the deficiencies in the NRRI surveys, the price data in those surveys on which Verizon relies are entitled to no weight. As a result, the Bank of America and Merrill Lynch reports that Verizon also cites are equally unreliable, because they use the data from the NRRI surveys to reach their respective conclusions about changes in UNE-P rates.[219]

Finally, even if the data in these various reports correctly state the prices of the UNE-P and for loops (and they do not) they demonstrate only that such prices were grossly excessive in the past. The substantial reductions in those rates have occurred either because State regulators (in the context of a Section 271 proceeding or a new proceeding to set UNE rates) have more closely applied the TELRIC methodology, or because the RBOCs – recognizing that the preexisting rates were too high to withstand the scrutiny of this Commission in a Section 271 proceeding – reduced them to win the in-region, intraLATA authority they have so eagerly sought.[220]

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[219] *See* Petition, Att. B at 1 & n.1, 12-13 & n.56; M. Bartlett and C. Johnson, Banc of America Securities, *UNE-P Competition; Assessing RBOC Vulnerability*, at 1-2, 7 (February 27, 2003) ("Bank of America Report"); A. Quinton, *et al.*, Merrill Lynch, *The Telecommunication: Telecom Act Seven Years On – the UNE Shock Wave Belatedly Reverberates around the RBOCs – And How!*, at 19, 22 (September 23, 2002) ("Merrill Lynch Report").

[220] Each of the reports on which Verizon relies cites the Section 271 process as a significant factor in the reduction of UNE-P and loop rates. *See, e.g., 2003 NRRI Survey* at 1 (reduction in loop and UNE-P prices is expected to continue over the next six months as more states review Section 271 filings by regional Bell operating companies or conduct updates of existing UNE pricing); Merrill Lynch Report at 2 ("the declines were likely related to pricing decisions

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There is nothing arbitrary or illegitimate about these reductions – they are precisely the result that Congress sought to achieve. Congress expressly provided in the 1996 Act that: (1) the Commission cannot approve a Section 271 application unless the BOC has shown *inter alia* that it has established reasonable, cost-based rates for UNEs in accordance with Sections 251(c)(3) and 252(d)(1) of the Act; and (2) in determining whether UNE rates in an interconnection agreement are just and reasonable, state commissions must apply the cost-based standard of Section 252(d)(1). *See* 47 U.S.C. §§ 252(d)(1), 271(c)(2)(B)(ii). State regulators and RBOCs, recognizing that the preexisting UNE rates could not withstand review by this Commission (in a Section 271 proceeding) or by a District Court (in an action brought under Section 252(e) to appeal a State commission's rulings in an arbitration of an interconnection agreement), have reduced them closer to the cost-based, TELRIC levels that Congress and this Commission intended. That result should be welcomed, not deplored.

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rendered in conjunction with the multitude of 271 applications filed by these companies during the second half of 2002"); Banc of America Report at 3, 12 ("As UNE rates continue to be scrutinized in front of (or in some cases in parallel with) any new RBOC 271 filing at the state level, it seems inevitable that we will continue to see pressure on UNE rates driving further retail to wholesale access line moves at the RBOCs. . . . UNE rates over the past several months have been cut dramatically in several large states in front of 271 relief").