



September 10, 2003

Via Electronic Mail

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

Re: In the Matter of Petition of WorldCom, et al., Pursuant to Section 252 (e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration, CC Docket No. 00-218, 00-249 and 00-251.

Dear Ms. Dortch:

Attached please find a letter addressed to Mr. Dan Gonzalez, Senior Legal Advisor, Wireline Competition, Federal Communications Commission from James C. Smith, Senior Vice President-Federal Regulatory of SBC Communications, Inc. The letter was faxed late yesterday afternoon.

We are submitting the original and one copy of this letter to the Secretary in accordance with Section 1.12 of the Commission's rules. Please include a copy of this submission in the record of the above-listed proceedings. If you have any questions, please contact me at (202) 326-8895.

Sincerely,

A handwritten signature in black ink, appearing to read 'JL', is written over the word 'Sincerely,'.

Jim Lamoureux

Attachment



James C. Smith
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September 9, 2003

Mr. Dan Gonzalez
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Re: In the Matter of Petition of WorldCom, et al., Pursuant to Section 252 (e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration, CC Docket No. 00-218, 00-249 and 00-251.

Dear Dan:

We are writing in response to your request for information concerning the implications of the Wireline Competition Bureau's recent Virginia Arbitration Order (the "*Order*") for TELRIC reform generally. As we show below, the *Order* highlights the fundamental flaws in TELRIC as a pricing methodology and underscores the need for immediate Commission level attention to this issue. While the Bureau of course simply was acting in the shoes of a state commission and was not speaking for the full Commission, states nevertheless inevitably will look to the *Order* as having the Commission's imprimatur with respect to the proper interpretation of TELRIC. This makes the need for a Commission proceeding to correct the TELRIC regime all the more urgent.

In particular, the *Order* illustrates how TELRIC's lack of grounding in reality affects even the question of which cost model to use. As the *Order* shows, it can lead to a requirement that parties cost out fictional network facilities, equipment, and services, generating rates that bear little relationship to the costs of real world networks. This is the case in the *Order* with respect to both the recurring cost model for loops and the non-recurring cost model.

As to the recurring loop cost model, because the *Order* understands TELRIC to *require* a network design constrained *only* by the location of current wire centers, *Order* ¶ 30 n. 84, and thus the rejection of real world "network design [or] data," *Order* ¶ 52, it resorts to the CLECs' "modified Synthesis model" ("MSM") for calculating Verizon's recurring loop costs. The MSM uses "clustering algorithms," an "unmodified PRIM algorithm," "road surrogate data," and a host of other complex mathematical devices to design an entirely hypothetical network in an effort to calculate "least cost, most efficient" loop costs. By design, that network bears no relationship to Verizon's network in Virginia, either today or in the future. *Order* ¶ 179. Indeed, based on its interpretation of TELRIC's strict hypothetical requirements, the *Order* rejects even considering Verizon's planned technology deployments over the next 3 to 5 years, finding that data

irrelevant according to TELRIC principles. See *Order* ¶¶ 32, 179. It thus models an “optimized” network that does not reflect the forward-looking design or technology of real world forward-looking networks. *Id.*¹

Similarly, with respect to non-recurring costs, the Bureau found that, because TELRIC requires the assumption of the “most efficient network possible . . . constrained only by current switching locations,” *id.* ¶ 567, it was required to adopt the AT&T/MCI non-recurring cost model, which it found “meets the TELRIC requirement of optimization,” *id.* The AT&T/MCI model has no grounding in the real world, but rather reflects little more than the musings of various AT&T and MCI “subject matter experts,” with “little detail regarding the process used by these experts in developing their estimates or the factual bases underlying the estimates.” *Order* ¶ 564. By its very design, it bears no relationship to real-world processes underlying non-recurring costs. Rather, it specifically “limits the activities for which a NRC is imposed.” *Order* ¶ 565. Moreover, it reflects the use of technology that is merely “theoretically feasible,” but, as the Bureau concedes, “has not actually been implemented by *any* carrier.” *Order* ¶ 568 (emphasis added). It is thus clear that the assumptions used by the AT&T/MCI “experts” were entirely unconstrained by the operational needs of a functional network. The *Order* thus vividly demonstrates that TELRIC reflects an analytical framework that shuns any notion of reality and encourages the use of an entirely hypothetical modeling approach.

Beyond the choice of cost model itself, moreover, the *Order* demonstrates the complete absence of real world constraints in TELRIC’s determination of the inputs and assumptions used to populate the models. For example:

- The AT&T/MCI non-recurring cost model used by the Bureau assumes 100% dedicated inside and outside plant in Verizon’s network—design features so utterly unrealistic that the *Order* itself expressly notes that there is no reasonable “assumption that any real network would be built this way.” *Id.* ¶ 587.
- The Bureau adopts the assumption that *all* fiber fed loops in Verizon’s forward-looking network will deploy “next generation digital loop carrier” or NGDLC. The Bureau concluded that this result was required by TELRIC because TELRIC requires use of the most “advanced and efficient” systems. *Id.* ¶ 311. Yet Verizon has no such equipment in its Virginia network today, and has no plans to deploy any in the future. *Id.* ¶¶ 310-322. As a result, the cost of loops in Virginia will be based on equipment, such as NGDLC line cards, that do not exist in Verizon’s Virginia network.

¹ On top of that, because the MSM only models costs for basic 2-wire loops, the *Order* requires the use of a series of so-called “out-of-model calculations” and “out-of-model factors” to determine various other loop rates, even though the Bureau conceded that it was “troubled by the lack of thoroughness and clarity” in the factors this approach required it to adopt. *Id.* ¶ 341.

- The Bureau adopted a “fall-out” rate of 2% for non-recurring order processing—meaning that the assumption for costing purposes is that 98% of all orders are handled electronically. Based again on the need for “TELRIC optimization,” the Bureau disregarded Verizon’s evidence that “no automated systems exists that can perform” the requisite tasks and that doing so would be extremely expensive. *Id.* ¶ 591. It simply required costs to be assessed based on the fiction that “manual intervention by Verizon at the ordering stage *should* be unnecessary.” *Id.* ¶ 529 (emphasis added).
- While acknowledging that networks evolve over time and thus that the switches in a network will be a mix of “new” and “growth” switches, the *Order* nonetheless assumes that most of the switches in Verizon’s network are purchased as “new” rather than “growth” switches. The *Order* relied on “TELRIC principles” to reject a mix that would have included a substantial portion of growth switch investment—as is the case in the real world—and to instead apply a new switch discount to the overwhelming majority of switching investment. *See id.* ¶ 387. It did so notwithstanding the Bureau’s own recognition that, in the real world, if carriers primarily bought *new* switches and very few growth additions, “it is unlikely that switch vendors would provide relatively large discounts on the initial switch investment.” *Id.* ¶ 386 n.1014.

Finally, the *Order* demonstrates that TELRIC does not even ensure that an incumbent may recover all of its costs in the manner in which they are incurred. For example, the *Order* shifts a substantial portion of non-recurring costs into recurring rates. Indeed, it uses the AT&T/MCI non-recurring cost model specifically because it “recovers more costs through recurring charges.” *Order* ¶ 584. The Bureau determined that “the better approach is to recover [non-recurring] costs through [annual charge factors incorporated in recurring rates] and not through NRCs.” *Id.*; *see also id.* ¶ 592 (database maintenance to recurring); ¶¶ 587-88 (installation to recurring). The result is that Verizon must essentially lend money to the CLECs to invest in entering the market, and then amortize its recovery over several years of uncertain demand. This decision ignores years of Commission precedent providing that the cost causer—here the requesting CLEC—should pay for those costs in the manner in which they are incurred. It also encourages entry by CLECs whose business case does not even permit it to cover standard start-up costs.

This letter provides but a few examples of the manner in which TELRIC exalts fiction over reality. It is imperative that the Commission overhaul TELRIC to ground the Commission’s UNE and interconnection pricing methodology in the actual forward looking networks of the incumbents. If you have further questions, please do not hesitate to contact me.

Sincerely,


James C. Smith
 Sr. Vice President-Federal Regulatory

CERTIFICATE OF SERVICE

I, Loretia Hill, do hereby certify that on this 10th day of September 2003, a copy of the foregoing "Letter" was served via U.S. Mail, First Class, Postage paid to the parties listed on the attached sheets.

/s/ Loretia Hill
Loretia Hill

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