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October 24, 2003

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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

Re: Petition of WorldCom, Inc. and AT&T Communications of Virginia, Inc., 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 Numbers 00-218 and 00-251

Dear Ms. Salas:

On behalf of Verizon Virginia Inc. ("Verizon") please find attached an original and four copies each of Verizon's Reply to Opposition of WorldCom, Inc. and AT&T Communications of Virginia, LLC to Verizon Virginia's Application for Review; Verizon's Motion for Leave to File Reply in Support of Motion to Stay; and Verizon's Reply to Opposition of WorldCom, Inc. and AT&T Communications of Virginia, LLC to Verizon Virginia's Motion for Stay. The attached documents are the public versions; a proprietary version of Verizon's Reply to Opposition of WorldCom, Inc. and AT&T Communications of Virginia, LLC to Verizon Virginia's Application for Review will be served upon the opposing parties.

Should there be any questions, please contact me at 202.663.6083.

Respectfully submitted,

Samir Jain

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Before the
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VERIZON VIRGINIA INC.'S REPLY TO OPPOSITION OF WORLDCOM, INC. AND AT&T COMMUNICATIONS OF VIRGINIA, LLC TO VERIZON VIRGINIA'S APPLICATION FOR REVIEW

(PUBLIC VERSION)

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Dated: October 24, 2003

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VERIZON VIRGINIA INC.'S REPLY TO OPPOSITION OF WORLDCOM, INC. AND AT&T COMMUNICATIONS OF VIRGINIA, LLC TO VERIZON VIRGINIA'S APPLICATION FOR REVIEW

SUMMARY AND INTRODUCTION

As Verizon VA showed in its application for review and its motion for stay, the Commission should reverse the August 29, 2003, Memorandum Opinion and Order (the "*Order*"). The *Order* is inconsistent with existing Commission precedent and rules, and it vastly increases the subsidies already received by CLECs relying on UNEs. It accordingly discourages the development of facilities-based competition, and thus exacerbates the very problems the Commission identified in the *TELRIC NPRM*. Indeed, the *Order* adopts extreme assumptions that in some cases were not even proposed by any party. As a result, the *Order* slashes Verizon

VA's existing rates, which the Commission has already deemed TELRIC-compliant, to radically low levels that will harm both Verizon VA and the public interest.

AT&T/WorldCom's initial response to the *Order*'s failings is to try to avoid or at least delay review altogether. They insist that because the *Order* does not set *all* of the rates, the binding determinations made in the *Order* need not be reviewed at this time. But the *Order* itself provides that its determinations are effective immediately, and nothing in any of the subsequent proceedings will change the *Order*'s decisions on model choice and inputs. In fact, AT&T itself is already pointing to the *Order* as binding precedent in proceedings before other state commissions. It accordingly is critical that the Commission act now to stay the *Order* and to correct the *Order*'s errors.

AT&T/WorldCom's efforts to defend the *Order* on the merits are no better. They repeatedly ignore or misinterpret binding Commission rules and precedent. For example, AT&T/WorldCom claim that the *Order*'s 100% IDLC/GR-303 determination, as well as its non-recurring determinations, are defensible on the ground that the Bureau was free to hypothesize that the forward-looking network would contain technologies that may be "technically feasible" to develop in the future — notwithstanding that those technologies are not "currently available," as the Commission's rules explicitly require. Similarly, AT&T/WorldCom defend the *Order*'s rate structure decisions concerning end-office switching and non-recurring costs, without reconciling those decisions with the Commission's repeated pronouncements that costs should be recovered in the manner in which they are incurred. And while they try to defend the *Order*'s choice of loop model and inputs, the Commission has repeatedly cautioned that these may only be used for universal service, not for setting UNE rates.

AT&T/WorldCom's arguments cannot make up for the fact that the *Order* is inconsistent on its face. For example, while the *Order* acknowledges that no rational manufacturer could offer the steep new switch discounts that are currently available if carriers bought predominantly new switches, it nonetheless assumes that more than 90% of all switching equipment can be purchased at those new switch discounts, which are as high as 99% off list price. The *Order* also sets high capacity loop rates that are not based on the costs of providing those loops, but instead are based entirely on ratios between basic 2-wire loops and high capacity loops that the *Order* specifically finds "lack . . . thoroughness and clarity." *Order* ¶ 341. And the *Order* fails to modify the factor that accounts for engineering and installation costs, even though it recognizes that the steep discounts it adopts for switching investment require an increase in that factor in order to ensure proper cost recovery. AT&T/WorldCom can do nothing to explain these inconsistencies.

AT&T/WorldCom also go so far as to defend decisions in the *Order* that are even more extreme than their own proposals below. For example, they defend the *Order's* increase to the total annual minutes of use over which investment is spread, and the resulting reduction in switching rates, even though they never proposed the adjustment the *Order* makes. AT&T/WorldCom similarly insist that the *Order*'s adoption of the same fill factor for analog and digital ports is sensible, even though they, like Verizon VA, affirmatively proposed a *lower* fill factor for digital ports. In addition, AT&T now supports the *Order*'s adoption of a flat rate structure for end-office switching, notwithstanding its opposition to that rate structure below on the ground that it does not properly align rates with costs.

Finally, in trying to defend the *Order,* AT&T/WorldCom insist that it does not seriously decrease rates at all. They focus on the marginal $0.67 increase in the statewide average two-

wire loop rate — a rate that remains substantially below the comparable rate in New York — suggesting that this somehow overcomes the massive reductions in high capacity loop rates, switching rates, and non-recurring charges. Yet tellingly, AT&T/WorldCom vigorously oppose Verizon VA's motion to stay the rates, arguing that CLECs would be harmed if the new low rates are not permitted to go into effect. In fact, the *Order* will produce end office switching rates that are the lowest in effect for Verizon in any of the 31 jurisdictions where it provides local service. The residential UNE-P rate in zone 1, which is where approximately three-quarters of customers are located, is one of the lowest in any Verizon jurisdiction for any comparable zone. The high capacity loop rates — which already benchmark to New York — are cut by as much as fifty percent. And numerous non-recurring rates are either slashed or eliminated.

These reductions are especially inappropriate given that the preexisting rates in Virginia were deemed TELRIC-compliant less that one year ago.[1/] Indeed, as a result of the rate reductions that Verizon VA implemented in connection with that 271 review, competitors in Virginia already have increased their reliance on UNE-P, in place of investing in their own facilities. By adopting extreme, below-cost rates, the *Order* would only increase that trend. As Verizon VA showed, that result would harm both Verizon VA and the public interest. Indeed, Moody's Investors Service just found that even under existing UNE rates, that Verizon "may have [its] debt ratings reduced because of government rules forcing [it] to lease lines at discounts

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1/ 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,* 17 FCC Rcd 21880, 21915, 21928 ¶¶ 62, 86 (2002) ("*Virginia 271 Order*").

to competitors.[2] For all these reasons, the *Order* should be reversed. Further, as Verizon VA separately showed, the Commission should stay the *Order* pending that decision or the resolution of the *TELRIC NPRM.*

ARGUMENT

The *Order* is flatly inconsistent with existing Commission rules and precedent. For example, the Commission's well-established rules explicitly provide that TELRIC rates may be based only on "currently available" technologies. 47 C.F.R. § 51.505(b)(1). Yet its assumption of 100% IDLC/GR-303 and its selection of AT&T/WorldCom's non-recurring cost model are both based on technological capabilities that admittedly do *not* exist today, but that the *Order* theorizes might develop in the future. And while Commission precedent provides that the universal service model should *not* be used to set UNE rates, the *Order* uses that model and its various input assumptions to set basic loop rates and as the starting place for the acutely understated high capacity loop rates it adopts.

The *Order* also prejudges significant policy questions that the Commission is currently considering in the *TELRIC NPRM.* For example, by adopting a flat rate structure for end-office switching, the *Order* decides the precise issue pending in the *TELRIC NPRM* as to whether such a "change[]" in the rate structure would "comply with the statutory pricing standard under section 252(d)(1)."[3] The *Order* similarly prejudges the significant new policy issue pending before the Commission concerning whether it should change its own long-standing policies and

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[2] Scott Lanman, "U.S. Local-Phone Carriers' Ratings May Be Hurt By FCC Rules," Bloomberg News Service, October 24, 2003.

[3] Notice of Proposed Rulemaking, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, FCC 03-224 ¶ 32 (rel. Sept. 15, 2003) ("*TELRIC NPRM*").

precedent and require incumbent LECs to recover non-recurring costs in recurring rates, and if so, in what circumstances. *See TELRIC NPRM* ¶¶ 121-24. Thus, while AT&T/WorldCom argue that the *TELRIC NPRM* is merely tentative and does not reflect any final Commission decisions,[4] they miss the point: the Bureau was not permitted to prejudge the very issues pending in that proceeding.

Finally, the *Order* adopts radically hypothetical assumptions that move in a direction directly *opposite* to the one signaled by the *TELRIC NPRM* and that push TELRIC to a new extreme. As Commissioner Martin has observed, "the Wireline Competition Bureau's interpretation of the TELRIC pricing rules in the recent Virginia Arbitration Order may not reflect the direction and spirit of today's decision" in the *TELRIC NPRM*.[5] For example, at the same time that the Commission has indicated that TELRIC assumptions should better reflect incumbents' real-world costs, the *Order* adopts the entirely unrealistic assumption that Verizon VA could purchase more than 90% of its switching equipment at new switch discounts as high as 99% off list price. The *Order* also adopts high capacity loop rates that are entirely unrelated to *any* measure of Verizon VA's real-world costs.

The result of these assumptions is to reduce rates to new lows, notwithstanding that the Commission deemed Verizon VA's *existing* rates compliant with TELRIC less than one year ago — and notwithstanding that even *those* rates already had been reduced in connection with Verizon VA's section 271 application. AT&T/WorldCom try to avoid this by insisting that the Commission's review was nothing more than a "general assessment of UNE rates," and that the

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[4] *See* Opposition of WorldCom, Inc. and AT&T Communications of Virginia, LLC to Verizon Virginia Inc.'s Motion for Stay and Application for Review at 15 (Oct. 14, 2003) (AT&T/WCom Opp.").

[5] *TELRIC NPRM*, Separate Statement of Commissioner Kevin J. Martin at 1.

Commission conducted only a limited review because it "recognized that Verizon's then-current rates might be changed as a result of [this] arbitration." AT&T/WCom Opp. at 95-99. But in reaching its conclusion that Verizon VA's existing rates were TELRIC-compliant, the Commission devoted more than 40 pages of its 118-page *Virginia 271 Order* to a thorough review of Verizon's UNE rates in Virginia, and rejected extensive arguments from other parties, including AT&T and WorldCom. *Virginia 271 Order* at 21915-57 ¶¶ 62-137. And the Commission specifically rejected AT&T and WorldCom's invitation to focus on the rates that would be forthcoming from this arbitration, finding explicitly that its approval of Verizon VA's rates as TELRIC-compliant was "based on [Verizon's] *present* rates." *Id.* at 21924 ¶ 77 (emphasis added). Similarly, contrary to AT&T/WorldCom's claim, AT&T/WCom Opp. at 98-99, the Commission was clear that it did "not rely on Verizon's promise of a true-up to find checklist compliance." *Id.* at 21946 ¶ 115.

Nor is there any merit to AT&T/WorldCom's suggestion that the Commission's analysis can be disregarded because it is based on a benchmark comparison to the New York rates. AT&T/WCom Opp. at 97. As the Commission explained, "the purpose of our benchmark analysis is to provide confidence that a rate . . . falls within the range that a reasonable application of TELRIC principles would produce." *Virginia 271 Order* at 21929 ¶ 89. The Commission concluded that its benchmark analysis was "a competitively meaningful analysis based on the way UNEs are actually purchased," and found that AT&T failed to provide any evidence to the contrary. *Id.* at 21943, 21944 ¶¶ 110, 112. And AT&T/WorldCom's selective quotation of the Commission's "concern" with whether all of the rates set by the Virginia SCC were TELRIC-compliant, AT&T/WCom Opp. at 96-97, is irrelevant: those are the very rates that were reduced so that they benchmarked to New York. *Id.* at 21929 ¶ 89. The Commission

concluded that the existing rates "fall[] within the range that a reasonable application of TELRIC principles would produce." *Id.* Thus, the *Order*'s determination that TELRIC somehow requires massive reductions in the existing Virginia UNE rates is nonsensical, and should be reversed.

I. RECURRING COSTS

A. Review of the *Order's* Non-Loop Determinations Is Appropriate Now.

AT&T/WorldCom claim that the *Order*'s findings as to non-loop issues are "merely interlocutory" and therefore non-reviewable until the Bureau issues its order setting forth final rates in connection with the parties' compliance filings. AT&T/WCom Opp. at 7-8, 63-64. But as a preliminary matter, this claim is contrary to the plain language of the *Order* itself, which provides, notwithstanding that the parties must make compliance filings with respect to certain rates, that "this order is effective immediately." *Order* ¶ 698. It also makes sense for the *Order* to be reviewable now. It contains all necessary determinations concerning the assumptions and inputs that must be used in calculating the final rates in this case. Those determinations therefore are final and already applicable to guide the compliance filings. In addition, CLECs are already insisting that the Bureau's determinations are binding and should guide the decisions of other state commissions. Verizon Virginia's Motion for Stay at 41-42 (Sept. 29, 2003) ("VZ-VA Motion for Stay"). Further, the Commission's rules specifically contemplate that applications for review may be considered for interlocutory orders issued under delegated authority. *See* 47 C.F.R. § 1.102(b)(3) (discussing procedure if an "application for review of a non-hearing or *interlocutory* ruling is filed.") (emphasis added).[6]

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[6] AT&T/WorldCom suggest that rule 1.115 *precludes* applications for review of interlocutory orders, AT&T/WCom Opp. at 63, but the rule states that a person "aggrieved by *any* action taken pursuant to delegated authority may file an application requesting review of that action by the Commission." 47 C.F.R. § 1.115(a) (emphasis added). The rule creates an exception only in the context of applications for review of interlocutory rulings made by the

B. Switching

The result of the *Order* is to dramatically slash switching rates. AT&T/WorldCom suggest that the *Order*'s rates are not too extreme because they allegedly are higher than switching rates that some states have set for *other* carriers. AT&T/WCom Opp. at 99-103. But the switching rates resulting from the *Order* are the lowest *for Verizon* in any of the thirty-one jurisdictions where it provides service.[7] Moreover, AT&T/WorldCom cannot deny that the new switching rates would be significantly lower than the existing rates in Virginia that the Commission previously found TELRIC-compliant. And this dramatic reduction produces a residential UNE-P rate in zone 1, where approximately three-quarters of the customers are located, that is one of the lowest in any Verizon jurisdiction for any comparable zone.[8] These extremely low rates will only exacerbate subsidy flows to CLECs and further promote uneconomic reliance on Verizon VA's network at the expense of efficient facilities-based competition.

Chief Administrative Law Judge, and even then permits such applications if the Chief Judge certifies them. *Id.* § 1.115(e)(1). And the single case AT&T/WorldCom cite, AT&T/WCom Opp. at 63, demonstrates that where the Commission seeks to bar interlocutory review, it does so explicitly.

[7] While AT&T/WorldCom claim that Verizon's switching rates in Massachusetts are lower than those resulting from the *Order*, their calculations both overstate the switching rates resulting from the *Order* and understate the rates in Massachusetts. With the correct calculations, the switching rates resulting from the *Order* are approximately 20% lower than those in Massachusetts. AT&T/WorldCom's claim that the rates in New Jersey are comparable is similarly based on incorrect calculations; the New Jersey switching rates are approximately 14% higher than those resulting from the *Order*.

[8] Verizon VA has updated its preliminary calculations discussed in its application for review. The final numbers will be filed in its October 28, 2003 compliance filing.

1. The *Order*'s End Office Switching Rate Structure Is Inconsistent With Commission Precedent and Creates New Artificial Subsidies.

The *Order*'s decision to eliminate usage charges for end office switching and impose a flat-rate structure conflicts with Commission precedent and creates new subsidies from low-volume users to high-volume users. Moreover, it prejudges the outcome of this same issue pending before the Commission in the *TELRIC NPRM*. Although AT&T now apparently has joined WorldCom in supporting the inordinately low flat rate produced by the *Order*, it originally *opposed* this approach and argued that a flat rate structure "does not properly align rates and costs." Direct Testimony of Robert J. Kirchberger on Behalf of AT&T at 15 (July 31, 2001) ("AT&T Ex. 4").[9] AT&T, which offers no explanation for its about-face, was correct in its original position, and the *Order* should be reversed.

Even AT&T/WorldCom are unable to deny two basic propositions. First, as the *Order* itself recognizes, under existing rules, "incumbent LECs' rates for interconnection and unbundled elements *must* recover costs in a manner that reflects the way they are incurred."[10] Second, the *Order* recognizes that some switching costs are traffic sensitive and "vary with usage." *Order* ¶ 473. The Commission has consistently reached that same conclusion. In the *Local Competition Order on Reconsideration*, for example, the Commission set usage-sensitive minute-of-use proxy rates for the switching UNE and expressly found that "the unbundled local

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[9] *See also* Joint Initial Post-Hearing Brief of WorldCom, Inc. and AT&T on Switch Cost Issues at 27 (Jan. 17, 2002) ("AT&T/WCom Switching Brief") (AT&T arguing that some switching costs are traffic sensitive and that costs must be recovered in the manner they are incurred).

[10] *Order* ¶ 458; First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 15874 ¶ 743 (1996) ("*Local Competition Order*") (emphasis added) ("as a general rule, []incumbent LECs' rates for interconnection and unbundled elements *must* recover costs in a manner that reflects the way they are incurred.").

switching element, as defined in section 251(c)(3), includes . . . the *usage-sensitive* switching matrix."[11] AT&T/WorldCom likewise agree that "Commission rules and precedent recognize that some portion of switching investment" is traffic sensitive.[12] Indeed, AT&T/WorldCom themselves calculated in this proceeding that between 16% and 40% of switching resources are traffic sensitive.[13]

Taken together, these two propositions require that a portion of end-office switching costs be recovered through a minute-of-use charge. The *Order*'s failure to do so creates new artificial subsidies between customers. A flat-rate structure requires all users — regardless of their actual usage levels — to pay for the cost of an average customer's usage level. As a result, customers with higher than average usage (which are targeted by CLECs) would avoid paying their fair share of traffic sensitive switching costs. *See* Verizon Virginia Rebuttal Testimony of Harold E. West III at 3 (Aug. 27, 2001) ("VZ-VA Ex. 115"). And low usage customers (whom Verizon is likely to continue serving) will pay for more usage than they actually use, subsidizing the high usage customers. This would be blatantly inconsistent with Commission policy, which instructs that costs should be "allocated among subscribers on the basis of their causal

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[11] Order on Reconsideration, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 13042, 13045 ¶ 6 (1996) ("*Local Competition Order on Reconsideration*"); *see also* 47 C.F.R. § 51.513(c)(2); Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, *Access Charge Reform Price Cap Performance Review for Local Exchange Carriers*, 11 FCC Rcd 21354, 21392-93 ¶ 73 (1996) (concluding in the access charge context that switching costs are usage sensitive "and so should be priced on a usage-sensitive basis").

[12] AT&T/WCom Opp. at 68; *see also* Verizon Virginia Inc.'s Opposition to AT&T/WorldCom's Application for Review at 10-11 (Oct. 14, 2003) ("VZ-VA AFR").

[13] *See* Verizon Virginia Inc. Initial Post Hearing Brief on Switching Issues at 17-18 (Jan. 17, 2002) ("VZ-VA Switching Br.").

responsibilities." *Order* ¶ 459. And it is inconsistent with the Commission's expressed desire in the *TELRIC NPRM* to eliminate subsidies so that UNE prices send correct economic signals.[14]

AT&T/WorldCom's arguments in defense of the *Order*'s flat-rate structure amount to little more than smokescreens. First, AT&T/WorldCom argue that switch *processor* costs are not usage-sensitive, but they are wrong. Verizon VA demonstrated that the size of the switch processor and memory resources — and therefore costs — increase as the level of expected usage increases.[15] Switch processors are initially sized based on expected usage and their costs therefore vary based on anticipated usage levels. *See* Tr. at 5451 (Gansert)).

AT&T/WorldCom respond by claiming that modern switch processors do not reach exhaustion levels and that switches today have enough spare capacity to "virtually eliminate[]" the need for Verizon VA's engineers to design and monitor switch processors. AT&T/WCom Opp. at 65-66. But that is wrong. Verizon VA's switches contain tools specifically designed to assist Verizon VA in monitoring processor capacity so that exhaust situations can be avoided, and so that a sufficient amount of spare capacity can be maintained. *See* Verizon Virginia Surrebuttal Testimony of David Garfield at 7-8 (Sept. 21, 2001) ("VZ-VA Ex. 123"). And, as the evidence demonstrates, Verizon VA has had to buy equipment to supplement switch processors for reasons related to capacity exhaustion.[16] *See* Verizon Virginia Recurring Cost

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[14] AT&T/WorldCom suggest that such a subsidy might be restricted only to periods of peak use or that it is difficult to know who will subsidize whom. AT&T/WCom Opp. at 68. They do not deny, however, that a flat-rate structure in an environment where some costs vary by usage inevitably results in one set of users subsidizing another.

[15] *See* VZ-VA Switching Br. at 19; Verizon Virginia Rebuttal Testimony of Francis J. Murphy at 53-55 (Aug. 27, 2001) ("VZ-VA Ex. 109"); VZ-VA Ex. 122 at 191-93; Tr. at 5447-51 (Gansert).

[16] AT&T/WorldCom's citation to Verizon VA witness Mr. Gansert, AT&T/WCom Opp. at 65, provides them no support. Mr. Gansert's testimony that, "in ordering the switch, it's

Panel Surrebuttal Testimony at 176-78 (Sept. 21, 2001) ("VZ-VA Ex. 122"). In any event, AT&T/WorldCom's argument addresses only whether processor costs should be included among the end-office switching costs that should be recovered through minute-of-use charges, not whether there should be a minute-of-use charge at all. As noted above, all parties and the Bureau agree that at least some end office switching costs are usage-sensitive.

Second, AT&T/WorldCom assert that because vendors do not charge usage-based rates to Verizon, Verizon should not be able to charge usage-sensitive rates to CLECs. AT&T/WCom Opp. at 68-69. This is nonsensical. As discussed above, the Commission, the Bureau, and even AT&T/WorldCom agree that at least a portion of Verizon VA's end office switching costs vary with usage. Equipment is engineered and sized based on expected demand or usage, and the size of that equipment — and therefore the price charged by vendors — increases with higher usage.[17]

Third, AT&T/WorldCom parrot the *Order*'s conclusion that usage-sensitive costs could best be recovered through a peak-period rate structure, which would charge different MOU rates for usage during the peak calling period and during non-peak times, but that such a structure is impractical. AT&T/WCom Opp. at 67. However, even if a peak-period structure might be more precise, the fact that such a structure is impractical does not justify abandoning usage-sensitive rates altogether and adopting a flat-rate structure that clearly does not reflect how costs are incurred. Instead, the *Order* should have adopted and approved minute-of-use rates to recover

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designed" so that the processor does not exhaust is nothing more than a statement that Verizon VA attempts to order a switch with sufficient processor and memory capacity to handle anticipated usage levels.

[17] *See, e.g.*, VZ-VA Ex. 123 at 6-8; Verizon Virginia Inc. Recurring Cost Panel Surrebuttal Testimony at 176 (Sept. 21, 2001) ("VZ-VA Ex. 122"); VZ-VA Switching Br. at 19-20; Verizon Virginia Inc. Post-Hearing Reply Brief at 107-08 (Jan. 31, 2002) ("VZ-VA Reply Br.").

the usage-sensitive costs for end-office switching. As noted above, that is what the Commission itself did when setting switching proxy rates, and the Commission repeatedly has approved 271 applications in which significant portions of switching costs were recovered through a minute-of-use rate.[18] The *Order* has no basis for abandoning this precedent.

Finally, AT&T/WorldCom suggest that a minute of use rate is not competitively neutral. AT&T/WCom Opp. at 69. But just the opposite is true. Because at least some portion of end-office costs are usage-sensitive, failure to impose a usage-based charge for these costs means that CLECs, for example, may incur lower costs than Verizon VA incurs for a high-volume customer. AT&T/WorldCom's suggestion that a flat-rate UNE structure is competitively neutral because a CLEC must offer *retail* customers flat-rated structures to compete in the market place, *id.* at 68-69, is incorrect. CLECs are free, just as Verizon VA is, to offer retail customers flat-rated service plans. But competitive neutrality requires that CLECs bear the same risks as Verizon VA in offering such retail rates (e.g., underestimating average usage and therefore under-recovering costs). A flat-rate structure, on the other hand, discriminates against *Verizon VA* because it, rather than the CLEC, must bear the risk that the flat-rate does not recover its usage-sensitive costs.

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[18] *Virginia 271 Order* at 21948-49 ¶ 121; Memorandum Opinion and Order, *Application by Verizon New England Inc., Verizon Delaware Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in New Hampshire and Delaware*, 17 FCC Rcd 18660, 18697-98 ¶ 61 (2002) ("*New Hampshire/Delaware 271 Order*"); Memorandum Opinion and Order, *Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Alabama, Kentucky, Mississippi, North Carolina, and South Carolina*, 17 FCC Rcd 17595, 17641 ¶ 93 (2002) ("*BellSouth Five-State 271 Order*").

2. The *Order*'s Economically Irrational Switch Discount Should Be Reversed.

The *Order* should have adopted the switch discounts proposed by Verizon VA, which were based on the prices that Verizon VA paid in connection with its purchases in 2000 and under current contracts. From this information, which was the most recent available data at the time the cost studies were done, Verizon VA calculated the actual effective discount during the timeframe the purchases were made. As Verizon VA explained, this data reflects the actual forward-looking mix of new and "growth" switches Verizon VA expects to purchase to add capacity to its network and is the best objective measure of the per-line switching prices manufacturers would offer even in a hypothetical TELRIC world.[19] These discounts reflect the revenues that Verizon's switch vendors expect to recover over the range of switch purchases they expect Verizon to make.

The *Order*, however, illogically assumes that Verizon VA would be able to purchase more than 90% of its switching equipment at "new switch" discounts, which are as high as *99%*. *See* VZ-VA AFR at 17. Yet the *Order* itself notes that, "[i]f carriers did not typically grow their switches over time, it is unlikely that switch vendors would provide relatively large discounts on the initial switch investments." *Order* ¶ 386 n.1014. The Commission and the D.C. Circuit have likewise recognized that vendors offer high new switch discounts to "lock in" carriers to purchase the relatively more expensive growth additions, and if they could not do so, the high new switch discounts would not exist.[20] Indeed, if a carrier attempted to purchase 90% of its

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[19] Tr. at 5235 (Gansert); *id.* at 5230 (Matt); Verizon Virginia Inc.'s Recurring Cost Panel Direct Testimony at 189-94 (July 31, 2001) ("VZ-VA Ex. 107"); VZ-VA Ex. 122 at 166-71.

[20] *See AT&T Corp. v. FCC*, 220 F.3d 607, 618 (D.C. Cir. 2000); Oral Argument Tr. at 35, *AT&T Corp. v. FCC* (argued Apr. 24, 2000).

switching capacity at new switch prices, vendors would undoubtedly increase their prices for new switching equipment. *See* Tr. at 2953-54 (Shelanski). Although AT&T/WorldCom seek to defend the *Order's* switch discount assumptions, even they cannot credibly claim that a rational switch vendor would offer the excessively high discounts the *Order* assumes.

Instead, AT&T/WorldCom make the contradictory argument that the actual discounts Verizon VA received in 2000 are the "best evidence" of forward-looking market prices, and that the *Order* therefore properly relied on those discounts, but that the actual mix of new and "growth" switches Verizon VA purchased in 2000 "in no way complies with TELRIC." AT&T/WCom Opp. at 70-71. This makes no sense. To be sure, the actual discounts Verizon VA obtained in 2000 *are* the best and most objective evidence of the forward-looking costs of adding switching capacity to Verizon VA's network. However, those discounts are predicated on the mix of new and "growth" switches Verizon VA purchased in 2000 — which, as Verizon VA explained, is the same mix it expects to purchase going forward. The *Order*'s, and AT&T/WorldCom's, fundamental error is assuming that those discount levels would remain the same if Verizon purchased a radically different mix of switches, such as buying 90% of its switching capacity as new switching equipment. But as even the *Order* recognizes, the "levels of new and growth switch discounts reflect vendors' judgments about anticipated purchases,"[21] and the amount of revenue those vendors requires to cover their costs. If vendors expected Verizon VA to buy more new switches and fewer growth additions, then they would necessarily

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[21] *See Order* ¶ 386 n.1014 (citing *BellSouth Five-State 271 Order* at 17635 ¶ 83; Memorandum Opinion and Order, *Joint Application by BellSouth Corp., BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Georgia and Louisiana*, 17 FCC Rcd 9018, 9059 ¶ 81 (2002) ("*Georgia/Louisiana 271 Order*").

increase their prices for new switches, in order to recover the same amount revenue from the altered mix. Thus, the average cost of switching capacity would not change from that shown by Verizon VA's evidence.

In an effort to bolster their illogical argument, AT&T/WorldCom assert that the discount levels Verizon VA received in 2000 are the same discounts Verizon VA received when it replaced its analog switches with digital switches in the years prior to 2000. AT&T/WCom Opp. at 70-71. AT&T/WorldCom point to no evidence in support of their claim, nor could they because they are wrong. When digital switches first became available, carriers purchased more new switches, and vendors rationally took that anticipated demand into account in determining how to structure prices and discount levels. There is no basis to assume that the discounts Verizon VA received in 2000 — by which point it had replaced most analog switches in its network — are the same as those that existed earlier when "vendors' judgments about anticipated purchases" would have been substantially different. *See* VZ-VA Switching Br. at 6 (explaining that vendors typically offer high discounts at the end of a particular technology's life).

For similar reasons, the *Order*'s supposed "life cycle approach" does not, as AT&T/WorldCom claim, account for the fundamental mismatch between 2000 discount levels and the radically different purchase patterns hypothesized by the *Order*. AT&T/WCom Opp. at 71. The *Order* arbitrarily assumes that the new switch discounts Verizon VA obtained in 2000 (when few of its switching purchases were new switches) would apply to a purchase of 90% of its switching capacity as new switch equipment, while the "growth" discount Verizon VA obtained in 2000 (when most of its switch purchases were additions) would apply to the additional 10% of capacity the *Order* assumes Verizon would purchase over the twelve-year life of a switch. That make no sense. In fact, because manufacturers would still have to recover the

same average per-line revenue even if the mix of new and growth purchases were different, the only correct means of estimating a "life-cycle" cost would be to determine the aggregate price that the switch manufacturer will try to recoup over the entire range of components it expects incumbents to purchase. Verizon VA's proposed switch discount, which reflects the amount manufacturers currently charge in order to recoup their required per-line revenue, is the best measure of this price.

Finally, even apart from the *Order*'s erroneous approach to the switch discount generally, AT&T/WorldCom fail to justify the *Order*'s adoption of an all-new switch discount for switch processor equipment in particular. As Verizon VA explained, the *Order* fails to account for evidence demonstrating that Verizon VA does upgrade and grow its switch processors and that these purchases are made at growth discount levels. *See* VZ-VA AFR at 19; VZ-VA Ex. 122 at 176-178. AT&T/WorldCom suggest that these switch processor upgrades are "part of an historical trend" that can be ignored, because, they insist, future upgrades "may or may not become available." AT&T/WCom Opp. at 72. Again, they point to no evidence supporting their assertion. The only evidence in the record demonstrates that Verizon VA expects to upgrade and grow its switch processors over the foreseeable future as it has in recent years, and that these purchases are made at growth, not new, discount levels. *See* VZ-VA Ex. 122 at 176-87; *see also* VZ-VA Ex. 123 at 6-12. As Verizon VA explained, processor equipment upgrades are needed on a continuous basis to ensure optimum switch operation going forward, and these costs should be included in forward-looking rates. *See* VZ-VA Ex. 122 at 176-78.

3. The Order's Assumption of 100% IDLC/GR-303 Must Be Reversed.

The *Order*'s assumption that 100% of the fiber-fed loops in the forward-looking network use IDLC, and therefore that switches use all IDLC-GR-303 digital line ports, is fundamentally inconsistent with the basic TELRIC requirement that rates must be based on "currently

available" technology. The record showed beyond question that IDLC-GR-303 cannot be used to unbundle standalone loops or to serve non-switched services, and that *no* carrier, in *any* network, has devised a means of doing so.

In trying to defend the *Order*, AT&T/WorldCom misrepresent the record or ignore the Commission's rules. First, in insisting that the evidence showed that IDLC-GR-303 can be used to unbundle standalone loops, AT&T/WCom Opp. at 57, AT&T/WorldCom fail to acknowledge or even address the evidence Verizon VA submitted showing that it is not possible today to use IDLC/GR-303 for loop unbundling. As Verizon VA showed, even Telcordia, the author of the GR-303 protocol, has noted that GR-303 cannot be used to unbundle stand-alone loops until a number of security, error protection, and OSS "implementation issues" are resolved.[22/] Indeed, AT&T itself has acknowledged that "[t]here are provisioning, alarm reporting, and testing issues that have not yet been worked out for using GR-303 in a multi-carrier environment," and that "other operational concerns must be addressed before the deployment of any solution whose underlying architecture and technology is premised on GR-303 DLCs."[23/] Not surprisingly then, no DLC equipment manufacturer sells equipment that allows standalone loops to be unbundled

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22/ VZ-VA Ex. 157 at 1 (Telcordia's website notes that "*new requirements* are needed to support alternative distribution technologies . . . as well as new services and applications (*e.g.*, . . . *local loop unbundling*).") (emphasis added); *see also* Tr. at 4585-86; Supplemental Testimony of Joseph A. Gansert (April 15, 2003) ("Gansert Supplemental Testimony"), Exhibit 5 (http://www.telcordia.com/resources/genericreq/gr303/ (last visited Apr. 2, 2003)); *see also* Verizon Virginia Inc.'s Proffer of Supplemental Evidence at 17-20 (April 15, 2003) ("VZ-VA Proffer"); Gansert Supplemental Testimony at 7.

23/ Letter from Joan Marsh, Director, Federal Government Affairs, AT&T Corp., to Marlene Dortch, Secretary, FCC, CC Docket Nos. 01-338, 96-98, and 98-147, at 3 (filed Dec. 4, 2002) ("Marsh Letter"); Gansert Supplemental Testimony at 5-7.

using IDLC, even with GR-303.[24] And as even AT&T witness Joseph Riolo admitted, "*[n]o* local exchange carrier . . . is presently unbundling with GR303 technology." Tr. at 4619, 4616 (Riolo) (emphasis added).

In an effort to defend the *Order's* conclusions, therefore, AT&T/WorldCom now point to the testimony from a Verizon VA witness in the *Non-Cost Arbitration* on which the *Order* incorrectly relies. But, as Verizon VA explained in its application for review, the selected quotes do *not* show that unbundling standalone loops over IDLC is possible: to the contrary, Verizon VA's witness indicated that to unbundle a loop over IDLC, Verizon VA could build an entirely new *unintegrated* DLC and "unintegrate" the existing loop. Thus, the discussion actually illustrates why *UDLC* is in fact needed in the network. *See* VZ-VA AFR at 24-25.

AT&T/WorldCom also claim that "Verizon glaringly omits any reference to . . . the admissions of BellSouth. . . . that it had unbundled IDLC loops." AT&T/WCom Opp. at 57. But BellSouth's "admissions" actually undermine AT&T/WorldCom's position, which may explain why AT&T/WorldCom never relied on them during the proceeding. While the BellSouth witness testified about means to provide access to IDLC loops, *none* of the methods he identifies involve unbundling *using* IDLC-GR-303. Instead, he describes the possibility of "reassess[ing] the loop from the IDLC system to a physical copper pair," "groom[ing]" the IDLC loops to a UDLC system, physically "hairpinning" the IDLC loop from the switch to the CLEC's collocation space, and several other examples that require "mov[ing] the requested loop from the

[24] Verizon Virginia Inc. Initial Post-Hearing Brief at 90-92 (Jan. 3, 2002) ("VZ-VA Initial Br."); Tr. at 4583-85 (Gansert); Verizon Virginia Inc. Non-Recurring Cost Panel Surrebuttal Testimony, Attachment A (Sept. 21, 2001) ("VZ-VA Ex. 124").

IDLC to .... [other] facilities."[25] This testimony accordingly proves that it is *not* possible to electronically unbundle standalone loops to CLECs over IDLC even where GR-303 is deployed, but that instead, the incumbent must use UDLC or some other expensive, manual process that would vastly *increase*, rather than decrease, the cost of an unbundled standalone loop.

Similarly, AT&T/WorldCom's repeated references to documents concerning Verizon's deployment of GR-303 in its own network to serve its own internal loops, *see* AT&T/WCom Opp. at 57-58, miss the point. There is no dispute that Verizon has deployed some GR-303 in the former GTE territory, though it has no plans to do so in Virginia or elsewhere in the Verizon-East footprint. But even where Verizon has deployed IDLC/GR-303, those systems simply do not have the technological capabilities necessary to provision standalone loops to CLECs in a multicarrier environment. As noted above, AT&T itself has acknowledged specifically the various "issues that have not yet been worked out for using GR-303 in *a multi-carrier environment*."[26]

Thus, as AT&T witness Riolo ultimately conceded, the GR-303 unbundling solution he advocates does not exist today, and thus is at most a hypothetical future goal that he theorizes "could be done technically." Tr. at 4616 (Riolo). AT&T/WorldCom insist this is sufficient because, they contend, the relevant test is not whether the IDLC/GR-303 that exists today is capable of unbundling standalone loops, but rather whether the hypothetical "*technical feasibility*

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[25] Affidavit of Keith Milner, *Joint Application by BellSouth Corp., BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Georgia and Louisiana*, CC Docket No. 01-227 ¶ 118 (filed Oct. 2, 2001) ("BellSouth GA/LA Milner Aff."); *see also* Affidavit of Keith Milner, *Joint Application by BellSouth Corp., BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Florida and Tennessee*, CC Docket No. 02-307 ¶ 99 (filed Sept. 20, 2002).

[26] Marsh Letter at 3; Gansert Supplemental Testimony at 5-7.

of unbundling IDLC-based loops" might be developed at some possible point in the future. AT&T/WCom Opp. at 58 (emphasis added). Indeed, the best they can say about their own evidence (as well as the findings in the *Order*) is that it demonstrates "the '*theoretical*' feasibility of IDLC/GR-303 unbundling" — not its current availability. *Id.* at 59 (emphasis added).

This approach violates the Commission's explicit requirement that any technology assumed for TELRIC-purposes must be "currently available." 47 C.F.R. § 51.505(b)(1). As the Commission found in its *Triennial Review Order*, the technology assumed for TELRIC purposes must actually be deployed and capable — *today* — of performing the relevant function in at least *some* carrier's network; it may not be technology that theoretically "may be available in the future."[27] The Supreme Court has pointed to this rule as one of the chief constraints on TELRIC.[28] Indeed, the *Order* itself recognizes that TELRIC disallows "overly optimistic assumption[s] about the capabilities of currently available technolog[ies]." *Order* ¶ 569. Thus, AT&T/WorldCom's suggestion that the *Order*'s 100% IDLC assumption can be defended based on evidence from a witness who sketched out a "theoretically" possible IDLC-unbundling methodology, *see* AT&T/WCom Opp. at 58-59, is entirely unavailing. Under the Commission's rules, the *Order* clearly must be reversed.[29]

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[27] Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket Nos. 01-338, 96-98, 98-147, FCC 03-36, ¶ 670 n.2020 (rel. Aug. 21, 2003) ("*Triennial Review Order*").

[28] *Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 506 & n.22 (2002) ("*Verizon Communications*") (noting that under TELRIC, "the marginal cost of a most-efficient element that an entrant alone has built and uses would not set a new pricing standard until it became available to competitors").

[29] For just this reason, the Commission has repeatedly held that TELRIC does *not* require the assumption that standalone loops are served over IDLC. *See Virginia 271 Order* at 21963-64

Finally, AT&T/WorldCom have never rebutted the fact that IDLC cannot be used to serve non-switched services. IDLC is a technology that is *integrated* into the switch. By definition, services provided over IDLC therefore are *switched*. AT&T/WorldCom never contested this point before the Bureau. They produced no evidence that demonstrated *any* carrier's use, in *any* network, of IDLC to serve non-switched services, or that explained how this was even physically possible.

AT&T/WorldCom incorrectly claim that GTE planning guidelines calling for deployment of IDLC/GR-303 somehow show that Verizon has conceded the possibility of serving *non-switched* lines over IDLC. AT&T/WCom Opp. at 59-60. But this makes no sense. Where IDLC/GR-303 is deployed, it will be used exclusively for *switched* services. All the non-switched services will be provided over the substantial UDLC (and copper) that already exist in the network. Indeed, the BellSouth documents to which the CLECs point in an effort to support the *Order* note that "[c]ertain circuits, such as special service [non-switched] circuits, *cannot be supported via an IDLC system.* In those instances where NGDLC is installed, BellSouth normally reserves some NGDLC capacity to support those special service circuits . . . *through a UDLC arrangement.*" BellSouth GA/LA Milner Aff. ¶ 119. Accordingly, *some* UDLC is required in the forward-looking network, and the *Order*'s 100% IDLC assumption is indefensible for this reason alone.[30/]

¶ 148; *BellSouth Five-State 271 Order* at 17625 ¶ 62; *Georgia/Louisiana 271 Order* at 9046 ¶ 50.

[30/] As Verizon VA explained in its application for review, the evidence showed that approximately ten percent of the network consists of non-switched services. *See* Tr. at 4160 (Gansert); VZ-VA Ex. 107 at 97-98. AT&T/WorldCom's challenge to that number fails since, contrary to AT&T/WorldCom's claims, the 10% figure includes only narrowband services that are properly considered for these purposes. *See* Tr. at 4160 (Gansert); VZ-VA AFR at 25 n.34.

4. The *Order* May Not Lawfully Eliminate the Obligation to Pay Reciprocal Compensation.

As Verizon VA explained in its application for review, where a CLEC hands off traffic to Verizon VA at an end office for termination to *Verizon VA's* customer, that CLEC must pay reciprocal compensation to Verizon VA for Verizon VA's own use of the switch to terminate that call. VZ-VA AFR at 27-29. AT&T/WorldCom argue, however, that the *Order* relieves them of that obligation. Specifically, they argue that "CLECs purchasing unbundled switching and paying the flat port charge for unbundled switching do not incur any reciprocal compensation obligation to Verizon for terminating the CLEC's traffic." AT&T/WCom Opp. at 72.

That interpretation of the *Order* is obviously misplaced and would lead to unlawful results in the scenario where a CLEC hands off traffic to Verizon VA to terminate to *Verizon VA's* customer. In this scenario, the flat-rated UNE-P switching charge does not compensate Verizon VA for the switching costs that *Verizon VA* incurs at the terminating end of the call. The flat-rated charge for end office switching paid by a UNE-P CLEC covers only the CLEC's use of the switch to *originate* the call; but Verizon VA must still use switching to terminate the call to its customer.[31/] The Act and the Commission's rules require CLECs to pay Verizon VA for the additional costs it incurs in terminating their traffic, and there is no question that Verizon

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In any event, the baseball arbitration rules required adoption of Verizon VA's 10% figure because AT&T/WorldCom failed to propose any other number.

31/ Nor does Verizon VA recover these termination costs from its own retail customer to whom it delivers the call: in the current calling party network pays regime, Verizon VA's retail rate are designed to recover the costs that Verizon VA incurs in *originating* its retail customer's calls. *See, e.g.,* Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610, 96245 ¶ 37 (2001) (noting that "current Commission rules" require compensation of the "called party's LEC for . . . the additional costs of terminating the call to the called party.") (*"Intercarrier Comp. NPRM"*).

VA incurs such additional costs when it uses its switch to terminate CLEC-originated traffic to its customers. [32]

AT&T/Worldcom do not dispute that carriers have a legal right to such compensation under the Act and the Commission's rules. They also do not dispute that Verizon VA incurs costs when terminating a CLEC's traffic. And as noted above, their argument that Verizon VA is "fully compensated for the costs of the switch through the port charge," AT&T/WCom Opp. at 73, is simply wrong. Further, AT&T/WorldCom concede that where they use their own switch to serve a customer who originates a call that terminates to a Verizon VA customer, they would owe Verizon VA reciprocal compensation for terminating that call. AT&T/WCom Opp. at 74 n.69. And in fact, AT&T and WorldCom do use their own switches in Virginia.[33] So, just as AT&T/WorldCom admit they owe Verizon VA reciprocal compensation to terminate a call in this scenario where they *own* the switch that is used to serve the customer who originates the call, so too they owe Verizon VA reciprocal compensation to terminate a call when they use originating unbundled switching to serve the customer who originates the call. Under either scenario, AT&T/WorldCom do not otherwise pay Verizon VA to terminate the call. Therefore,

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[32] *See* 47 U.S.C. § 251(b)(5); *Local Competition Order* at 16024-25 ¶ 1057, 16055 ¶ 1112; *Intercarrier Comp. NPRM* at 9624-37 ¶ 8 (2001) (noting that "current Commission rules" require compensation of the "called party's LEC for . . . the additional costs of terminating the call to the called party."); *see also* Order, *Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, FCC Docket No. 95-185, FCC-03-215, 2003 WL 22047787, ¶ 6 (rel. Sept. 3, 2003) (quotations omitted).

[33] *See, e.g.*, 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 (Aug. 1, 2002), Declaration of John Torre, Attachment 1 ¶¶ 24, 40.

under the Act and the Commission's rules, AT&T/WorldCom owe reciprocal compensation. For all these reasons, the *Order* was *required* to set a reciprocal compensation rate.

AT&T/WorldCom nonetheless argue that the Bureau is free to interpret the Commission's reciprocal compensation rules through adjudication. *See* AT&T/WCom Opp. at 73. But that misses the point. If interpreted the way AT&T/WorldCom suggest, the *Order* would be *reversing* the Commission's reciprocal compensation rules, not "*interpreting*" them.[34] Any such change must be made, if at all, within the context of the Commission's pending rulemaking on intercarrier compensation in which this issue has been specifically raised.[35]

Because the *Order* fails to establish the applicable charge, the Commission should approve the charge Verizon VA includes in its compliance filing and make clear that any interpretation of the *Order* that denies Verizon VA the right to impose such charges on carriers when Verizon VA terminates their traffic would be unlawful.

5. The *Order* Incorrectly Adjusted Verizon VA's Computation of Total Annual Minutes.

As Verizon VA explained in its application for review, the *Order*'s adjustment to Verizon VA's calculation of total annual minutes was unfounded and results in a significant

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[34] *See, e.g.*, *Air Transport Ass'n of Am., Inc. v. FAA*, 291 F.3d 49, 56 (D.C. Cir. 2002) ("As the United States Supreme Court has noted, APA rulemaking is required if an interpretation 'adopt[s] a new position inconsistent with . . . existing regulations.'") (quoting *Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 100 (1995)); *Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 117 F.3d 579, 586 (D.C. Cir. 1997) ("To allow an agency to make a fundamental change in its interpretation of a substantive regulation without notice and comment obviously would undermine th[e] APA['s] requirements.").

[35] *See Intercarrier Comp. NPRM* at 9624-37 ¶¶ 37-76. AT&T/WorldCom do not even try to defend the *Order* on the grounds that it imposes some form of a bill-and-keep arrangement — presumably because a true bill-and-keep arrangement would have to be symmetrical, and thus the CLECs could not collect a reciprocal compensation charge from Verizon VA for terminating *its* calls. *See* 47 C.F.R. § 51.711(a).

understatement of Verizon VA's tandem switching costs.[36] Verizon VA's cost studies determine the total number of minutes of use based in part on the calculation that 251 days out of a year experience usage levels equivalent to the average daily load during the busy season. No party challenged this calculation or proposed or justified an alternative. Nevertheless, the *Order* inexplicably and erroneously requires Verizon VA to assume *339* days — an assumption that is supported by no record evidence, that none of the parties even had an opportunity to address, and that is facially wrong.

AT&T/WorldCom acknowledge, as they must, that they did not propose the 339-day assumption adopted by the *Order*. Indeed, in rerunning Verizon VA's SCIS cost model, AT&T/WorldCom never adjusted the number of total minutes or the underlying input concerning the number of days *at all*, but instead use the same 251 days as Verizon. *See* AT&T/WorldCom Ex. 12 (Restated Workpapers). While AT&T/WorldCom claim that WorldCom somehow implicitly "objected" to the 251-day assumption, that "objection" consisted of nothing more than an isolated statement by a WorldCom witness that the method by which Verizon calculates total minutes in its switching cost studies has been a contentious issues in two *other* cases. *See* Direct Testimony of Chuck Goldfarb on Behalf of WorldCom, Inc. at 6 (July 31, 2001) ("WCom Ex. 5"). WorldCom's witness did *not* propose an alternative assumption, nor did WorldCom provide *any* evidence in *this* case that Verizon VA's figure was somehow wrong. *See id.*

AT&T/WorldCom also point to their use of 270 days in their modified universal service model, but this provides no support for the *Order*'s assumption of 339 days. *See* AT&T/WCom

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[36] Although this error does not affect the calculation of end office switching rates given the *Order*'s use of a flat rate structure, if the *Order*'s decision to adopt such a flat rate is reversed — as it should be — then the *Order*'s erroneous method of determining total minutes of annual use also would improperly reduce end office switching rates.

Opp. at 74. AT&T/WorldCom's proposed 270 days is closer to Verizon VA's 251 days than the *Order*'s 339 days. In any event, there is no justification for adopting AT&T/WorldCom's 270 days proposal. AT&T/WorldCom never offered any explanation as to why 270 days was more appropriate than 251 days and, notably, never suggested that this default figure should be used in Verizon VA's studies; as discussed, AT&T/WorldCom themselves did not use that number in their own reruns of Verizon VA's studies, and instead used Verizon VA's input of 251 days. *See* Surrebuttal Testimony of Steven Turner on Behalf of AT&T and WorldCom, Inc. at 5-6 (Sept. 21, 2001) ("AT&T/WCom Ex. 19"). In these circumstances, there simply was no basis for the *Order* to adopt an assumption of *339* days. At most, under the Commission's baseball arbitration rules, the *Order* should have chosen between 251 and 270 days. AT&T/WorldCom's assertion that somehow the "circumstances warrant[ed]" the *Order*'s departure from baseball arbitration rules. AT&T/WCom Opp. at 74. But a departure from the baseball arbitration rules would at most allow adoption of a figure *between* 251 and 270 days. It cannot justify, however, adopting the 339-day assumption, which is a vastly more extreme approach than *any* party proposed and which simply makes no sense, particularly given the absence of any record support.

While AT&T/WorldCom repeat the *Order*'s suggestion that the minutes of use in Verizon VA's study are lower than those reported in ARMIS, AT&T/WCom Opp. at 74-75, that alleged disparity is the result of two fundamental errors in the *Order*'s methodology. *See* VZ-VA AFR at 31 n.41. First, it used the wrong version of Verizon VA's switching studies to determine the number of tandem trunks in Verizon VA's network. AT&T/WorldCom do not even mention, let alone justify, this error. Second, as even AT&T/WorldCom concede, AT&T/WCom Opp. at 75 n.70, the 2001 ARMIS DEMs data on which the *Order* relies include

minutes that are unrelated to billable switched minutes and which therefore should have been excluded from the *Order*'s calculation. The problems in the *Order*'s methodology — which no party proposed or even had an opportunity to address — demonstrate the *Order*'s error in straying far beyond the record and adopting its own erroneous calculation rather than using Verizon VA's unchallenged input.

6. The *Order*'s Reduction in Switching Investment Costs Requires Adjustments to the EF&I Factor and Right-to-Use Costs.

EF&I. As the *Order* itself recognizes, "as material costs decline, the EF&I factor should increase." *Order* ¶ 525. Notwithstanding this acknowledgement, the *Order* fails to increase Verizon VA's EF&I factor even though it drastically reduces switching material investment costs by adopting discount levels well below those in Verizon VA's study. The result is to understate significantly Verizon VA's switching engineering, furnishing, and installation costs. VZ-VA AFR at 32-33.

AT&T/WorldCom's sole counter-argument is entirely non-responsive. They claim that "the EF&I factor is applied to the switch investment calculated to take into account the life cycle of Verizon's switches, including both new switches (with the associated new switch discount) and the growth additions added every two years. Applying the EF&I factor to switch investment that includes both new and growth switch equipment takes into account the range of switching equipment." AT&T/WCom Opp. at 76. As a threshold matter, as discussed above, the *Order*'s switch discount does *not* accurately reflect the discount levels over the "life cycle" of switches. But even leaving that aside, AT&T/WorldCom do not dispute that the effect of the *Order* is to *reduce* overall switching investment. And as the *Order* recognizes, in such circumstances "the EF&I factor [therefore] should increase." *Order* ¶ 525. This makes sense: applying the

unadjusted EF&I factor to the reduced investment would produce lower EF&I costs, even though Verizon VA's engineering, furnishing, and installation costs would *not* decrease merely because the switching equipment prices are assumed to be more heavily discounted. To render the EF&I factor accurate and fair, it must be increased to take into account the difference between the higher switching material costs used by Verizon VA to *calculate* the factor and the lower switching material costs ultimately adopted in the *Order*.

Right-to-Use Fees. The *Order*'s treatment of right-to-use ("RTU") fees is likewise flatly inconsistent with the *Order*'s assumption that 90% of switches would be bought at the new switch discount. The *Order*'s RTU fees primarily reflect the ongoing RTU fees associated with switch growth additions and upgrades, which are substantially lower than the RTU fees for the expensive initial software load that is required in connection with new switch purchases. *See* VZ-VA AFR at 33-34.

AT&T/WorldCom do not dispute that new switches incur substantially higher RTU fees than switch growth additions and upgrades. Instead, AT&T/WorldCom contend that the *Order*'s rejection of Verizon VA's evidence that new switch RTU fees are approximately $2 million per switch was appropriate because it was based on a contract between AT&T and Lucent and was allegedly "irrelevant to Verizon's costs." AT&T/WCom Opp. at 76. But *no* evidence in the record supports AT&T/WorldCom's assertion that Verizon VA's RTU fees for a new switch are somehow different from AT&T's. To the contrary, Verizon VA witnesses testified that $2 million is an appropriate estimate of the RTU fees associated with new switch purchases, and the $2 million figure is the *only* record evidence concerning the amount of new switch RTU fees. *See* VZ-VA Switching Br. at 23; VZ-VA Ex. 122 at 198-99. Given that no party disputes that

RTU fees for new switch purchases exceed ongoing RTU fees, the RTU figure must be increased to reflect the higher up-front RTU fees implicit in the *Order*'s 90% new switch assumption.

7. No Party Supported the *Order*'s Digital Line Port Utilization Rate.

The *Order* adopts the same fill factor for both analog and digital line ports, even though *all parties* proposed a *lower* fill factor for digital ports. *See* VZ-VA AFR at 34-35. Indeed, the fill factor the *Order* adopts for digital ports is higher than any party advocated.[37] There is no basis for this decision, and it should be reversed.

AT&T/WorldCom now try to defend the *Order*'s determination by pointing to a rerun that they performed of Verizon's switching model, in which they used the same fill factor for analog and digital line ports. *See* AT&T/WCom Opp. at 77. But to begin with, AT&T/WorldCom never even discussed this approach in their testimony; indeed, the testimony describing the relevant rerun makes no mention of the analog and digital line port fill.[38] Furthermore, the utilization rate that AT&T/WorldCom use in that rerun for both analog and digital line ports is 49.9% — substantially *lower* than the 93% fill that the *Order* adopts for both analog and digital line ports.[39]

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[37] *See* Verizon Ex. 107 at 195-196; Pitts Supplemental Surrebuttal, Supporting Workpapers "VA Sw Ports," Tab "Inputs," Lines 90-92.

[38] *See* Supplemental Surrebuttal Testimony of Catherine E. Pitts on Behalf of AT&T and WorldCom, Inc. at 13-14 (Nov. 20, 2001) ("AT&T/WCom Ex. 24").

[39] *See Order* n.1115; *see also* Pitts Supplemental Surrebuttal, Supporting Workpapers "VA Sw Ports," Tab "Inputs," Lines 90-92.

8. Growth Rates for Tandem Trunk Ports and Usage Should Be Identical.

The *Order* adopts a growth rate of 3% for tandem trunk ports but a 5% growth rate for tandem trunk minutes of use, even though it recognizes that "[t]here is a need for consistency between . . . the number of line ports, trunk ports, and minutes of use over which to spread the investment." *Order* ¶¶ 412, 417, 419. As the *Order* notes, "If there is an inconsistency, cost per unit may be overstated or understated." *Id.* ¶ 417. Indeed, the inconsistency in the *Order* here by itself results in a cost underrecovery in the tandem minute of use rate of approximately 13%.

AT&T/WorldCom do not address this determination. Instead, their sole response to Verizon VA's application for review is to parrot the *Order*'s erroneous suggestion that Verizon VA proposed different growth rates for tandem trunk ports and usage. *See* AT&T/WCom Opp. at 77. In fact, Verizon VA's tandem switching cost studies assume that tandem trunk ports and usage would *both* grow by 5% per year.[40] Using the same growth rate for tandem trunk ports and usage is the only logical approach. As Verizon VA explained in its application for review, assuming a higher growth rate for usage than for tandem trunk ports would require Verizon VA's tandem trunk facilities to process proportionately more and more traffic every year. *See* VZ-VA AFR at 35. The 41% difference in Verizon VA's study was between end office *line* minutes of use and end office *trunk* minutes of use, which had nothing to do with tandem switching at all.[41]

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[40] *See* Verizon Ex. 125P, Supporting Workpapers, Folder "VA EXCEL and WORD STUDIES," Folder "VA SWITCHING SUPPORT FILES," Folder "VA UNBUNDLED REC & SWITCH," Excel File "Backup VA MOUR-10-31 Part C-8," Worksheet "Tdm MOU," cells G9, G12, G14, G21.

[41] *See* Verizon Ex. 125P, CD "VZ-VA FCC ARB (Additional Cost Studies)," Folder "VA EXCEL and WORD STUDIES," Folder "VA SWITCHING SUPPORT FILES," Folder "VA UNBUNDLED REC & SWITCH," Excel File "Backup VA MOUR-10-31 Part C-8," Worksheet "EO MOU," cells C58 and C60.