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March 1, 2004

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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 of Verizon's Application for Review of Compliance Order. The attached documents are the public versions; a proprietary version of Verizon's Application for Review of Compliance Order 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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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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

In the Matter of In the Matter of Petition of WorldCom, 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 No. 00-218
In the Matter of Petition of 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 No. 00-251

VERIZON VIRGINIA INC.'S APPLICATION FOR REVIEW OF COMPLIANCE ORDER

Pursuant to 47 C.F.R. § 1.115(a), Verizon Virginia Inc. ("Verizon VA") respectfully submits this Application for Review of the Wireline Competition Bureau's January 29, 2004 Memorandum Opinion and Order[1] (the "*Compliance Order*") as a precautionary measure to ensure its right to Commission review of the Bureau's determinations in this proceeding. Verizon VA previously submitted an Application for Review of the Bureau's August 29, 2003

[1] *See* Memorandum Opinion and Order, *Petitions of WorldCom, Inc. and AT&T Comm. 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 Nos. 00-218, 00-251 (rel. Jan. 29, 2004).

Memorandum Opinion and Order[2/] (the "*August Order*") in this same proceeding. The rates contained in the *Compliance Order* are the product of the various determinations the Bureau made in the *August Order* concerning the choice of models, inputs, and other assumptions; as such, the *Compliance Order* is nothing more than ministerial. *See, e.g., Compliance Order* ¶ 3 (order merely determines the parties' filed rates' "compliance with the Cost Order" and does not "relitigate an[y] issue resolved in [that] order"). As a result, a separate application for review of the *Compliance Order* should not be necessary.

Nevertheless, in an abundance of caution,[3/] Verizon VA is filing this application for review of the *Compliance Order* and hereby incorporates by reference its Application for Review and Reply in Support of Its Application for Review of the *August Order*, both of which are attached. As Verizon VA showed in its application, the determinations in the *August Order* are erroneous in numerous respects -- they violate both the Act and the Commission's TELRIC rules, are arbitrary and capricious, and create new artificial subsidies that will hamper the development of facilities-based competition. Because the *Compliance Order* implements those errors, it too should be reversed for the reasons Verizon VA previously provided.

2/ *See* Memorandum Opinion and Order, *Petitions of WorldCom, Inc. and AT&T Comm. 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 Nos. 00-218, 00-251 (rel. Aug. 29, 2003).

3/ AT&T/WorldCom, for example, have taken the erroneous position that Verizon VA's application for review of the *August 29 Order* was "premature" with respect to all-non loop issues until the non-loop rates were set. *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 5 (Oct. 14, 2003).

Submitted by

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Dated: March 1, 2004

CERTIFICATE OF SERVICE

I do hereby certify that true and accurate copies of the foregoing, Verizon Virginia Inc.'s Application for Review of Compliance Order, were served by hand delivery via courier this 1st day of March, 2004, to:

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Before the
FEDERAL COMMUNICATIONS COMMISSION
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VERIZON VIRGINIA INC.'S APPLICATION FOR REVIEW

(Public Version)

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Before the
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Washington, D.C. 20554

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VERIZON VIRGINIA INC.'S APPLICATION FOR REVIEW

Pursuant to 47 C.F.R. § 1.115(a), Verizon Virginia Inc. ("Verizon VA") respectfully submits this Application for Review of the Wireline Competition Bureau's August 29, 2003 Memorandum Opinion and Order (the "*Order*").[1/]

SUMMARY AND INTRODUCTION

The Commission should reverse the *Order*. The *Order* improperly prejudges decisions that are now pending before the Commission and adopts extreme assumptions and inputs that are

1/ *See* Memorandum Opinion and Order, *Petitions of WorldCom, Inc. and AT&T Comm. 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 Nos. 00-218, 00-251 (rel. Aug. 29, 2003).

contrary to both Commission precedent and the record. Indeed, in order to reduce rates, the *Order* goes so far as to modify inputs *not* contested by any party, and in some cases adopts inputs that are more extreme than were proposed by any party and consequently produces rates that are lower than those proposed by any party. Moreover, the *Order* manipulates other inputs in a manner that state commissions have condemned as a way to "twice-TELRIC[]" rates by "double counting the TELRIC" reductions to expenses, and then goes on to effectively "triple TELRIC" those expense reductions. And the *Order* omits still other adjustments that even it recognizes are necessary. For all these reasons, the *Order* violates the Commission's rules and basic principles of administrative law.

As an initial matter, the *Order* prejudges major policy issues now under consideration by the full Commission and does so in ways that are inconsistent with existing rules. For example, the *Order* adopts a radical flat-rate structure for end office switching that is contrary to existing Commission precedent, that even AT&T did not support because it fails to properly align rates with costs, and that creates new subsidies from low usage customers to the high volume customers that CLECs typically target. The *Order* also requires that most non-recurring costs be recovered on a recurring basis, even though that too is contrary to existing rules and would force Verizon VA to serve as the CLECs' banker and to subsidize any CLECs that fail to retain customers long enough to pay off the loan.

Furthermore, the *Order* adopts radical assumptions that also are contrary to Commission precedent. To cite just a few examples, the *Order* assumes that more than 90% of all switching equipment can be purchased at new switch discounts of up to 99% off list price, even while simultaneously recognizing that no rational manufacturer could possibly offer such discounts if carriers bought predominantly new switches. The *Order* assumes that all fiber-fed loops in all locations use integrated digital loop carrier even though no currently available technology permits the use of that technology to unbundle loops. 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 unsubstantiated and demonstrably erroneous ratios between basic 2-wire loops and high capacity loops. The *Order* also adopts a non-recurring cost model that simply assumes away many of the tasks necessary for Verizon VA to process CLEC orders.

And the *Order* changes inputs that no party challenged and adopts inputs that are substantially more extreme than any party proposed. In the case of switching, for example, the *Order* sets the digital port fill factor at the same level as the analog port fill factor, even though *all* parties agreed that the fill factor for digital ports should be significantly lower than the fill for analog ports. The effect is to lower the costs of switching for fiber-fed lines substantially. Similarly, the *Order* significantly increases the total annual minutes of use over which investment is spread, and therefore reduces switching rates, by radically increasing the number of days that are assumed to experience peak usage in Verizon VA's studies. Yet *no* party challenged this input, and *no* alternative was proposed in the record.

The effect of these and other errors is to slash rates dramatically. For example, preliminary runs of cost studies show that the *Order* will produce end office switching rates that are by far the lowest in effect in any of the 31 jurisdictions where Verizon provides local service, roughly sixty percent lower than the existing rates that this Commission has found TELRIC-compliant, and result in the non-loop portion of the UNE-P being about one-third lower than what even AT&T proposed here. The residential UNE-P rate in zone 1, which is where approximately three-quarters of customers are located, is the *second 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.

The *Order* does all of this even though the Commission found the existing rates in Virginia to be TELRIC-compliant less than one year ago in connection with its review of Verizon VA's 271 application. And those existing rates themselves are the product of significant reductions that were made to meet this Commission's benchmark standard compared to New York. Thus, the current rates *already* are equal to, and in the case of the so-called UNE-P, *lower* than, the corresponding rates in New York — a state that itself has applied TELRIC aggressively.

The Commission should not permit this continued race to the bottom. The *Order*'s determinations are in numerous respects contrary to applicable precedent and the record evidence, and are arbitrary and capricious. Moreover, although Verizon VA moved to permit the parties to supplement and update the record almost one year ago and subsequently filed a formal Proffer of Supplemental Evidence, the Bureau declined to consider it. As a result, the *Order* is based on a stale and incomplete record. Because of these errors, the *Order* increases existing subsidies and creates all-new ones for CLECs that rely on UNEs, thereby discouraging the development of facilities-based competition. Indeed, as a result of the prior rate reductions in Virginia, competitors already have shifted from their previous reliance on facilities they have deployed themselves to reliance on UNE-P at subsidized rates. The *Order* would significantly exacerbate that trend. For all these reasons, the *Order* should be reversed.

ARGUMENT

The *Order* moves in precisely the wrong direction. At a time when the Commission is trying to reform its rules to eliminate artificial subsidies in order to promote efficient competition, the rates resulting from the *Order* would create new subsidies, increase existing ones, and thereby encourage reliance on Verizon VA's network rather than investment in competing facilities. It would be particularly irrational to implement the *Order* now because it pushes TELRIC to radical new extremes that are inconsistent even with existing rules and that further exacerbate the very flaws in TELRIC that the Commission has identified and is seeking to reform in its pending rulemaking. 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*.[2/]

In its *TELRIC NPRM*, the Commission explained that TELRIC embodies a "central internal tension" because it "purports to replicate the conditions of a competitive market by assuming that the latest technology is deployed throughout the hypothetical network, while at the same time assuming that this hypothetical network benefits from the economies of scale associated with serving all of the lines in a study area." *TELRIC NPRM* ¶ 50. The Commission noted that this internal inconsistency "may work to reduce estimates of forward-looking costs below the costs that would actually be found even in an extremely competitive market. It therefore may undermine the incentive for either competitive LECs or incumbent LECs to build new facilities, even when it is efficient for them to do so." *Id.* ¶ 51.[3/] The Commission further

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2/ 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 (rel. Sept. 15, 2003) ("*TELRIC NPRM*"), Separate Statement of Commissioner Martin at 1.

3/ *See also id.* ¶ 3 ("To the extent that the application of our TELRIC pricing rules distorts our intended pricing signals by understating forward-looking costs, it can thwart one of the central purposes of the Act: the promotion of facilities-based competition.").

explained that the "excessively hypothetical nature of the TELRIC inquiry" renders it a "black box" that is "difficult to reconcile with our desire that UNE prices send correct economic signals." *Id.* ¶ 7. As a result, the Commission tentatively concluded that its "TELRIC rules should more closely account for the real-world attributes of the routing and topography of an incumbent's network." *Id.* ¶ 52.

The Commissioners themselves have echoed these conclusions. For example, Chairman Powell has correctly recognized that the TELRIC rules are "subsidized and below costs," "distort a competitor's decision whether to invest in new facilities," and need to be changed to "an approach grounded in the real-world attributes of the incumbent's network."[4/] Commissioner Martin has explained that the rules need to be adjusted to "more accurately reflect incumbent costs and help spur deployment in new facilities and services." *TELRIC NPRM*, Separate Statement of Commissioner Martin at 1. Commissioner Abernathy has pointed out that the current pricing standard is "excessively hypothetical," "sends inappropriate investment signals and produces irrational pricing." *Id.*, Separate Statement of Commissioner Abernathy at 1. And Commissioner Adelstein has acknowledged that the rules may need to be changed to "more closely account for certain real-world factors." *Id.*, Separate Statement of Commissioner Adelstein at 1.

Likewise, in a Policy Paper accompanying the *TELRIC NPRM*, Commission Staff has concluded that TELRIC requires reform in order to ensure appropriate cost recovery. As the paper states, "if investment costs are falling over time, and the period between TELRIC price adjustments is shorter than asset lives, then traditional TELRIC pricing will not permit

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4/ Jeremy Pelofsky, *FCC Chief Denies Leaving, Outlines Media Agenda*, Star-Ledger, Aug. 19, 2003; *TELRIC NPRM*, Separate Statement of Chairman Powell at 1.

incumbents to recover the cost of their investment."[5] And this shortfall is substantial: "When investment costs are falling by 11% per year (as is assumed for switching assets in the FCC Synthesis Model), the TELRIC correction factor is approximately *50%*. That is, switching prices should be increased by *50%* from those suggested by Synthesis Model runs." OSP Working Paper at 43.

Given all of this, it would be inherently arbitrary and capricious to endorse rates that not only are based on admittedly flawed rules, but that repeatedly are based on extreme approaches that are both inconsistent with existing rules and that inexorably drive rates lower still. This is especially true when the Commission found the existing rates to be TELRIC-compliant less than a year ago, and the *Order* would drive rates substantially below even TELRIC. Given that the existing rates already do not "send correct economic signals," "undermine the incentive for either competitive LECs or incumbent LECs to build new facilities," and are "below the costs that would actually be found even in an extremely competitive market," it would make no sense to reduce rates even more as the *Order* would do.

That is particularly true because the *Order* not only exemplifies the flaws in TELRIC that the Commission has identified, but goes beyond them. To take just one example, the *Order* assumes that 100% of all fiber-fed loops use IDLC-GR-303 technology even though, as the Commission has noted, "[e]ven if the objective is to replicate the results of a competitive market, an approach that reconstructs the network over time seems to be more appropriate than one that

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5/ David M. Mandy & William W. Sharkey, "Dynamic Pricing and Investment from Static Proxy Models," FCC, Office of Strategic Planning and Policy, OSP Working Paper Series No. 40, at 1 (Sept. 2003) ("OSP Working Paper"); *see also id.* at 1-2 ("Indeed, when investment costs are falling over time and TELRIC price reviews are conducted at intervals shorter than expected asset lives, the firm will earn less than its target rate of return under traditional implementations of TELRIC.").

assumes the instantaneous deployment of 100 percent new technology." *TELRIC NPRM* ¶ 68. But the *Order* wanders further into the hypothetical by basing this 100% IDLC-GR-303 input on the assumption that this technology can be used to unbundle standalone loops, based on the theory that it might be "technically feasible" to develop such a capability in the future, even though no such capability is yet "currently available" as the Commission's current rules require.

The *Order* further compounds TELRIC's inability to send appropriate economic signals through its refusal even to consider directly relevant supplemental evidence that Verizon VA sought to introduce almost a year before the *Order* was issued — evidence that would have showed that many of the assumptions on which the Bureau's *Order* is based are outdated and unsupportable.[6] That evidence was critical to ensuring that the decision in this case was based on relevant and updated information. The market, legal, and regulatory landscapes changed dramatically in the nearly two years after the cost studies before the Bureau were completed (based on data that now is over three years old), and in the nearly year and one-half after the

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[6] *See* Verizon Virginia Inc.'s Motion to Permit Parties to Supplement the Record (Nov. 22, 2002); Verizon Virginia Inc.'s Proffer of Supplemental Evidence (Apr. 15, 2003) ("VZ-VA Proffer"). The *Order*'s suggestion that accepting Verizon VA's evidence would have resulted in delay, *Order* ¶ 21, is belied by the facts that the *Order* was issued almost a full year after Verizon VA's initial motion to permit the parties to supplement the record and that the *Order* has now expressly *invited* AT&T/WorldCom to submit additional record evidence concerning non-recurring costs. Similarly, the Bureau's insistence that it could not have considered Verizon VA's evidence without providing the parties and staff an opportunity for discovery and cross-examination, *id.* ¶ 23, is completely at odds with its apparent willingness to permit AT&T/WorldCom to devise and submit new cost proposals *without* providing Verizon VA an opportunity to respond. As the courts have explained, "[a]n agency acts arbitrarily and capriciously when it unjustifiably discriminates between similarly situated parties." *Ramapough Mt. Indians v. Babbitt*, Civ. No. 98-2136, 2000 U.S. Dist. LEXIS 14479, at *21 (D.D.C. Sept. 30, 2000).

hearings ended in this proceeding. By failing to consider relevant evidence, the *Order* exacerbated the current flaws in TELRIC and committed reversible error.[7]

In these circumstances, implementing the *Order* would be irrational and unlawful. For all the reasons outlined in Verizon VA's accompanying Stay Petition, the Commission should simply stay the *Order* until it reforms its TELRIC rules. But even if the Commission were to choose not to wait until its underlying rules are corrected, it should reverse the *Order* and make the numerous corrections necessary so that the resulting rates are at least as economically rational as the current TELRIC rules permit.

I. RECURRING COSTS

A. Switching

The *Order*'s determinations about switching costs prejudge issues pending before the full Commission and rest on extreme assumptions that are contrary to Commission precedent and the record. The result of the *Order* is to drastically slash switching rates so that they are the lowest in any of the thirty-one jurisdictions where Verizon provides service, roughly sixty percent lower than the level the Commission previously found TELRIC-compliant, and result in the non-loop portion of the UNE-P being about one-third lower than the rates AT&T proposed (and lower even than what WorldCom proposed as well). And this dramatic reduction produces a residential UNE-P rate in zone 1, where approximately three-quarters of the customers are, that is the second lowest rate in any Verizon jurisdiction for any comparable zone. These extremely

[7] *See, e.g.*, *United Mine Workers of Am. v. Dole*, 870 F.2d 662, 673 (D.C. Cir. 1989) (failure to supplement the record may raise serious doubts "about whether the agency chose properly from the various alternatives open to it"); *see also Radio-Television News Dirs. Ass'n v. FCC*, 184 F.3d 872, 888 (D.C. Cir. 1999) ("The FCC retains discretion to . . . reopen the record, to ensure that it fully accounts for relevant factual and legal developments . . . .").