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April 29, 2004

**Ex Parte**

Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

**Re: 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**

Dear Ms. Dortch:

On April 29, 2004, Dr. Howard Shelanski (a Verizon economic consultants), Samir Jain of Wilmer, Cutler & Pickering, Leslie Owsley, Maggie McCready and the undersigned met with Steve Morris, Jeremy Marcus, Alvaro Gonzalez, Marvin Sacks, Dick Kwiatkowski, Jeff Carlisle, Tamara Preiss and Martin Perry to discuss Verizon's position regarding the appropriate UNE pricing methodology, which is at issue in the above referenced docket. The attached presentations were used as a basis for discussion during the meeting.

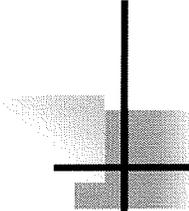
Consistent with Commission rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-referenced proceedings.

Sincerely,

A handwritten signature in cursive script that reads "Donna Epps".

**Attachment**

cc: J. Carlisle  
T. Preiss  
J. Marcus  
S. Morris  
M. Sacks  
A. Gonzalez  
M. Perry  
D. Kwiatkowski



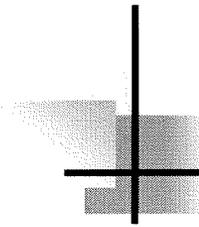
# Practical Application of Actual Forward-Looking Costs

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**Maggie McCready**  
Executive Director  
Financial Planning & Analysis

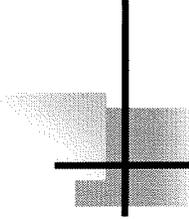
April 29, 2004



# Actual Forward-Looking Costs

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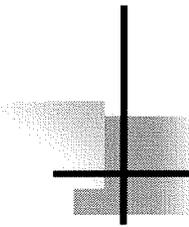
- ▼ The development of “actual forward-looking costs” will be based on a combination of the characteristics of the existing network and realistic adjustments for planned future deployments and network efficiencies.
- ▼ It is not an embedded approach, nor is it a complete replacement of every piece of equipment residing in the current in-place network.
- ▼ Cost development is a two-step process:
  - Determine the forward looking network architecture
  - Determine the cost of that network based on inputs which reflect the realistic costs that the carrier experiences and expects to experience going forward



# Network Layout

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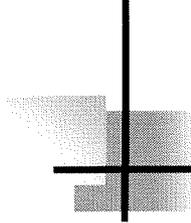
- ▼ Based on actual ILEC records, use the current locations of:
  - Customers or terminal locations
  - Wire Centers and number of lines served
  - Distribution Areas (DA)
  - Remote Terminal Serving Areas (RTSA)
  
- ▼ Using Engineering Guidelines, determine locations of:
  - Digital Loop Carriers (DLCs)
  - Serving Area Interfaces (SAIs)
  - Cable routes
    - ✓ Road maps or minimum spanning trees with route adjustment / road factors
    - ✓ Efficient cable sizing



## Network Layout (cont.)

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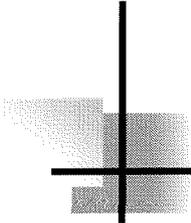
- ▼ Start with the technology mix being used today and adjust to reflect the deployments the ILEC expects to make over the course of a realistic engineering planning period.
  - Structure Mix (aerial, buried, underground)
  - Integrated Digital Loop Carrier (IDLC) versus Universal Digital Loop Carrier (UDLC) line interfaces
  - GR303 versus TR08 IDLC digital line terminations
  
- ▼ For central office circuit switching, design typical offices based on combinations of 4 actual characteristics:
  - Switch Vendor
  - Office Line Size
  - Busy Hour CCS per line and line concentration ratio
  - Host/Remote configurations



# Cost Inputs

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- ▼ Determine appropriate realistic cost of the network, based on inputs the carrier expects to experience for:
  - Cost of capital
  - Depreciation rates
  - Structure sharing
  - Material prices (including effective vendor discounts)
  - Capitalized costs to engineer and install
  - Utilization
  - Operating expenses
  - Nonrecurring costs
  - Demand



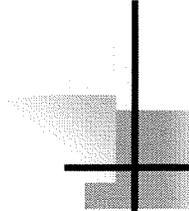
# Actual Forward-Looking Economic Costs

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**Dr. Howard Shelanski**  
University of California  
at Berkeley

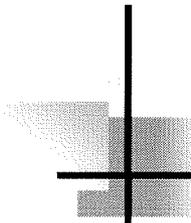
**April 29, 2004**



# Forward-Looking Economic Costs (FLEC) should be based on real-world networks

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- ▼ Using real-world networks sends the correct pricing signals to CLECs and ILECs alike.
- ▼ ILECs' competitive and regulatory incentives to act efficiently mean that real-world FLEC reflects efficient network design and operation.
- ▼ And even if a CLEC can be more efficient, then it will have an incentive to build rather than lease.



## Two approaches to real-world FLEC

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- ▼ Replacement or Revaluation Approach: use the current cost of deploying the actual mix of facilities in the network, adjusted to account for anticipated changes during a reasonable engineering or planning period.
- ▼ Actual Long-Run Incremental Cost Approach: estimate the actual costs the ILEC will incur for the facilities it plans to purchase over the planning period, including the appropriate share of fixed, joint, and common costs.

# ILECs have strong incentives to manage their networks efficiently

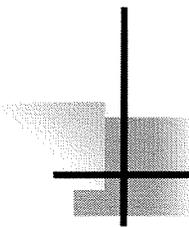
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- ▼ Competition has been strongest in the ILECs' most lucrative markets, providing strong incentive for ILECs to cut costs.
- ▼ Increasing inter-modal competition – e.g., from cable, wireless, and IP telephony – makes it impossible for ILECs to remain viable with inefficient networks.
- ▼ ILECs do not have their heads in the sand: they know these things and manage their networks accordingly.

# Unbundled Network Elements must be priced correctly at FLEC

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- ▼ Transition to broadband does not mean narrowband facilities have no value or should be priced at less than forward-looking economic cost.
- ▼ To price facilities below FLEC would be to bias service providers towards their use and to distort efficient technological migration.
- ▼ If narrowband facilities are not the right ones to use going forward, then entrants can decide not to buy UNEs. Pricing should not be set to alter that decision.
- ▼ ILECs continue to invest in and upgrade their narrowband facilities and they continue to have substantial economic value looking forward.



## Planning periods should be tied to reasonable predictions of future technology

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- ▼ UNE prices based on real-world networks should be forward-looking, and should look only as far forward as network technology can reasonably be predicted.
- ▼ The network will reflect a mix of technologies going forward, and it would be incorrect to base prices on a model that artificially assumed full deployment of the most advanced, foreseeable technology. Prices should be based on the actual technological mix only as far in the future as that mix can credibly be predicted.
- ▼ The engineering planning periods of ILECs, IXC's and other telecommunications networks provide useful guidelines for setting such a planning period.

# FLEC reflects both static and dynamic efficiency considerations

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- ▼ UNE prices should advance “static” efficiency by ensuring that current network resources are used efficiently – i.e., that UNE buyers pay the full costs of the resources they use and UNE providers are not forced to waste resources to provide services.
- ▼ But UNE prices must also advance “dynamic” efficiency by preserving proper investment decisions for ILECs and CLECs alike, so that future networks provide consumers with the best mix of technologies and the greatest benefits of facilities-based competition.