IN THE SUPREME COURT OF FLORIDA

CASE NUMBER: SC02-2647

VERIZON FLORIDA, INC.

Appellant & Cross Appellee

v.

LILA A. JABER, et al.

Appellees & Cross Appellee

and

AT&T Communications of the Southern States, LLC

Cross Appellant

v.

LILA A. JABER, et al.

Appellees & Cross Appellee

On Appeal from the Florida Public Service Commission
Docket No. 990649B-TP

REPLY BRIEF AND BRIEF ON CROSS APPEAL

Tracy W. Hatch
Florida Bar No. 449441
AT&T Communications of the Southern States, LLC
101 N. Monroe St., Suite 700
Tallahassee, FL 32301
Phone: 425-6360
Fax: 850-425-6361

Norman H. Horton, Jr.
Florida Bar No. 156386
Messer, Caparello & Self, P.A.
P.O. Box 1876
Tallahassee, FL 32302
Phone: 850-222-0720
Fax: 850-224-4359

Attorneys for AT&T Communications of the Southern States, LLC

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STATEMENT OF CASE AND FACTS

On May 26, 1999, the FPSC issued Order No. PSC-99-1078-PCO-TP which granted in part and denied in part a petition filed by the Florida Competitive Carrier Association of which AT&T is a member. The Commission action resulted in the establishment of a docket to investigate the pricing of Unbundled Network Elements ("UNEs") for the major incumbent providers, including Verizon. The docket initially progressed with the three carriers combined but eventually the Commission separated BellSouth from Verizon and Sprint and proceeded with an "A" docket for BellSouth and a "B" docket for Verizon/Sprint (R. p. 188). Thereafter parties prefiled direct, rebuttal and surrebuttal testimony addressing the issues established by the Commission. AT&T and other competitive carriers jointly sponsored witnesses and filed joint prehearing statement and other documents, but participated in the proceeding as a separate party. (The Commission refers to the group of AT&T and others as the "ALEC Coalition").

The Commission was hearing this case because the federal Telecommunications Act of 1996 provides that when incumbents and competitive carriers are unable to agree to prices for UNEs, the state commission sets a just and reasonable and nondiscriminatory rate for each UNE. 47 U.S.C. § 251. The standards for states to use were established in rules adopted by the FCC and found in 47 C.F.R. § 51.501 et seq. The use of total element long run incremental cost ("TELRIC") as the

methodology and the authority to apply these standards on a state basis was upheld in AT&T v. Iowa Utilities Board, 525 U.S. 366 (1999). The specific pricing rules adopted by the FCC based on the TELRIC methodology was subsequently upheld in Verizon Communications, Inc. v. FCC, 535 U.S. 467 (2002). UNE rate levels are critical to competitive carriers and to the development of local competition. Without access to UNEs incumbents such as Verizon can effectively impede entry by competitive carriers. The future of local competition is directly related to UNE rates because it is these rates that will determine whether entrants have access to the network so critically needed by new providers. The Commission held a hearing in April 2002 and subsequent to the hearing parties filed posthearing briefs. At a special agenda conference October 17, 2002 (R. p 2643) the Commission reviewed and discussed the recommendation presented by Commission Staff and voted on the issues in the case. The result of that vote is reflected in Order No. PSC-02-1574-FOF-TP issued November 15, 2002. On December 2, 2002, AT&T and MCI filed a Motion for Reconsideration pursuant to Rule 25-22.060, Florida Administrative Code and on December 16, 2002, Verizon filed a Notice of Appeal. Since there was a pending Petition for Reconsideration, the appellate process was stayed. On June 2, 2003 after withdrawing the Petition for Reconsideration AT&T filed a Notice of Cross Appeal. On July 7, 2003, the PSC issued an order acknowledging the withdrawal.

SUMMARY OF ARGUMENT

Verizon's points on appeal of the Commission order are little more than a dispute over the weight given the evidence by the Commission and an effort to have this Court substitute its judgment for that of the Commission.

However, on the Cross Appeal issue raised by AT&T the cost model filed by Verizon fails to comply with the FCC's pricing rules as it does not model the least cost most efficient network design. Given this flaw the model does not produce, and cannot be used to produce UNE rates that are reasonable.

I.

VERIZON HAS FAILED TO SHOW THAT THE COMMISSION ORDER ON COST OF CAPITAL, DEPRECIATION AND LOADING FACTORS IS NOT BASED ON THE RECORD.

As a cross appellant, AT&T agrees with Verizon that the Commission order should be reversed but disagrees that reversal is required by the issues raised by Verizon in their brief. The argument presented by Verizon is that, as to cost of capital, depreciation and load factors, the Commission relied upon information outside the record for the basis of their decision and that the commission ignored calculation errors thus leading in incorrect computations. Since the responses to the points raised by Verizon are similar, AT&T is replying to them collectively.

In support of its position, Verizon offers numerous citations to the agenda conference and discussions between staff and the Commissioners. While the references are accurate, Verizon does not fully describe the full scope of the discussions that took place between Staff and the Commissioners on these issues. If these discussion and the underlying support are fully reviewed, it will be clear that the Commission order, as to these points, is not arbitrary or capricious. Verizon is simply asking this Court to re-weigh the evidence and change the Commission's mind — something the Court has repeatedly refused to do and which §120.68(7), Florida Statutes, says the Court should not do. Gulf Power Co. v. Florida Public Service Commission, 453 So. 2d 799 (Fla. 1984); Citizens v. Public Service Commission, 425

So. 2d 784 (Fla. 1983); Citizens v. Public Service Commission, 425 So. 2d 534 (Fla. 1982); Shevin v. Yarborough, 247 So. 2d 505 (Fla. 1973).

Verizon takes issue with the Commission's decision on cost of capital only with respect the FPSC relied on the testimony submitted by witness Draper of the PSC. During the hearings the Commission received cost of capital testimony from four (4) witnesses; one from Verizon, two from ALEC intervenors and one from Staff (Order, p. 78). These witnesses recommended forward looking cost of capital from 8.5% to that of Verizon at 12.95%. (Order p. 88). The cost of equity used by the four witnesses had a similar range from a low of 10% to a high of 14.75% as proposed by Verizon. (Order p. 88). Each of the witnesses was subjected to questions on deposition and at the hearing. During the agenda there was substantial discussion of the testimony presented by witness Draper but ultimately the Commission made a decision which is reflected in their order. In reaching their decision, the Commission gave full consideration to the testimony and exhibits presented by the four witnesses (Order pp. 78 - 88). Not surprisingly, the witnesses do not necessarily agree with each other but the Commission, upon review of the evidence, found witness Draper's companies a reasonable proxy (Order p. 83); growth rates for his DCF analysis appropriate (Order p. 83) and his use of cost of equity models more appropriate than the single models used by other witnesses (order p. 84). In their conclusion, the Commission found witness Draper's cost of capital to be "forward-looking" and

accepted his proposal (Order p. 87). Verizon may not like the result; neither does AT&T for the result should have been lower, but the Commission made an evaluation and a decision based on that evaluation and there is no basis for reversal.

Verizon also takes exception to the Commission's decision with respect to the depreciation lives used in the decision. It was the Commission's decision to use depreciation inputs approved for BellSouth in Order PSC-01-1181 as a compromise (Order p. 75).

To support their position Verizon again provides several agenda transcript citations but they do not provide a comprehensive picture. Throughout the discussion of depreciation lives, Staff and Commissioners expressed concern with the Verizon proposal, and both expressed concern that what Verizon had presented was not supported by the record and that Verizon had not met their burden (Agenda Tr. pp. 42, 44, 49, 51, 52). At one point, Staff affirmatively advised the Commission that they could require Verizon to re-run their studies because of this failure (Tr. p. 50). The Commission was concerned with lack of support put forth by Verizon and addressed this in their Order acknowledging their quandary (Order p. 75). Rather than restart the process however, the Commission opted for a proposal put forth by the ALEC witness and moved forward.

Again, the decision is not to the liking of Verizon but they did not meet their burden and the Commission was correct to incorporate an alternate as presented by

a party. Verizon was given an opportunity to support their position and having failed to do so should not now be heard to complain. Florida Public Service Commission v. Florida Waterworks Association, 731 So. 2d 836 (1 DCA 1999); Sunshine Utilities v. Fla. Pub. Svc. Comm., 577 So. 2d 663 (1 DCA 1991); South Florida Natural Gas Co. v. Florida Public Service Commission, 534 So. 2d 695 (Fla. 1988); Florida Power Corp. v. Cresse, 413 So. 2d 1187 (1982).

Finally, after having argued that the Commission erred by making decisions on extra record basis, Verizon now suggests that the Commission improperly failed to consider points raised in a extra-record letter filed by Verizon which raised "calculation errors."

After the Commission Staff filed its recommendation, Verizon filed an extra-record letter and schedules with the Executive Director of the PSC raising what Verizon alleged were calculation errors. The Commission granted a Motion to Strike the extra-record letter filed by AT&T and other parties and Verizon now argues that the Commission should have considered these extra-record statements.

The Commission's disposition of this letter was entirely proper and appropriate. Verizon attempted to present positions which had not been subjected to review and cross examination and tried to bypass the established procedure to their advantage and to the detriment of AT&T and other parties. The record in this case was closed and the Commission rightfully declined to accept this effort by Verizon to add evidence.

Florida Bridge Co. v. Bevis, 363 So. 2d 799 (FLA. 1978). Furthermore, if Verizon felt there were calculation mistakes in the final order, the Commission rules establish an opportunity for parties to bring to the attention of the Commission such mistakes pursuant to Rule 25-22.060, Florida Administrative Code, Motion for Reconsideration. Verizon had the opportunity to seek correction of these errors through a Petition for Reconsideration and AT&T and others could have responded. Instead Verizon sought to bypass the process and deprive parties an opportunity to respond by filing a letter and they are now complaining because they were not successful in grabbing the cookies. The issue is whether the Commission correctly granted the Motion to Strike and that it is clear that they did.

II.

THE COST STUDY UTILIZED BY VERIZON IS NOT A TELRIC STUDY AND THE COMMISSION ERRED IN UTILIZING THE STUDY AND THE RATES DEVELOPED USING THE STUDY.

Although the Commission did have sufficient record information for those portions of the order challenged by Verizon, the order is deficient in other respects and should be reversed. Specifically, the cost model used by Verizon is not TELRIC compliant and thus not sufficient for use to set UNE rates. By using a cost study which does not meet the requirements of the FCC, the Commission has allowed the establishment of rates which are noncompliant and it is this which distinguishes the issue raised by AT&T from those raised by Verizon. Verizon argues that the Commission should have given more weight to their witnesses whereas it is the position of AT&T that the study relied upon by Verizon is deficient as a matter of law and any rates developed using this deficient study are erroneous and the order must be reversed, §120.68(7), Florida Statutes.

Network elements are used by competitive carriers to provide services to their customers thus the rate which they pay to the incumbent, such as Verizon, is critical to the ability to enter and remain in the competitive telecommunications market. If the rate is too high it can bar entry and there will be no competition and no benefits to the consumers. The Telecommunications Act of 1996 (Pub. L. No. 104-104) directs state commissions to set just, reasonable and nondiscriminatory rates for interconnection

or the lease of network elements. Those rates are to be based on the cost of providing the network element and may include reasonable profit (47 U.S.C. §252(d)(1)) however, the rate must be determined without reference to a rate-of-return or other rate-based process. The FCC determined that costs should be the forward-looking economic cost of an element as the sum of the total element long-run incremental cost (TELRIC) of the unbundled network element and a reasonable allocation of forward-looking common costs. (47 C.F.R. §51.505(a)).

The authority of the FCC to promulgate rules applicable instates was addressed and upheld in AT&T Corp. v. Iowa Utilities Board, 525 U.S. 366 (1999) and the pricing rules adopted by the FCC utilizing the TELRIC methodology were upheld in Verizon Communications Inc v. FCC, 535 U.S. 467 (2002). TELRIC is defined in 47 C.F.R. § 51.505(b) as:

> The total element long-run incremental cost of an element is the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's provision of other network elements.

The FCC defines Efficient Network Configuration in §51.505(b)(1) to be:

> [t]he total element long run incremental cost of an element should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers.

This provision is typically known as the "scorched node" approach to TELRIC

network design. Under this provision, the network designed by a TELRIC compliant model assumes the existing wire center locations and then "builds" the lowest cost, most efficient network possible using the most efficient technology currently available. The objective is to establish rates for elements utilizing an efficient, forward looking basis rather than on recovery of embedded investment utilizing an existing or less efficient network. In fact, the inclusion of embedded costs is specifically excluded by the FCC in 47 C.F.R. §51.505(d).

To comply with the FCC's rules and U.S. Supreme Court decision, the calculation of costs must be based on how things *should* be done, not how they were done in the past, taking as a given the incumbent's wire centers. Verizon's model does not do this. Verizon based their proposals on results produced using a version of the Integrated Cost Model (ICM) which purports to provide estimates of the forward looking costs to provide telecommunications service in Florida (Order 02-1574 p. 43) but which has been manipulated to make it resemble the current network in some instances

For example, the ICM

1) Places digital loop carrier (DLC) equipment based on existing DLC in the embedded network;

2) Arbitrarily places certain DLC equipment where it would not otherwise exist to enable the ICM to model a feeder route that exists in the embedded network;

3) Does not model forward looking switching technology.

The flaws in the ICM were acknowledged by Verizon's witness and, in fact, concerns were expressed by the Commission as to whether ICM is TELRIC compliant. (Order p. 65).

With respect to the DLC equipment Verizon's witness on deposition said:

> Well, the DLC input started with the existing DLC locations and in some cases ended there, too, but there were situations in which we wanted to preserve existing feeder routes that we would add additional locations in the model. So we would have a feeder route that we know existed in the network, we had to put a DLC where one did not exist so that ICM would model that feeder route. (Exh. 25, Tucek Depo. p.42)

He later disagreed that selecting DLC locations would be inconsistent with TELRIC but said

> . . . what we do in ICM-Florida is try to move the modeled network closed to the real network which means that the costs produced by the model are more . . . reflective of the costs we expect to incur. (Exh. 25 p. 59).

He went on to assert that a cost model following the constraints consistent with the FCC methodology

> . . . "probably are not as reflective of the costs an ILEC expects to incur." (Exh. 25 p. 60).

And finally, he denied the characterization that ICM creates a model that reflects the existing embedded network but clarified his difference to be that [the model] moves it closer to the existing network . . . (Exh. 25 p. 60).

Rather than building an efficient network as required by the FCC, Verizon has replicated existing network and the model does not yield costs based on the most efficient technology currently available and the lowest cost network configuration (51.505(b)) but on a model designed to recover embedded costs. The Commission noted the flaws with ICM in Order No. 02-1574, citing to Verizon's response to the Commission Staff's discovery that reiterates the testimony of Mr. Tucek. (Order No. 02-1574, p. 67).

Another example of the deficiency with the ICM is the use of GTD-5 switches and exclusion of ATM switching. The switch technology advanced by Verizon in this proceeding inappropriately contains the GTD-5 switches that are deployed in Verizon's Florida territory. The GTD-5 comprises 72 of 90 of Verizon's wire centers (Tr. p. 757). It is neither an accident nor a sheer coincidence that Verizon places the same type of switch in its modeling in the same places as one currently finds in its embedded network. This is simply another example of Verizon modeling its embedded network, which is another clear violation of §51.505(b)(1). The Commission's endorsement of the GTD-5 as forward looking technology is premised on the rationale that simply because Verizon is the only ILEC to use the GTD-5 does

not alone render it non-TELRIC compliant and the GTD-5 may not be forward looking for any other ILEC but it appears forward looking for Verizon, and Verizon will still be purchasing the GTD-5 as remotes switches.

Section 51.505(b)(1) requires that the TELRIC be based on the least cost, most efficient technology available given existing embedded wire center locations. The GTD-5 switch simply is not the least cost, most efficient technology nor is it forward looking. (Tr. pp. 1158; 1226 - 1228). Although the Commission rejected the conclusion of AT&T and others, they acknowledged that no other ILEC uses the GTD-5 switch and that the switch is not used by Verizon in any service area other than the former GTE territories. (Order p. 143). Moreover, even though Verizon said they would be adding GTE-5s, the GTD-5s that Verizon will be purchasing in the future are simply as remotes to subtend an existing GTD-5 host switch. It is not their primary switching technology. The fact that Verizon has not announced any plans to add any new GTD-5s as a host switch is a clear indication that it is not forward looking even for Verizon. This is simply another effort by Verizon to recover embedded network costs at the expense of competitors. Verizon's embedded network is irrelevant to the question of which switching technology is the least cost most efficient forwarding looking technology appropriate for inclusion in a TELRIC compliant cost model. The Commission also notes the GTD-5 is not forward looking technology for any ILEC except Verizon but allows its use in the study. No one has suggested that Verizon is

so out dated that any technology would be forward looking for them and it is simply illogical to say that technology is forward looking for one but not another.

It is also interesting that in another proceeding the Commission determined that the GTD-5 was not forward looking for the purpose of determining the cost of basic local service. (Docket No. 980696-TP; Order No. PSC-99-0068-TP). Verizon was a party to that docket and there is nothing in the present record that is inconsistent with the Commission's determination in Order No. 99-0068. The Commission erroneously suggests that there is a difference between the generic proceeding in Docket No. 980696-TP and the instant proceeding but any such distinction is without difference. By Order 99-0068, the Commission determined the cost of providing basic local exchange service of each ILEC including Verizon (then GTE Florida, Inc.). The only thing generic in that proceeding was that the modeling methodology utilized was the same for each ILEC with more than 100,000 access lines. The forward looking costs determined in that proceeding for Verizon, including those attributable to switching costs, were specific to Verizon.

The deficiency of the ICM is further demonstrated by the exclusion of ATM switching technology from the study. Verizon is currently deploying forward-looking ATM switching technology in its network a fact which Verizon itself brought to light only in response to discovery from the Staff. (Exhibit 18; Tr. p. 876.) Verizon's deployment of this technology in its own network in Florida is a clear indication that

Verizon considers this technology to be efficient and forward looking; yet, Verizon did not include this forward looking technology in its modeling of a forward looking network. There is no discussion of this in the Order. ATM technology is in every sense a forward-looking technology. The absence of a forward-looking technology actually being deployed in Verizon's network from Verizon's switching cost studies is a clear violation of the TELRIC standard.

Notwithstanding the flaws noted with the ICM and that the ICM is absolutely inconsistent with scorched node requirement of §51.505(b)(1), the Commission concluded that the ICM should be used to set UNE rates for three reasons: 1) there is no viable alternative basis upon which rates can be set 2) there is some comfort in the fact that the ICM-FL model does not fully replicate Verizon's existing network because it models less sheath feet of cable than currently exists and 3) because other modifications to the inputs produce rates that are on balance reasonable. (See Order No. 02-1574, p. 57).

The Commission clearly erred in its conclusion. Once having determined that the model was flawed the Commission should not — and could not under §120.68(7), Florida Statutes — proceed to utilize that flawed study in their order. There is no question that the ICM fails to comply with the requirements of §51.505(b)(1). The assumption of existing DLC locations in the ICM and the arbitrary placement of DLC equipment where none would otherwise exist to insure the existing embedded feeder

routes are modeled are clear violations of the scorched node requirements. No adjustment to the inputs to the model can possibly remedy this flaw. Neither does the fact that the ICM reproduces less sheath feet remedy this violation of §51.505(b)(1). It is inescapable that the ICM-FL is not TELRIC compliant. On this fact alone the ICM must be rejected.

The Commission also erred in concluding that there is no other viable alternative to setting rates than the ICM. Recognizing that a state commission may find itself in a situation where the appropriate information necessary to determine UNE rates may be unavailable, the FCC has provided a mechanism to put interim UNE rates in place pending receipt and analysis of the appropriate information which in this case is a TELRIC compliant cost model. Section 51.513(a) of the FCC's pricing rules provides:

> Where a state commission determines that the cost information available to it with respect to one or more elements does not support the adoption of a rate or rates that are consistent with the requirements set forth in §§ 51.505 and 51.511, the commission may establish a rate for an element that is consistent with the proxies specified in this section as long as the commission sets forth in writing a reasonable basis for its selection of a particular rate. (Emphasis added)

The proxy rates for various UNEs are set forth in §51.513(c). Contrary to the Commission's conclusion in the Order, there is a viable alternative to set UNE rates. This alternative is the FCC's proxy rates found in §51.513(c). Moreover, a viable

alternative for establishing interim UNE rates that is supported by the record would be the rates proposed by AT&T and WorldCom in this proceeding. These rates are shown in Exhibit 43. For those UNEs for which rates are not shown in Exhibit 43, AT&T and WorldCom urge the Commission to adopt the rates approved for BellSouth in Orders Nos. PSC-01-1181-FOF-TP and PSC-01-2132-PCO-TP issued in Docket No. 990649A-TP. The Commission could have rejected the ICM and still have appropriate UNE rates on an interim basis until Verizon produces an appropriate TELRIC compliant cost model.

CONCLUSION

The Court should decline to reverse the Commission order as requested by Verizon as Verizon is merely asking the Court to reweight the evidence considered by the Commission and reach a different conclusion. On the other hand the ICM which Verizon proposed and utilized in this proceeding does not yield results which are compliant with the requirements of TELRIC and the FCC. Verizon has structured the ICM not so much to provide a forward looking efficient network as to recover costs associated with their existing network. That is clearly contrary to every rule the FCC has adopted implementing TELRIC methodology and the model simply should not be left to stand. The PSC had before it ample exposure of the deficiencies with ICM and chose to disregard them even while acknowledging these deficiencies and concerns. The result is the endorsement of a study which is flawed and which, if allowed to stand will hamper any development of effective competition. The Commission's erroneous reliance upon the ICM should not be left to stand and this Court should remand this matter to the PSC with instructions to utilize the proxy rates of the FCC until such time as Verizon can prepare and produce a TELRIC compliant study.

Respectfully submitted,

NORMAN H. HORTON, JR., ESQ.
Florida Bar No. 156386
FLOYD R. SELF, ESQ.
Florida Bar No. 608025
MESSER, CAPARELLO & SELF, P. A.
Post Office Box 1876
Tallahassee, FL 32302-1876
(850) 222-0720

and

Tracy W. Hatch, Esq.
Florida Bar No. 449441
AT&T Communications of the Southern States, LLC
101 N. Monroe St., Suite 700
Tallahassee, FL 32301

Attorneys for AT&T Communications of the Southern States, Inc.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been served on the following parties by U. S. Mail this 24th day of July, 2003.

Patricia Christensen, Esq.
Office of General Counsel, Room 370
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

David Smith
Office of General Counsel
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Nancy B. White
c/o Nancy H. Sims
BellSouth Telecommunications, Inc.
150 South Monroe Street, Suite 400
Tallahassee, FL 32301

Virginia Tate, Esq.
AT&T Communications of the
Southern States, LLC
1200 Peachtree St., Suite 8068
Atlanta, GA 30309

Tracy W. Hatch, Esq.
AT&T Communications of the
Southern States, LLC
101 N. Monroe Street, Suite 700
Tallahassee, FL 32301

Jeffrey Whalen, Esq.
John Fons, Esq.
Ausley Law Firm
P.O. Box 391
Tallahassee, FL 32302

Michael A. Gross
Florida Cable Telecommunications
Assoc., Inc.
246 E. 6th Avenue
Tallahassee, FL 32301

Kimberly Caswell
Verizon Select Services
FLTC-0007
P.O. Box 110 (FLTC0007)
Tampa, FL 33601-0110

Donna McNulty, Esq.
WorldCom, Inc.
Suite 201
1203 Governors Square Blvd
Tallahassee, FL 32301-2960

Mr. Brian Sulmonetti
WorldCom, Inc.
6 Concourse Parkway, Suite 3200
Atlanta, GA 30328

Marc W. Dunbar, Esq.
Pennington, Moore, Wilkinson, Bell &
Dunbar, P.A.
P.O. Box 10095
Tallahassee, FL 32302-2095

Charles J. Rehwinkel
Sprint-Florida, Incorporated
MC FLTHO0107
P.O. Box 2214
Tallahassee, FL 32399-2214

Mark Buechele
Supra Telecom
Suite 200
1311 Executive Center Drive
Tallahassee, FL 32301

Carolyn Marek
Vice President of Regulatory Affairs
Southeast Region
Time Warner Communications
233 Bramerton Court
Franklin, TN 37069

Vicki Kaufman, Esq.
Joe McGlothlin, Esq.
McWhirter, Reeves, McGlothlin,
Davidson, Rief & Bakas, P.A.
117 S. Gadsden Street
Tallahassee, FL. 32301

Richard D. Melson
Hopping Green Sams & Smith, P.A.
P.O. Box 6526
Tallahassee, FL 32314

William H. Weber
Senior Counsel
Covad Communications Company
1230 Peachtree Street, NE, 19th Floor
Atlanta, GA 30309

Matthew Feil, Esq.
Florida Digital Network, Inc.
390 North Orange Avenue, Suite 2000
Orlando, Florida 32801

Mr. Don Sussman
Network Access Solutions Corporation
Three Dulles Tech Center
13650 Dulles Technology Drive
Herndon, VA 20171-4602

Rodney L. Joyce
Shook, Hardy & Bacon LLP
600 14th Street, NW, Suite 800
Washington, DC 20005-2004

Michael Sloan
Swidler & Berlin
3000 K Street, NW #300
Washington, DC 20007-5116

George S. Ford
Z-Tel Communications, Inc.
601 S. Harbour Island Blvd.
Tampa, FL 33602-5706

Nanette Edwards
ITC^DeltaCom
4092 S. Memorial Parkway
Huntsville, AL 35802

ALLTEL Communications Services, Inc.
One Allied Drive
Little Rock, AR 72203

Mr. John McLaughlin
KMC Telecom, Inc.
1755 North Brown Road

Lawrenceville, GA 30043-8119

Eric Jenkins, Esq.
Genevieve Morelli, Esq.
Kelley Law Firm
1200 19th Street, NW, Suite 500
Washington, DC 20036

Jonathan Canis, Esq.
Michael Hazzard
Kelley Law Firm
1200 19th Street, NW, Suite 500
Washington, DC 20036

Christopher Huther
Megan Troy
Preston Gates Law Firm
Suite 500
1735 New York Avenue NW
Washington, DC 20006-5209

Marvin Barkin
Marie Tomassi
Trenam Kemker Law Firm
200 Central Avenue
Bank of America Tower, Suite 1230
St. Petersburg, FL 33701

Mr. Robert Waldschmidt
Howell & Fisher
Court Square Building
300 James Robertson Parkway
Nashville, TN 37201-1107

Norman H. Horton, Jr.

CERTIFICATE OF COMPLIANCE

I HEREBY CERTIFY that this Reply Brief and Brief on Cross Appeal has been prepared using Times New Roman 14-point font.

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Norman H. Horton, Jr.