

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

CROSS REPLY BRIEF

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ISSUE

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

The Telecommunications Act of 1996 (the “Act”) was a fundamental restructuring of the local telecommunications industry. Rather than a continuation of the regulated monopoly, the intent was to establish a competitive market in the local telecommunications industry and to accomplish this, the Act imposes duties on the incumbent carriers, such as Verizon, to ensure that new entrants have an ability to enter the market. Among the requirements is the obligation of the ILEC to share the existing network with new entrants pursuant to resale or interconnection agreements approved by State Commissions. Incumbent LECs are required to offer unbundled network elements to requesting carriers at “rates, terms and conditions that are just, reasonable and nondiscriminatory.” (47 C.F.R. §51.503). These rates are determined by state utility commissions pursuant to the methodology established by the Federal Communications Commission. The authority of the FCC to adopt and apply such a methodology to the state was affirmed in AT&T Corp. v. Iowa Utilities Board, 525 U.S. 366 119 S. Ct. 721, 142 L. Ed 2d 835 (1999) and the specific methodology was upheld in Verizon Communications, Inc. v. FCC, 535 U.S. 467, 122 S.Ct. 1646, 152 L.Ed.2d 701 (2002). The FCC adopted methodology is thus the standard for states to use.

The FCC determined that rates for UNEs should be the forward looking economic cost of an element which is the sum of Total Element Long Run Increment Cost (TELRIC) plus a reasonable allocation of forward looking common costs (47 C.F.R. § 51.505(a)). Significantly, the FCC decided that TELRIC should be based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration given the incumbent wire centers (47 C.F.R. §51.505(b)(1)). Importantly, the FCC excludes embedded costs, which are the costs that the incumbent LEC has incurred in the past and that are recorded on the books, from the calculations of the forward looking economic cost of an element. (47 C.F.R. §51.505(d)(1)).

The objective is to establish rates for those elements necessary for new entrants to enter the market based on forward looking costs by reference to a hypothetical most efficient element Verizon v. FCC, supra. Rates are not based on current practices or costs of incumbents as this would require the new entrants to pay for past inefficiencies and costs. Generally new entrants to a market will enter a market using the most efficient technology available rather than inefficiencies. The telecommunications industry is such that new entrants are not able to enter the market without relying upon the ability to obtain UNEs from incumbents. If the pricing of UNEs is based on historical, embedded costs, entry will be impossible and there will be no competition in the telecommunications local market as

envisioned by Congress or as expected by the Florida Legislature with their changes to Chapter 364, Florida Statutes.

In this proceeding, Verizon proposed rates to be charged for UNEs based on a study which is not TELRIC compliant. The costs are not based on how things should be done but are based on how they were done. In response to this, both Verizon and the PSC simply recite the standard of review and the deference that should be given to the Commission.

It is interesting to note that neither the Commission nor Verizon explain how Verizon's cost model complies with FCC Rule 51.505(b)(1). The Commission does include a short discussion of TELRIC and cites to several cases to support their apparent position that they have the ability to apply a liberal standard in determining TELRIC compliance. Interestingly, each of the cited cases underline the important of having TELRIC compliant studies.

In AT&T Corp. v. FCC, 220 F 3d 607 (D.C. Cir 2000) AT&T challenged the FCC approval of Bell Atlantic's 271 application (In addition to establishing a mechanism for local exchange competition, the Act also established a procedure whereby Bell Operating Companies could receive authority to provide in region long distance service 47 U.S.C. §271. Upon certification by the state of compliance in an expedited process the FCC made the ultimate decision of compliance with a 14 point checklist). Although AT&T did not prevail in the

eventual decision the Court did recognize the need for studies to be TELRIC compliant. There may be flexibility but the Court cited to the NYPSC statement that

what TELRIC contemplates is the network that would actually be built, using the most cost-efficient, forward looking technology available. . . .

In WorldCom, Inc. V. FCC, 308 F3d 1 (D.C. Cir. 2002). The court was reviewing another §271 approval. Here the court recognized that because the FCC only has 90 days to dispose of a §271 filing, there must be deference to state agencies who typically perform a significant amount of background work during TELRIC proceedings. *id* at 5 and AT&T 220 F 3d at 611-616.

Finally in Illinois Bell v. Wright, 245 F Supp 2d 900 (N.D. Ill 2003) the court said:

[6][7][8] Ameritech Illinois was obligated under the FCC Rules to provide a cost study conforming to TELRIC principles in support of its proposed manual loop qualification procedure. 47 C.F.R. § 51.505(e). The cost for a network element under the TELRIC methodology is based not on the cost to the ILEC of providing that element using its current practices, but rather on the “forward looking cost by reference to a hypothetical, most efficient element at existing wire centers . . . *Verizon Communications, Inc. v. Federal Communications Comm’s*, 535 U.S. 467, 122 S.Ct. 1646, 1667, 152 L.Ed.2d 701 (2002).

Although these cases are cited by the Commission for the proposition that they have great latitude they can be read to support the argument of AT&T — Verizon must file a study which is TELRIC compliant and if it is not then the rates developed using that study must be rejected. The Commission certainly must have flexibility and an ability to apply their expertise, but they may not ignore the requirements of the FCC pricing rules nor may they accept a study which does not comply with these rules.

To support the argument that the study submitted by Verizon is not TELRIC compliant, AT&T noted several deficiencies with the switch used by Verizon, and placement of DLCs.

Both the Commission and Verizon focused on AT&T's assertion that the GTD-5 switch is not least cost or forward looking as required by TELRIC. It isn't. In Docket No. 980696-TP, Order No. PSC-99-0068-TP (99 FPSC 1) the Commission said:

Would a new efficient provider choose to purchase a GTD switch? We suspect not because there is no record evidence which shows that GTD switches are being purchased in quantity in the United States. This proceeding is to determine the cost an efficient provide would encounter in Florida. Although witness Petzinger did not provide sufficient evidence that the GTD switch is not forward-looking because of its technology, we find her assertions persuasive that the GTD switch is not in common use in the United States, nor are new GTD switches currently being purchased in any appreciable quantity. Therefore, we do not believe that it is likely an efficient provider in Florida would tend to purchase a

GTD switch rather than a 5ESS or DMS switch.
Therefore, we shall require that GTEFL use the default values for the placement of 5ESS and DMS switches, along with our ordered switch discount.

99 FPSC 1 at 385 (emphasis supplied).

Both Verizon and the Commission argue that AT&T “misrepresents” the earlier generic order (Verizon Brief p. 25; Commission Brief p. 6). That is not accurate. In the generic docket, in which all the local exchange companies including Verizon were parties, the Commission said that it was not likely that an efficient provider in Florida would tend to purchase a GTD-5 switch yet in the instant proceeding the PSC finds it appropriate for Verizon. Nothing has changed since the generic order and the Commission cannot simply change its mind. Teleprompter Corp. v. Hawkins, 384 So.2d 648 (Fla. 1980). Verizon argues that the company will continue to use the GTD-5 switch and plans to purchase more; however there is still a lack of showing that the GTD-5 is forward looking. TELRIC requires the establishment of a cost efficient forward looking network which the Verizon study is not with inclusion of the GTD-5. If Verizon wants to use GTD-5 switches they may, but AT&T should not be punished and required to pay higher rates because of the Verizon decision. This effort to recover embedded costs is precisely the problem addressed and specifically prohibited by Rule 51.505(d)(1).

Even if the court agrees with the Commission and Verizon with respect to the GTD-5 switch, the ICM study is still non-TELRIC and that is even clearer when considering the evidence and testimony with respect to the placement of the DLC. The DLC is a Digital Loop Carrier and is used in the network to increase capacity on lines. Part of a DLC system is in the central office but most is in the network. The FCC defines “Efficient network configuration” 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. 47 C.F.R. §51.505(b)(1).

A wire center is a physical location where the switch is located and where the wires serving individual customer locations in a geographic area terminate. Under Rule 51.505(b)(1), the wire centers stay the same but to be TELRIC compliant the network from/to the wire center must be forward looking, most efficient technology. In practical terms the rule requires that the wires and other network equipment, including DLCs, be the most efficient, off the shelf technology available and the wires and cables placed in the most efficient fashion to serve existing customer locations. Verizon’s own description of how it constructed its ICM Model shows that its ICM does not comply with Rule 51.505(b)(1). As noted by the Supreme Court, the embedded network, which is the existing network, is

not the most efficient network. Verizon v. FCC, supra; 47 C.F.R. 51.505(d).

On several occasions, the Verizon witness described how the location of DLCs were established and it was not on the basis of a forward looking, most efficient network. For example, in deposition (Hearing Exhibit 25) the witness was asked how ICM (the Verizon model) determines where to locate a DLC and his response was:

A. Okay. 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 knew existed in the network, we had to put a DLC where one did not exist so that ICM would model that feeder route. We felt that was important because feeder routes are a major part of plant investment, particularly replacement cost, and you pick that up on the model by doing that. (Emphasis added; p.25).

In that same deposition the following exchange took place

Q. What is your understanding of the FCC's TELRIC methodology, vis-a-vis scorched nodes?

A. By "scorched node," they mean that you assume the wire centers' locations are all fixed.

Q. And it's only the wire centers that are fixed and everything else is just built as a result of forward-looking least cost technology; is that correct?

A. I believe that's the interpretation of some parties.

I'd point out, again, that the standard is to estimate the cost the ILEC expects to incur, but that assumption may not meet that standard

Q. To the extent that you do not model DLC within the ICM, that you select the DLC location, that would not be consistent with the FCC's TELRIC methodology, would you agree with that?

A. I would have to disagree with that.

. . .

A. Because what we do in ICM-Florida is try to move the modeled network closer to the real network, which means that the costs produced by the model are more reflected, reflective of the costs we expect to incur. (p. 58,59)

Also:

Q. In developing ICM, . . . it seems to me that what you're attempting to do with ICMs is create a model that reflects Verizon Florida's existing embedded network. Would that be a fair characterization?

A. No.

Q. What are the differences?

A. It moves it closer to the existing network, but it does not model it exactly. (p. 60)

and finally in response to a questions regarding DS1 and DS3 loops the witness said:

so we based the study on the systems that are actually being used to provide service to the customer.

Clearly Verizon is attempting to model its "forward looking" network as closely to their existing (i.e. embedded) network as possible. Rather than let the model place

DLCs as needed based on the most efficient network configuration, Verizon manipulated its model to preserve the locations of embedded DLCs and manually placed additional DLCs to insure that certain fiber optic feeder routes would be included in the modeled network. These manipulations by Verizon are expressly precluded by the requirements of Rule 51.505(b)(1).

While Verizon's witness denied that the model reflects the existing network saying "it moves it closer . . . but it does not model it exactly," even moving it closer violates TELRIC. Under Verizon's theory, unless the modeled network exactly matches the existing network then the model is TELRIC compliant. That isn't a forward looking most efficient network that complies with Rule 51.505(b)(1).

Verizon wants to move the model closer to the existing network because that would be more reflective of the costs they expect to incur. By doing this, Verizon is trying to manipulate the model so they recover the costs of their existing, embedded network at the expense of new entrants. The problem with this was clearly recognized by the Supreme Court:

. . . the problem with a method that relies in any part on historical cost, the cost the incumbents say they actually incur in leasing network elements, is that it will pass on to lessees the difference between most-efficient cost and

embedded cost.²⁹ See First Report and Order ¶705. Any such cost difference is an inefficiency, whether caused by poor management resulting in higher operating costs or poor investment strategies that have inflated capital and depreciation. If lease elements were priced according to embedded costs, the incumbents could pass these inefficiencies to competitors in need of their wholesale elements, and to that extent defeat the competitive purpose of forcing efficient choices on all carriers whether incumbents or entrants. The upshot would be higher retail prices consumers would have to pay.

Verizon, *supra* at 511.

The Verizon study is flawed; it is not TELRIC compliant and the Commission recognized that deficiency but erroneously used it anyway.

In their brief, the Commission recites that portion of the UNE Order wherein the Commission accepted the Verizon study for purposes of setting rates for UNEs. In part the Commission says:

Although we have concerns as to the extent to which it approximates its current network in some respects, we believe that ICM-FL should nevertheless be accepted as the basis for setting UNE rates for Verizon in this proceeding, for the following reasons. First, there is not viable alternative basis upon which rates can be set. To completely reject Verizon's model would require Verizon to refile studies at a future time, using a modified model; however, there is little meaningful record support for what specific refinements should be made. Second, we take some comfort that ICM-FL does not fully replicate Verizon's existing network, in that it models fewer sheath feet of cable than currently exist. Third, due to the various modifications Verizon's model inputs approved in other sections of this Order, we believe that the rates yielded by ICM-FL on balance are reasonable. Accordingly, we find that the network design reflected in

ICM-FL shall be accepted for purposes of establishing recurring UNE rates in this proceeding, subject to our adjustments in other sections of this Order. (Order PSC-02-1574 p. 67; Record p. 2842)

Earlier in this reply, AT&T referenced opinions cited by the Commission. Taken as a whole these opinions support the importance of TELRIC and the need for studies to be TELRIC compliant. The Commission had concerns about the Verizon model and AT&T has shown that there are issues with the model. The Commission suggests that AT&T is attempting to elevate these “concerns” to a higher level than necessary. (Commission Brief p. 11) The flaw in the Commission’s argument is that none of the three reasons listed by the Commission to justify its decision entitle the Commission to “gloss over” the clear failure of Verizon to comply with Rule 51.505(b)(1). There is no discretion available to the Commission when the FCC’s rule is clear and precise on the point raised here by AT&T.

The result of this order has a significant impact on the ability of competitive carriers to enter the telecommunications market and concerns should be elevated and resolved. To allow Verizon to implement these rates in part because the Commission did not want to make Verizon refile a study is not consistent with the essential requirements of law. To allow Verizon to establish rates to be charged to

new entrants on a non-TELRIC complaint study does not and will not further the growth of a competitive market in the Verizon territory.

CONCLUSION

The court should remand this case to the FPSC with directions that Verizon should produce a TELRIC complaint study.

Respectfully submitted,

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