BEFORE THE
STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

I/M/O the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey	:	BPU Docket No. TO00060356

REPLY BRIEF ON BEHALF OF THE
NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

REDACTED VERSION

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I. PRELIMINARY STATEMENT

> *It's been four years now since the federal Telecommunications Act of 1996 has been signed, and New Jersey residents still can't purchase local service from the provider of their choice and, in turn, purchase long distance from a traditional incumbent local exchange carrier (ILEC).*
>
> *Saying that the markets are almost open is like crying wolf, since open competition was supposed to be the case months after the 1996 bill was signed.*

Anthony Birritteri, "Clarity Needed in Telecommunications Competition Role Out," *New Jersey Business Magazine* (Oct. 2000).

Local telecommunications competition in New Jersey is still in critical condition. Competitors control less than 3.4% of local loops in New Jersey. Martha McKay, "Local Competition Still Elusive After the 'Revolution,'" *The Record* (Feb. 8, 2001). (This and other newspaper and magazine articles cited in this brief are included as Attachment 1.) This is less than half the national average. *Id*. And the situation is getting worse, not better. Companies once so eager to enter the local market are now exiting the state. For example, Conectiv Communications, which had about 13,000 phone lines in New Jersey, is pulling out of the local market entirely. Joseph Swavy, "Conectiv Deal Brings New Player to Market," *The Press of Atlantic City Online* (June 7, 2001). And as competitors are failing, Verizon is thriving. John T. Ward, "Verizon Rising," *The Sunday Star-Ledger* (July 1, 2001). Indeed, as Bruce Kushnick of New Networks Institute said, "[t]he monopoly never left." *Id*. Unless the New Jersey Board of Public Utilities ("Board") establishes unbundled network element ("UNE") rates based on proper forward-looking costs, competitors will continue to exit the market, signaling the death knell for local telecommunications competition in New Jersey.

All parties to this proceeding agree that establishment by the Board of appropriate UNE rates is critical for the development of local competition in the State of New Jersey— a key Congressional goal

of the Telecommunications Act of 1996. Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56, codified at 47 U.S.C. § 153, *et seq.* (1996) ("1996 Act"). Further, all parties agree that the Board should use the Federal Communications Commission's ("FCC") total element long-run incremental cost ("TELRIC") methodology to establish these rates. This, however, is where the agreement between the parties ends.

As the extensive proceeding undertaken by the Board demonstrates, *e.g.*, Ratepayer Advocate Initial Brief at 15-16, and as the parties' initial briefs highlight, the parties fundamentally disagree on how the Board should arrive at TELRIC-compliant rates. This disagreement is predicated on the opposing incentives of the parties. Verizon New Jersey, Inc. ("Verizon-NJ") would benefit from the establishment of excessively high UNE rates because such rates would discourage, and likely prevent, market entry by competitive carriers. *See* WorldCom Initial Brief at 2. Conversely competitive local exchange carriers ("CLECs") and New Jersey ratepayers would benefit from low UNE rates because such rates would encourage CLECs to enter the market. In setting rates, the Board should be cognizant that if rates are set too low they will skew the incentives of CLECs towards entering the market solely through the use of UNEs rather than through a combination of UNEs and the deployment of their own facilities, and they will harm Verizon-NJ by preventing it from recovering its forward-looking costs. *See* Verizon-NJ Initial Brief at 1-4.

Unlike Verizon-NJ and the CLECs, the Ratepayer Advocate is the *only* party to this proceeding whose primary interest is the *people* of the State of New Jersey. The Ratepayer Advocate has no incentive to support either overstated or understated UNE rates. Rather, the Ratepayer Advocate's purpose is the same as Congress' was in enacting the 1996 Act — to promote local

competition — through the establishment of "rates, terms, and conditions that are just, reasonable, and nondiscriminatory." 47 U.S.C. § 251(c)(3). Thus, the Ratepayer Advocate supports the establishment of rates by the Board that are low enough to promote competition, yet, as Verizon-NJ recommends, sufficient to enable Verizon-NJ to recover its forward-looking costs plus a reasonable profit, and thereby provide high quality services and upgrade its network as appropriate and efficient. *See* 47 U.S.C. § 252(d); Ratepayer Advocate Initial Brief at 4-5; Verizon-NJ Initial Brief at 1.

Accordingly, and contrary to Verizon-NJ's misplaced attempts to characterize the Ratepayer Advocate as simply another CLEC, Verizon-NJ Initial Brief at 1, 11, the Ratepayer Advocate can only support UNE rates that comply with the TELRIC methodology and thereby offer the greatest chance of bringing competitive choice to New Jersey.[1] Acting on their own incentives to gain competitive advantages in the marketplace, neither Verizon-NJ's nor AT&T's cost models utilize TELRIC-compliant inputs and assumptions. *E.g.*, Covad Initial Brief at 1; AT&T Initial Brief at 8-13, 23-32, 40-46; WorldCom Initial Brief at 15-18; Cablevision Lightpath Initial Brief at 15; Verizon-NJ Initial Brief at 21-31; *see infra* Section III.A.2. Thus, neither set of cost models generate UNE rates that fall within the range of TELRIC. *See Application of Verizon New England Inc., Bell Atlantic*

[1] When Verizon-NJ criticizes the positions put forth by the Ratepayer Advocate, Verizon-NJ does nothing more than group the Ratepayer Advocate with the CLECs. Verizon-NJ Initial Brief at 1, 11. This flagrantly mischaracterizes the Ratepayer Advocate's role in this proceeding. The Ratepayer Advocate represents the people of New Jersey. Accordingly, the Ratepayer Advocate supports the development of competition, but not of any particular competitor (including Verizon-NJ), in New Jersey. Indeed, Verizon-NJ's casual grouping of the Ratepayer Advocate with the CLECs is belied by the Ratepayer Advocate's position that there was insufficient evidence to support the AT&T cost models. Ratepayer Advocate Initial Brief at 29-30.

Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) And Verizon Global Networks Inc., for Authorization to Provide In-Region, InterLATA Services in Massachusetts, CC Docket No. 01-9, FCC 01-130, Memorandum Opinion and Order ¶¶ 27-28, 35 (rel. April 16, 2001) ("*MA 271 Order*"); *Joint Applications by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, CC Docket No. 00-217, FCC 01-29, Memorandum Opinion and Order ¶¶ 55, 60, 64, 81 and 91 ("rel. Jan. 22, 2001) ("*KS/OK 271 Order*"); *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order ¶ 679 (1996) ("*Local Competition Order*").

As discussed in the Ratepayer Advocate's initial brief, the Board must, therefore, either correct for the individual deficiencies in one or both of the models, or must determine an alternative basis, such as relying on comparable TELRIC-based UNE rates for elements in a neighboring state, to establish TELRIC-compliant UNE rates for New Jersey. Ratepayer Advocate Initial Brief at 30-33. Because the record does not provide support for making corrections to the AT&T cost models, the Ratepayer Advocate declined to endorse these models. *Id.* at 29-30. The record supports many, but not all of the adjustments that would need to be made to the Verizon-NJ cost models to enable them to generate TELRIC-compliant rates. *Id.* at 31-33. Accordingly, the Ratepayer Advocate also proposes that the Board rely on several of the TELRIC-compliant rates ordered by commissions in neighboring states. *Id.* at 32-33. In our opinion, UNE rates should be lower than the corresponding UNE rates in

neighboring states, but in no event higher than the UNE rates in New York or Pennsylvania. However, where the Ratepayer Advocate was able to make specific and complete corrections to Verizon-NJ's inputs and assumptions and thereby generate a New Jersey specific TELRIC-compliant rate — such as the recurring loop rate — the Ratepayer Advocate proposed a specific alternative rate. *Id.* at 32-50. The Ratepayer Advocate's proposed comparable rates and adjustments are contained throughout the RPA Initial Brief, with specific, numeric rate proposals contained in the Appendix thereto.

In assessing the flaws in the Verizon-NJ cost models identified by the Ratepayer Advocate (and by all other parties), the Board should include as a key aspect of its analysis the relative burden of proof of the different parties. The FCC explicitly established that an incumbent provider, such as Verizon-NJ, bears the burden of proving any costs it seeks to recover through UNE rates:

> We note that incumbent LECs have greater access to the cost information necessary to calculate the incremental cost of the unbundled elements of the network. Given this asymmetric access to cost data, we find that *incumbent LECs must prove to the state commission the nature and magnitude of any forward-looking cost that it seeks to recover in the prices of interconnection and unbundled network elements.*

Local Competition Order ¶ 680 (emphasis added); *see* 47 C.F.R. § 51.505(c). Thus, where Verizon-NJ and another party both make claims about the validity of a Verizon-NJ proposed cost, the Board may only permit such recovery if the Board expressly finds that the evidence adduced in support of Verizon-NJ's claim outweighs the evidence of the other party. Should the Board find that the other party's evidence outweighs or is of equal weight to Verizon-NJ's, the Board may not permit recovery of the cost by Verizon-NJ.

The Board, therefore, should only permit Verizon-NJ to recover properly proven, TELRIC-compliant, forward-looking costs, an approach that will foster the development of competition. In

crucial aspects, however, Verizon-NJ's model fails to meet TELRIC requirements. In its initial brief, the Ratepayer Advocate identified numerous areas where Verizon-NJ's inputs or assumptions were inconsistent with TELRIC, and suggested corrections that could be made to cure many of these flaws. In light of its failure to propose TELRIC compliant rates or studies, the Board should not endorse Verizon-NJ's proposals.

In addition to the flaws in Verizon-NJ's proposals identified in this reply brief and in the Ratepayer Advocate's initial brief, and perhaps the clearest examples of Verizon-NJ's dismissive attitude towards any evidence not its own is Verizon-NJ's assessment of the parties' positions on interoffice transport, house and riser cable and dark fiber. Verizon-NJ not only fails to rebut challenges to its proposed rates or claims of technical feasibility for these UNEs, but even denies the very existence of challenges to its proposals. Verizon-NJ Initial Brief at 121 ("[t]he cost study assumptions [for interoffice transport] . . . have not been subject to criticisms by the parties"), 212 ("[n]o party has submitted testimony challenging Verizon NJ's proposal" for house and riser cable) and 213 ("only Verizon NJ offered testimony on the technical infeasibility and impracticality" of interconnecting dark fiber at splice points). At least one CLEC presented testimony challenging Verizon-NJ on its proposals for each of these UNEs. Ankum Rebuttal at 111-119 (transport); Kahn Rebuttal at 8-20 and Attachment BK-4 (house and riser cable); Graham Rebuttal at 6-7 (dark fiber); *see* Ratepayer Advocate Initial Brief at 80-82, 138-151. In addition, Verizon-NJ has failed to offer substantive evidence to support why several of its proposed rates are substantially higher than corresponding rates in New York or Pennsylvania. Verizon-NJ's refusal to acknowledge, let alone rebut, this evidence seriously undermines the credibility of Verizon-NJ's proposals for those UNEs.

Finally, the Ratepayer Advocate urges the Board to discount the impassioned, but irrelevant and frequently misguided, rhetoric all too frequently offered up in Verizon-NJ's Initial Brief. For example, Verizon-NJ's claim that CLECs adopted a "hold hostage" strategy, intentionally staying out of the market to pressure the Board to adopt UNE rates below cost, is both preposterous and irrelevant. Verizon-NJ Initial Brief at 3-4. As the downturn in capital markets over the past year shows, CLECs need all the customers they can get. CLECs also need certainty in rates to plan properly and are not benefitted by delay. More to the point, however, even were Verizon-NJ's unsupported allegation true, it is not the behavior of CLECs or of Verizon-NJ in the marketplace that should provide the basis for UNE rates; rather it is the 1996 Act and the FCC's TELRIC rules.

Accordingly, the Board should conduct a thorough analysis of all the evidence before it, keeping firmly in mind the relative burdens of proof of the parties and the requirements of the TELRIC methodology. Only then will the Board be able to establish rates within the range of TELRIC.

III. RECURRING COST OF UNES[2]

A. TELRIC Methodology

1. Legal Standard

a. Basic Conceptual Disputes

Verizon-NJ criticizes the Ratepayer Advocate's application of the TELRIC methodology to Verizon-NJ's cost studies for failing to accept the premise that forward-looking costs are costs that Verizon-NJ "could actually expect to incur to provide UNEs in New Jersey." Verizon-NJ Initial Brief at 11. Verizon-NJ is correct that the Ratepayer Advocate does not recommend that UNE rates should be based on this measure of cost. This is because TELRIC does not permit Verizon-NJ to recover actual costs. Indeed, as AT&T correctly notes in its brief, the term actual costs is little more than a thinly veiled euphemism for embedded costs, AT&T Initial Brief at 8, which Verizon-NJ knows full well it may not recover. 47 C.F.R. § 51.505(d)(1); *Local Competition Order* ¶¶ 704-707; *see* Taylor Aff. ¶ 5. TELRIC permits the recovery of efficient, forward-looking costs. 47 C.F.R. §§ 51.505(a, b and d); *Local Competition Order* ¶¶ 679-685, 690-693, 704-711. Actual costs are fully distinct from forward-looking costs. Thus, Verizon-NJ is simply wrong in its application of TELRIC principles.

Verizon-NJ's use of its existing network, its embedded plant and historical costs, is fundamentally the wrong basis for a cost study under the TELRIC methodology. *See, e.g.,* Taylor Aff.

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[2] In order to be consistent, the Ratepayer Advocate has kept to the outline established by the Board of Public Utilities for purposes of writing its Reply Brief. Any gaps in the outline are intentional, as not every issue was addressed in this Reply Brief.

¶¶ 8, 10; T. 201:23-202:11 (11/29/00). Rather, the only aspect of Verizon-NJ's actual, existing network that should be assumed in a proper forward-looking cost model is its existing wire center locations. 47. C.F.R. § 51.505(b)(1). The FCC explicitly stated as much in the *Local Competition Order* when addressing this very issue.

> We, therefore, conclude that the forward-looking pricing methodology for interconnection and unbundled network elements should be based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that the reconstructed local network will employ the most efficient technology for reasonable foreseeable capacity requirements.

Local Competition Order ¶ 685. The FCC established this forward-looking cost methodology because it best represents the prices that would result in a competitive market. *Id*. at ¶ 679; *see Investigation Regarding Local Exchange Competition for the Telecommunications Market*, Docket No. TX952631, Telecommunications Decision and Order at 9 (Dec. 2, 1997) ("*Generic Order*"). By setting rates as they would exist in a competitive market, TELRIC ensures the proper signals for efficient competitive entry. *Local Competition Order* ¶ 679; *Generic Order* at 9.

Accordingly, Verizon-NJ's actual costs represent an improper starting point for the Board to use in determining TELRIC-complaint rates. Indeed, as the federal District Court in Delaware found in rejecting a cost study similar to the one Verizon-NJ presents here, "the current state of Bell's network is irrelevant for purposes of a long-run cost analysis. The state of Bell's [current] network 'in the coming years' is equally irrelevant." *Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F. Supp.3d 218, 238 (Del. Dist. Ct. Jan. 6, 2000) ("*Bell Atlantic-Delaware*").

Verizon-NJ attempts to justify its non-compliance with the TELRIC methodology with a myriad of inappropriate citations that allegedly support its approach. In its brief, Verizon-NJ cites to the

FCC's *Local Competition Order* several times. *See* Verizon-NJ Initial Brief at 8-12. Yet, despite its attempt to rely on the FCC's order, Verizon-NJ never cites to the FCC's ultimate conclusion on the subject. *See Local Competition Order* ¶ 685 (reproduced above). Instead, despite the FCC's explicit requirement to use a "reconstructed local network," but for existing wire center locations, *id*., Verizon-NJ continues to allege that it should be able to recover its "actual costs." Verizon-NJ Initial Brief at 11; Taylor Aff ¶¶ 5-10.

Worse than its improper use of the *Local Competition Order*, however, is Verizon-NJ's erroneous claim that the New Jersey District Court made any finding as to whether its rates were TELRIC-complaint. Verizon-NJ Initial Brief at 2 (discussing *AT&T v. Bell Atlantic-New Jersey*, Civ. No. 97-5762, Opinion (D.C.N.J. June 6, 2000) ("*Bell Atlantic-NJ*")). The fact is that the District Court did not base its decision on whether Verizon-NJ's rates met TELRIC standards. While the District Court invalidated the rates that the Board set in its *Generic Order*, it did not invalidate the Board's finding that Verizon-NJ's (then Bell Atlantic-NJ) earlier cost study was flawed. *Generic Order* at 67. Rather, the court supported that finding, ruling that Bell Atlantic-NJ's engineering practice "without some more tangible measurement relating it to an efficient, forward looking system cannot be the basis for setting forward-looking rates as required by the Act." *Bell Atlantic-NJ* at 34.

Verizon-NJ's position here is puzzling at best, given that Verizon, its predecessor companies and its witnesses have long recognized, and continue to recognize, that the central tenet of the TELRIC methodology is that only forward-looking, and not actual, costs may be recovered. In their 1999 joint brief to the 8th Circuit Court of Appeals challenging the TELRIC methodology, GTE Service Corporation and Bell Atlantic Corporation stated that the FCC, in establishing TELRIC, "declined to

base prices . . . on the actual forward-looking costs that an incumbent would expect to incur in making an actual piece of its network available." Brief for Petitioners Regional Bell Companies and GTE in *Iowa Util. Bd. v. FCC*, No. 96-3321 at 8-9 (8th Cir., filed July 16, 1999) ("GTE/Bell Atlantic Joint 8th Cir. Brief") (attached to AT&T Initial Brief at Appendix 2); *see* AT&T Initial Brief at 25-29. Verizon continues to recognize this today, stating in a July 2001 federal appellate brief that TELRIC is "a forward-looking (or replacement) cost methodology that sets rates based on the costs that would be incurred by a hypothetical perfectly efficient carrier that relied on the most efficient technology and architecture available." Brief of Petitioner and Supporting Intervener in *United States Telecom Ass'n v. FCC*, Nos. 00-1012, 01-1075, 01-1102 & 01-1103 at 31 (July 2, 2001) ("Verizon Federal Appeal Brief") (relevant pages attached hereto at Attachment 2).

Further, when testifying before the Delaware Public Service Commission in 1997, Verizon-NJ witness Taylor testified that TELRIC "'says rip every switch out. All of them. . . . Every switch in the network rip them out. Leave the . . . wire center location where they [sic] are. And build the network that you would build today to serve the demand.'" *Bell Atlantic-Delaware* at 238 (quoting testimony of William E. Taylor before the Delaware Public Service Commission, Findings and Recommendations of the Hearing Examiners, Del. PSC Doc. No. 96-324 at J.A. 1325 (April 7, 1997)). Yet, these costs that Verizon itself stated are not recoverable under TELRIC are the very costs Verizon-NJ witness Taylor testified that the Board should permit Verizon-NJ to recover in this proceeding: "The study should be based on the company's *actual expected costs*." Taylor Aff. ¶ 10 (emphasis added). Thus, by Verizon-NJ's own admission, its attempt to recover "actual cost" is inconsistent with the TELRIC methodology.

Verizon-NJ's band-aid for this gaping hole in its cost methodology is the insupportable claim that its model is not just based on its actual anticipated costs, but rather on "the actual costs an efficient forward-looking carrier would be expected to incur to provide UNEs." Verizon-NJ Initial Brief at 11 (citing to *Local Competition Order* ¶ 675). Even if any actual network attributes (other than wire center locations) were an appropriate basis for determining TELRIC-compliant rates — which they are not — Verizon-NJ is asking the Board to make the leap from accepting that TELRIC emulates the costs "an efficient forward-looking carrier would incur" to accepting that Verizon-NJ is, in fact, such an efficient forward-looking carrier. Verizon-NJ provides no substantial basis to support such a leap.

That Verizon-NJ was required to operate under an incentive plan of regulation in 1987, Verizon-NJ Initial Brief at 25, 86-87, does not, contrary to Verizon-NJ's assertions, mean that Verizon-NJ has been or is currently operating as an efficient competitor would operate in a truly competitive market place. In making these assertions, Verizon-NJ ignores the key distinction between its retail obligations and its wholesale obligations. The 1987 incentive regulation plan and the subsequent 1992 plan were expressly designed to apply to Verizon-NJ's retail operations. Specifically, in exchange for certain commitments by Verizon-NJ to improve its network for retail customers by committing to the ubiquitous deployment of fiber optics, the Board deregulated some of Verizon-NJ's operations (for example, the Yellow Pages) and placed its retail telephone operations under an incentive regulation plan. Verizon-NJ's behavior towards retail customers, and the regulation incentives affecting that behavior, cannot provide a basis for inferring its efficiency as a wholesaler of UNEs. Indeed, Verizon-NJ's own lawyer recognized during the hearing that comparing its retail operations to its wholesale operations was inappropriate.

> Q. What happens if they [wholesale rates] were higher [the retail rates], would that cause you concern?
>
> MR. MC BRIDE: Your Honor, I'm going to object. This is asking for opinions that go beyond the scope of this witness' [Meacham] testimony. The question focuses on a retail rate versus cost results, wholesale cost results .... *The problem with the hypothetical is that it's comparing apples to oranges*. Rates may or may not be, retail rates may or may not be set based on cost.

T.1246:14-21, 1247:25-1248:3 (12/18/00) (emphasis added); *see also* T.1245:14-25 (12/18/00). Accordingly, whatever incentives Verizon-NJ was given to provide efficient retail services 14 years ago, they are inapplicable to determining whether Verizon-NJ has been an efficient provider of wholesale UNEs.

To the extent this regulatory plan gave Verizon-NJ incentives to provide service efficiently, Verizon-NJ has not acted upon them. Rather, the service Verizon-NJ provides to New Jersey consumers is systematically worse than that provided by Verizon throughout almost all of the other Verizon East jurisdictions.[3] For example, Verizon-NJ's average installation interval for business and residential customers in 2000 was 3.7 days, more than a full day longer than in any other Verizon East jurisdiction. http://gullfoss2.fcc.gov/cgi-bin/websql/prod/ccb/ armis1/forms/preset/get_sqpr2.hts, Average Installation Intervals in Days for Years 1994-2000, Verizon Communications, Business & Residence, Data Run Date: 7/3/2001. Similarly, in 2000, Verizon-NJ had the longest out of service repair interval for any Verizon territory in the region. http://gullfoss2.fcc.gov/cgi-bin/websql/prod/ccb/armis1/forms/preset/get_sqpr5.hts, Out of Service Repair Intervals (in Hours) for

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[3] Data was not available for Connecticut.

Years 1994-2000 (Includes Initial Out-of-Service and Repeat Out of Service Intervals), Verizon Communications, Business & Residence, Data Run Date: 7/3/2001. Moreover, Verizon-NJ had a higher incidence of customer complaints than nine of the twelve other Verizon East jurisdictions in 2000. http://gullfoss2.fcc.gov/cgi-bin/websql/ prod/ccb/armis1/forms/preset/get_sqpr1.hts, State Complaints per 1,000,000 Lines for Years 1993-2000, Verizon Communications, Business & Residence, Data Run Date: 7/3/2001. Accordingly, while the incentive regulation plans may have encouraged Verizon-NJ to provide efficient service, the level of service actually provided by Verizon-NJ fails to reflect such efficiencies.

Other than its unsupported claim that it had incentives to operate efficiently, Verizon-NJ offers no substantial evidence that it is actually operating as an efficient competitor would. As the incumbent and as the proponent of its cost studies, Verizon-NJ bears the burden of proving its assertions, *Local Competition Order* ¶ 680, and its failure to so prove fatally undermines its assertion that it is operating as an efficient competitor would in a competitive market place.

Conversely, the Ratepayer Advocate and various CLECs have demonstrated that Verizon-NJ's cost models would enable Verizon-NJ to recover actual, embedded costs. For example, all parties recognize that the forward-looking loop feeder plant technology available today is a next generation digital loop carrier system known as GR-303. *E.g.*, Lundquist Rebuttal at 14-17; Baranowski Rebuttal at 7; Exh. ATT-13; Exh. WCOM-15. Yet, rather than assume 100% GR-303 in its cost models, Verizon-NJ only assumes 10% GR-303. Verizon-NJ Initial Brief at 79; T:2240:7-11 (1/3/01). While Verizon-NJ claims that it is not deploying large amounts of GR-303 in its network today, Verizon-NJ Initial Brief at 79; T.1094:19-22 (12/19/00), this misses the point. GR-303 is the

most efficient technology available today. That Verizon-NJ chooses to actually deploy GR-303 technology at a languid pace has no bearing on GR-303 technology being the appropriate technology to model in a forward-looking cost study.

SBC Communications Inc. has identified the efficiencies and cost savings that flow from such a forward-looking assumption. SBC projects that it will deploy GR-303 throughout its network as part of its $6 billion Project Pronto. Murray-Riolo Rebuttal at 114-116, Exh. TLM/JPR-4. In describing this initiative, SBC stated that its "network investments will have a profound impact on its cost structure; in fact, the efficiencies SBC expects to gain will pay for the cost of the deployment on an NPV basis." Murray-Riolo Rebuttal at 114-115, Exhibit TLM/PJR-4 at 7 (quoting SBC's *Investor Briefing*, "SBC Announces Sweeping Broadband Initiative," Oct. 18, 1999). Verizon-NJ, by contrast, seeks to recover excessive costs by modeling older versions of digital loop carrier technology.

Verizon-NJ further attempts to recover embedded costs in other aspects of its cost studies. As shown in the Ratepayer Advocate's Initial Brief, Verizon-NJ's proposed recovery for CLEC access to loop makeup information (loop qualification), is based on embedded, not forward-looking, technology, including inefficient manual techniques that would not be utilized in a forward-looking environment. Ratepayer Advocate Initial Brief at 113-118.

Similarly, as shown in the Ratepayer Advocate's Initial Brief, Verizon-NJ's entire nonrecurring cost model ("VZ NRCM") is premised on embedded assumptions. Ratepayer Advocate Initial Brief at 83-107. The starting point used by Verizon-NJ for the VZ NRCM was "the current state of affairs." Taylor Aff. ¶ 8. In particular, existing work activities were assumed as baselines for calculating nonrecurring costs. Meacham Aff. ¶ 15, 17, 20; Exh. VNJ-12, Description of NRCM Methodology at

4. The current state of affairs, based as it is on a historical monopoly rather than a truly competitive market, is not the appropriate basis for determining TELRIC-compliant nonrecurring rates.

For all these reasons, Verizon-NJ's critique that the Ratepayer Advocate's cost recommendations "do not 'mimic' the actual costs" Verizon-NJ will incur in providing UNEs, Verizon-NJ Initial Brief at 11, succeeds not in undermining the Ratepayer Advocate's recommendations, but rather in exposing the overarching methodological flaw that pervades Verizon-NJ's cost studies — *i.e.* Verizon-NJ's studies are not based on a forward-looking environment. Verizon-NJ's cost studies should therefore be corrected, where possible, using forward-looking inputs and assumptions that are not based on Verizon-NJ's existing network, but rather on the most efficient, readily available network technology, assuming only Verizon-NJ's current wire center locations. *See Local Competition Order* ¶ 685; 47 C.F.R. § 51.505(b)(1). Where there is insufficient record evidence to enable the Board to correct Verizon-NJ's cost study inputs and assumptions, the Board should adopt comparable UNE rates ordered by neighboring state commissions. Ratepayer Advocate Initial Brief at 30-33.

C. Input Issues Affecting All UNEs

1. Cost of Capital

The Ratepayer Advocate agrees with Verizon-NJ that a determination of the cost of capital should be grounded in the forward-looking economic costing principles established by the FCC. The purpose of the cost of capital so obtained is to determine what return should be allowed on the assets invested in UNEs. The proper way to compute this forward-looking cost of capital is to first determine the type of capital the company has used to finance the UNE assets and then to determine the cost associated with each element. Once we get beyond that basic starting point, Verizon-NJ's and the

Ratepayer Advocate's approach to determining the cost of capital depart substantially. Verizon-NJ has ignored reasonable, accepted financial principles and fashioned its own erroneous approach to arrive at its cost of capital. Ratepayer Advocate Initial Brief at 34. This is in contrast to the Ratepayer Advocate's approach, which is consistent with both accepted financial and accounting principles as well as sound regulatory principles. *Id.* The Board should adopt the 8.8% rate proposed by the Ratepayer Advocate because it is a reasonable figure based on forward looking TELRIC principles. Ratepayer Advocate Initial Brief at 35. Verizon-NJ improperly reaches an inflated 12.6% cost of capital that relies on the incorrect assumption of a competitive market with Verizon-NJ as a competitive player. Verizon-NJ Initial Brief at 32; Vander Weide Rebuttal at 2.

Verizon-NJ incorrectly concludes not only that the market for local service in New Jersey is competitive, but that this necessarily will increase the business risk associated with the provision of UNEs. Verizon-NJ Initial Brief at 32. Based purely upon the conclusions of Verizon-NJ witness Vander Weide, Verizon-NJ complains that the parties in this proceeding "fail to recognize" that "local service is competitive in New Jersey." Verizon-NJ Initial Brief at 32, citing Exh. VNJ-1 at 15.

The Ratepayer Advocate has identified copious empirical data illustrating otherwise. Ratepayer Advocate Initial Brief at 1-3, 36-37. In fact, Verizon-NJ is currently enhancing its monopoly position, not losing it. Recent reports show that Verizon-NJ has "gained 65,000 residential lines, or 1.5 percent, and 120,000 business lines, or 4.7 percent." David DeKok, "Verizon Reports Loss of Phone Customers Fewer Residential Lines Make Up State Network," *The Harrisburg Patriot (*May 18, 2001) at 1. One article remarks that "after a shaky beginning, Wall Street's darling is the nation's top local and wireless phone company and an up-and-coming long-distance contender." John T. Ward,

"Verizon Rising," *The Sunday Star Ledger* (July 1, 2001) at 2. Additionally it states, "in an environment of failing small carriers. . . analysts expect Verizon's earnings per share to rise almost 7 percent this year, after a 2.5 percent increase in 2000." *Id.*

The issue in this proceeding, moreover, concerns Verizon-NJ as a wholesale provider of UNEs in New Jersey — not as a local service provider. Ratepayer Advocate Initial Brief at 36; Lundquist Rebuttal at 12. It is undisputed that there is no competition in the wholesale UNE market in New Jersey. Ratepayer Advocate Initial Brief at 36. If a carrier wishes to purchase wholesale UNEs in New Jersey to provide service in a Verizon-NJ exchange, it *must* buy them from Verizon-NJ. There are no other options, and thus no competition.

The FCC explicitly concluded that "incumbent LECs bear the burden of demonstrating with specificity that the business risks that they face in providing unbundled network elements and interconnection services would justify a different risk-adjusted cost of capital or depreciation rate." *Local Competition Order* ¶ 702. Verizon-NJ has made no serious effort to meet this burden, but continues to incorrectly analyze its cost of capital based on the assumption that it is not a monopoly provider of wholesale UNEs. Verizon-NJ Initial Brief at 32; VNJ Exh. 3, Vander Weide Direct at 53.

Verizon-NJ's argument that the Board should recognize the potential increase in business risk it will face in the future is incorrect. Verizon-NJ Initial Brief at 32. Verizon-NJ cites the FCC's *Local Competition Order* for support. Verizon-NJ Initial Brief at n. 105, citing *Local Competition Order* ¶¶ 686, 687, 702. A proper reading of the FCC's *Order* shows that while the FCC recognizes that business risk may increase as competition emerges in the local market, it also understands that "this increased risk can be partially mitigated . . . by offering term discounts, since long-term contracts can

minimize the risk of stranded investment." *Local Competition Order* ¶ 687. Further, potential increases in risk will be offset by "growth in overall demand" that will "increase the potential of the incumbent LEC to use some of its displaced facilities for other purposes." *Id.* Therefore, any potential risk that Verizon-NJ would face if competition is ever a reality are diminished by the mitigating steps that Verizon-NJ will be able to take.

Verizon's cost of capital proposal has been emphatically rejected throughout the Verizon region. Ratepayer Advocate Initial Brief at 38; *See Joint Complaint of AT&T Communications of New York, Inc*., Opinion 97-2, Opinion and Order Setting Rates for First Group of Network Elements at 38 (April 1, 1997) (*"NY UNE Case"*); *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, New York Public Service Commission Case 98-C-1357, Recommended Decision on Module 3 Issues at 79 (May 16, 2001) (*"NY Recommended Decision*"); *Joint Petition of Nextlink Pennsylvania, Inc.,* Pennsylvania Public Utility Commission, Docket Nos. P-00991648 and P-00991649, Opinion and Order at 73 (September 30, 1999) (*"Pennsylvania Global Order*"); *Further Pricing of Verizon Pennsylvania Inc.'s Unbundled Network Elements, et. al.,* Interim Opinion and Order, Docket Nos. R-00005261 and R-00005261C001 at 15 (May 24, 2001) (*"Pennsylvania Interim Order"*); *Investigation into New England Telephone and Telegraph Company's (NET's) Tariff Filing*, Vermont Public Service Board Docket No. 5713, Phase II, Module 2-Cost Studies at 35 (Feb. 4, 2000); *Approval of Agreements and Arbitration of Unresolved Issues Arising Under § 252 of the Telecommunications Act*, Maryland Public Utilities Commission Order No. 73707 at 27 (Sept. 1997) (*"MD UNE Order*"); *Ex Parte: To Determine Prices Bell Atlantic-Virginia, Inc. Is Authorized to*

Charge Competitive Local Exchange Carriers, Virginia State Corporation Commission Case No. PUC970005, Final Order at 8 (April 15, 1999); *Findings*, Delaware Public Service Commission Docket No. 96-324, Opinion & Order No. 4542 at 14-15 (July 8, 1997) (*"DE UNE Order"*); *Bell Atlantic-Delaware* at 240-241.

Verizon-NJ cites a decision of the Massachusetts Department of Telecommunications and Energy ("Massachusetts Department") as agreeing with its cost of capital methodology, but the Massachusetts Department's determination was criticized by the FCC as yielding rates that are "relatively high" compared to other Verizon states and containing "potential flaws." *MA 271* at ¶¶ 38, 251; *See* Verizon-NJ Initial Brief at 37; Ratepayer Advocate Initial Brief at 37. The FCC's conclusion was based on the Massachusetts Department's adopted cost of capital of 12.16%, a figure less than the rate Verizon-NJ proposes here. *MA 271 Order* ¶ 38.

In a regrettable last-ditch effort to discredit the analysis of the Ratepayer Advocate, Verizon-NJ attacks witness Rothschild. Verizon-NJ Initial Brief at 33. An MBA in Finance and Banking, Mr. Rothschild has been a utilities consultant for nearly 30 years and has testified in numerous cases before the Board over a period of well over two decades. Rothschild Direct at 1. Mr. Rothschild has testified in approximately 250 state hearings before 25 venues, including 42 appearances in the state of New Jersey alone. Rothschild Direct Appendix A.

Dr. Vander Weide has also testified in New Jersey, albeit less frequently. In the most recent proceeding in New Jersey in which a decision has been rendered, the ALJ found the testimony of Mr. Rothschild to be reasonable. By contrast, the ALJ characterized Dr. Vander Weide's cost of capital study as making inaccurate assumptions and employing "methodologies to ensure that his DCF study is

skewed" to yield an excessive return on equity. *I/M/O the Filing of Public Service Electric and Gas Company Pertaining to its Stranded Costs and its Unbundled Rates*, OAL Dkt. Nos. PUC 7347-97 and PUC 7348-97, BPU Dkt. Nos. EO97070462 and EO97070461 Initial Decision and Report at 54 (August 14, 1998) (Attachment 3). Other state commissions and courts have similarly rejected Dr. Vander Weide's analysis. *NY UNE Case* at 38; *NY Recommended Decision* at 79; *Bell Atlantic-Delaware* at 240-241; *See also* AT&T Initial Brief at 75.

a. Cost of Equity

Verizon-NJ proposes a 15% cost of equity that is greatly overstated and assumes that Verizon-NJ's provision of wholesale UNEs involves risk commensurate with industrial concerns. Verizon-NJ Initial Brief at 34. Verizon-NJ argues that the only way to estimate its cost of equity is to examine publicly traded companies with comparable levels of risk. Verizon-NJ Initial Brief at 35. Verizon-NJ concedes that the proper analysis would be publicly traded companies selling wholesale UNEs. *Id.* Yet, because no publicly traded companies provide only wholesale UNEs, Verizon-NJ uses proxy groups of companies in the S&P Industrials with a variety of risk levels. Verizon-NJ Initial Brief at 39. Dr. Vander Weide starts his DCF approach by analyzing industrial companies rather than telecommunications companies. Verizon-NJ Initial Brief at 35. He arbitrarily concludes that the risk of the industrial companies is comparable to Verizon-NJ's UNE investment. *Id.* The notion that Verizon-NJ's sale of wholesale UNEs has as much risk as the provision of competitive goods such as cars, furniture or pharmaceuticals is counter-intuitive. Vander Weide Rebuttal at 33-34; *See* Ratepayer Advocate Initial Brief at 36. The Board should reject this flawed methodology in favor of the approach that the Ratepayer Advocate has recommended.

Verizon's return on equity shows that it is far from a risky enterprise. Verizon Communications, in aggregate, has seen its earned return on equity consistently exceeded 25%. *See Value Line Report* (January 5, 2001) (Attachment 4).

Year	Verizon Earned Return on Equity
1997	29.0%
1998	32.5%
1999	29.1%
2000 (forecast)	41.5%
2001 (forecast)	37.5%

Moreover, Verizon continues to garner these excessive earnings in the midst of the financial downturn that is gripping almost all other companies in the telecommunications industry. *See* John T. Ward, "Verizon Rising", *Star Ledger* (July 1, 2001).

The Ratepayer Advocate's cost of equity analysis is not understated, as Verizon-NJ argues. Verizon-NJ claims that "… the RPA would have the Board believe… that Verizon-NJ is a low-risk monopoly provider of unbundled network elements…" Verizon-NJ Initial Brief at 32. This is not a fair description of Mr. Rothschild's methodology. Mr. Rothschild determined the cost of equity by directly examining the cost of equity of Verizon Communications, Inc., an integrated telecommunications company that includes regulated as well as unregulated operations. This makes Verizon Communications, Inc. a good proxy for UNEs. While it would have been reasonable for Mr. Rothschild to lower his cost of equity in consideration of the lower risk of the market dominant UNE portion of Verizon's business, he was conservative and did not make such a downward adjustment.

In addition, Verizon-NJ's criticism of the Ratepayer Advocate's analysis fails to note that it averaged the results from the DCF model with the risk/premium CAPM model to adjust for bias. Ratepayer Advocate Initial Brief at 33; Rothschild Direct Exh. 1 at 25.

The Ratepayer Advocate's recommended 10% cost of equity accurately and conservatively reflects the business risk facing Verizon-NJ, and should therefore be adopted by the Board.

. . . c. Debt/Equity Ratio

To arrive at its debt to equity ratio, Verizon-NJ improperly assumes a competitive market that does not exist. Verizon-NJ Initial Brief at 43. As previously stated, Verizon does not have a level of risk comparable to that of other companies that carry the ratio of debt to equity suggested by Verizon-NJ. *Id.* Only by directly examining Verizon and using a consolidated capital structure, as the Ratepayer Advocate has done, can a true picture be determined. Ratepayer Advocate Initial Brief at 43. Based on this approach, the Board should adopt a debt to equity ratio of 60.94% to 39.06%. Ratepayer Advocate Initial Brief at 42, 46.

One of the many serious problems that infects Dr. Vander Weide's analysis is his insistence that capital structure be determined based on market price valuations rather than book value determinations. Neither Mr. Rothschild nor the Ratepayer Advocate is aware of any instances where this Board has approved a capital structure based upon market price valuations, as proposed by Dr. Vander Weide. In addition, Verizon-NJ management does not make its capital structure decisions based upon Dr. Vander Weide's common equity assumptions.[4] *See* T:410-416 (11/29/00); Ratepayer Advocate Initial

[4] In addition, in testimony before the Board in Docket TO0120095, Verizon-NJ acknowledged that the book value approach to capital structure is consistent with the way the Board of

Brief at 36. Instead, the historic data shows that management has kept its book value capital structure within a relatively narrow range while market value capital structures have moved materially. Indeed, Dr. Vander Weide agrees that the book value of Verizon's common equity is currently considerably lower than its market price. T.373:23-383:13 (11/29/00). He further acknowledges that the market value of Verizon's assets are considerably lower than its book value. T.383:12-383:22 (11/29/00). These admissions highlight the fallacy of Dr. Vander Weide's conclusion that "capital costs always depend on market values." T.374:15-16 (11/29/00).

Verizon-NJ claims that Mr. Rothschild's testimony is based on erroneous data, Verizon-NJ Initial Brief at 41, but the record does not support this claim. Mr. Rothschild relied upon book value data from Value Line.[5] The company claims, without support from its own witness, that the Value Line book value data for Verizon is inaccurate. Mr. Rothschild responded to this claim as follows:

> What I think is appropriate is that the up-dated Value Line report is due out - - the next one, three months after October which is probably today.
>
> It's probably in my mail and when I get back to the office, I can see it. And, it would be appropriate to look at that and see if Value Line has changed. If not, it would be appropriate to talk to Value line and see why there is a difference.

Directors of Verizon-NJ determines its capital structure. *See* Direct Testimony of James A. Rothschild, *In the Matter of the Application of Verizon New Jersey, Inc. for (i) Approval of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-line Rate Regulated Business Service as Competitive Services, and Compliance Filing*, BPU Dkt. No. TO01020095 (May 15, 2001) at p. 23, lines 5-9.

[5] It is standard practice in New Jersey to use Value Line estimates to determine the proper cost of capital.

> And also, you have to see whether there is a reconciliation of those numbers. And I think in fairness to the Company and in fairness to the Board, an analysis should be done to make sure we are looking at the right thing.

T.2433:3-17 (01/05/01). Rather than allow Mr. Rothschild an opportunity to provide the update report to clarify the record, the company chose to keep the record confused on this point. T.2434:14-18 (01/05/01). Attached to this reply brief is a copy of the Value Line report on Verizon Communications, Inc. that did come out on January 5, 2001, as Mr. Rothschild predicted. *See Value Line Report* (Jan. 5, 2001) (attached hereto at Attachment 4). The January 5, 2001 Value Line reports confirms the accuracy of the $6.90 book value for Verizon Communications, Inc. that Mr. Rothschild used. Verizon-NJ never presented a witness to testify that the book value for Verizon Communications, Inc. was something different than what was reported in Value Line.

During Mr. Rothschild's cross-examination, the company attempted to exaggerate the effect of a change in the book value by assuming that even if the book value of Verizon were materially higher, Value Line's forecasted return on book equity would still remain at the same level. Mr. Rothschild responded:

> Well, I can check your arithmetic or agree to it, but I would not agree to the appropriateness of the computation because if you're making one change to one Value Line number, and not making any changes to other Value Line numbers and taking them at face value, it's not appropriate.

T.2457:9-15 (01/05/01).

In spite of Mr. Rothschild's warning, the company's brief takes huge liberties with the Value Line numbers, picking and choosing to manipulate them to a 21.31% "indicated cost of equity." Verizon-NJ Initial Brief at 42. Neither the methodology nor the numbers have the support of any

expert witness in this proceeding. Without any support, this computation should be treated by the Board for what it is — meaningless rhetoric based on unverified computations.

2. Depreciation Lives

While Verizon-NJ and other parties to this proceeding propose alternative sources for the depreciation lives to apply for UNE costing purposes, none have shown why the Board should deviate from the depreciation parameters it most recently adopted for Verizon-NJ. These Board approved rates, contained in the year 2000 Depreciation Update, should be similarly adopted in this proceeding. Both AT&T and WorldCom urge the Board to apply depreciation lives based upon the FCC's 1999 depreciation prescription order.[6] The Ratepayer Advocate believes that the FCC's depreciation analysis and adopted life estimates provide a useful benchmark for evaluating individual ILECs' depreciation proposals, especially for those state regulatory commissions which have not performed their own depreciation investigations in recent years. In the instant case, however, adopting FCC-derived values would amount to second-guessing the Board's recent judgments on this issue with particularity to Verizon-NJ.

Verizon-NJ takes issue with the economic lives that the Ratepayer Advocate derives from the Company's 2000 Depreciation Update, claiming that they are improperly calculated. Verizon-NJ Initial Brief n. 188; *see* RPA Initial Brief at 46; Lundquist Rebuttal at 47; Exh. VNJ-72, 2000 Depreciation Rate Update Addendum to 1999 Depreciation Rate Update Submitted for Review by the

[5] FCC CC Docket No. 98-137, Report and Order, released December 30, 1999 (FCC 99-397); cited in AT&T Communications' Initial Brief (page 105) and WorldCom's Initial Brief (page 32).

Board's Staff (Jan. 18, 2000). However, Verizon-NJ offers no specific explanation of its disagreement with these calculations, which are simple, straightforward, and well documented by the Ratepayer Advocate's costing witness. T. 3195-3197 (01/26/01); RPA Response to Verizon-NJ Transcript Request T. 3198 (01/26/01). When the economic lives that RPA recommends are input into Verizon-NJ's cost models, they produce exactly the same depreciation rates appearing in the 2000 Depreciation Update. See file "lcmall.wk4", lines 215-225, provided in RPA Response to VNJ Data Request 1-26. Indeed, as the Ratepayer Advocate clearly illustrated, use of Verizon's Depreciation Rate Update significantly reduces Verizon-NJ's rates. RPA Initial Brief at 46-47; Lundquist Direct at 46. Use of the 2000 Depreciation Rate Update results in a 4% reduction to the cost of unbundled loops, and a 3% reduction to the cost of unbundled local switching and POTS port costs. RPA Initial Brief at 47; Lundquist Direct at 48.

Verizon-NJ instead proposes to use its 1999 Depreciation Rate Update for determining the proper depreciation lives to use in this proceeding. Verizon-NJ Initial Brief at 50. Indeed, Verizon-NJ provides no viable justification for not using the most current, forward looking data for the Board to make a reasoned and accurate determination. *Id. See also* RPA Initial Brief at 47. The Board should use the rates that it has already approved and that are reflective of Verizon-NJ's most recent accounting data.

Accordingly, the Board should reject Verizon-NJ's allegation as baseless, and adopt the depreciation-related adjustments to the Company's cost studies that the Ratepayer Advocate has demonstrated to be necessary. Ratepayer Advocate Initial Brief at 47.

. . . 5. Common Costs

The Board should recognize a common overhead factor that does not exceed 10%. Ratepayer Advocate Initial Brief at 47; Lundquist Rebuttal Attachment at 8. Verizon-NJ seems to suggest that a higher common overhead factor is appropriate, citing Ms. Prosini's testimony. Verizon-NJ Initial Brief at 61. However, Verizon-NJ concedes that it used a 10% common overhead factor in its cost study. Verizon-NJ Initial Brief at 60. Verizon-NJ further acknowledges that the Board's previous adoption of a 10% common cost factor was reasonable and that "'[o]ther states have found 10% to be reasonable'" as well. Verizon-NJ Initial Brief at 60-61, citing *Generic Order* at 75. Thus, the Board should follow its previous determination and adopt a common overhead factor not to exceed 10%. Ratepayer Advocate Initial Brief at 47-48.

D. Loop Input Issues

. . . 5. Digital Loop Carrier

a. GR-303

Verizon-NJ asserts two primary arguments in support of its cost study assumptions that the vast majority of the network is comprised of the more costly Universal Digital Loop Carrier ("UDLC") and that only a *de minimis* 10% of the network is served by efficient, forward-looking GR-303 IDLC technology. First, the incumbent argues that its 10% assumption of GR-303 is a "conservatively 'high' expression" of GR-303 deployment compared to the amount of GR-303 it has installed in its network. Verizon-NJ Initial Brief at 79. Second, Verizon-NJ argues that it is technically infeasible to unbundle GR-303 loops and therefore, the loop costs should not include a larger percentage of this IDLC interface. *Id.* at 82-85. Both of these arguments fail under the weight of the evidence and arguments

presented in the initial briefs. Ratepayer Advocate Initial Brief at 51-57; AT&T Initial Brief at 121-124; WorldCom Initial Brief at 18-22.

Verizon-NJ's first argument is based on the faulty premise that its cost study should be based on *its* network, as opposed to the least cost, most efficient, forward-looking network required by TELRIC. As explained above in Section III. A.2, a TELRIC-compliant network is not necessarily the same as the network that Verizon-NJ has designed and deployed. Throughout this proceeding, Verizon-NJ has failed to understand that its current network configurations are completely irrelevant to a proper TELRIC analysis. Verizon-NJ's approach baselessly assumes that its current network is the most efficient. Indeed, in the case of the GR-303 assumption, Verizon-NJ's actual network demonstrably *is not* the most efficient and should not be used in determining loop prices. Rather, the Board, consistent with TELRIC principles, should require Verizon-NJ to assume the most efficient forward looking technology.

Verizon-NJ does not appear to dispute that GR-303 represents the least cost, most efficient forward-looking technology. Nowhere in its Initial Brief does Verizon-NJ claim that GR-303 is not the forward-looking technology. Rather, Verizon-NJ appropriately characterizes GR-303 as "forward-looking." Verizon-NJ Initial Brief at 79. Despite this recognition, Verizon-NJ assumed that a paltry 10% of its loops would be served by this efficient technology. Verizon-NJ is correct that this technology is forward-looking, but wrong in virtually ignoring it in its cost study in favor of UDLC.

As thoroughly explained in the Ratepayer Advocate's Initial Brief, **[Begin Verizon Proprietary]**

[End Verizon Proprietary]. Ratepayer Advocate Initial Brief at 53-54 (citing WCOM-15 at 22). Thus, that GR-303 is forward-looking technology is not disputed and, according to TELRIC costing principles, which all parties have agreed apply, the Board should require Verizon-NJ to assume 100% application of this technology.

In an attempt to circumvent TELRIC's costing principles, Verizon-NJ also argues against assuming 100% GR-303 on the basis of its witness' assertion that it is technically infeasible to unbundle loops served by a GR-303 interface. Verizon-NJ Initial Brief at 80-85. While Verizon-NJ makes this assertion, it has failed to introduce any corroborating documentation to support it. Indeed, in stark contrast to Verizon-NJ's litigation position, **[Begin Verizon Proprietary]**

[End Verizon Proprietary]. Ratepayer Advocate Initial Brief at 55 citing WCOM-15 at 1.

Likewise, the New York Public Service Commission found that it is technologically feasible to unbundle GR-303 provisioned loops. Specifically, the New York Commission found that deployment of GR-303 was "technologically practicable" and that "subscriber loops can be most efficiently provided via integrated digital loop carrier technology using the GR-303 protocol." Exh. WCOM-11 at 11.

6. Fill Factors

a. Distribution

Verizon-NJ bases its distribution fill factor, like so many other aspects of its cost study, on its embedded practices; it never explains the anomalous overcharge that this proposal would impose on CLECs, and it ignores the rejection of its approach to fill factors by the New Jersey District Court and the FCC. *See* Verizon-NJ Initial Brief at 87-91.

Verizon-NJ stoutly defends the use in its cost study of "ultimate demand" engineering and the utilization levels that this approach generates. *Id.* at 88-91. Those utilization levels, however, suffer from numerous flaws as a basis for a TELRIC study. First, Verizon-NJ bases these numbers on embedded conditions, and in particular on current demand estimates by its engineers. *Id.* at 87. As discussed above, reliance on embedded conditions and current figures irretrievably taints any cost study that is meant to produce efficient, forward-looking costs. *Supra* Section III.A.2. In the case of distribution fill, the consequences of this backward looking method are evident. As explained in the Ratepayer Advocate's initial brief, the advent of line sharing technologies and of pair gain systems can be expected to diminish the level of "ultimate demand." Ratepayer Advocate Initial Brief at 61-62. Verizon-NJ's distribution fill factor reflects none of these forward-looking considerations.

Verizon-NJ also neglects to explain why, as described by Ratepayer Advocate witness Lundquist, today's customers are expected to pay for facilities that will provide service in the distant future, while future customers will also be asked to pay for this extravagant "ultimate demand" provisioning. Ratepayer Advocate Initial Brief at 60-61; Lundquist Rebuttal at 30.

Finally, Verizon-NJ provides no reason to ignore regulators' resounding rejection of its approach to distribution fill factors. For example, the FCC has found the case for the ultimate demand approach "unpersuasive." *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45,

Forward-Looking Mechanism For High Cost Support for Non-Rural LECs, CC Docket No. 97-160, Tenth Report and Order, FCC 99-304 ¶ 200 (rel. Nov. 2, 1999) ("*Universal Service Order*"). The District Court that reviewed the *Generic Order* rejected Verizon-NJ's use of embedded data to determine this fill factor. *Bell Atlantic-NJ* at 34. Most recently, the New York Public Service Commission's Administrative Law Judge has recommended a distribution fill factor of 50%, a number very close to the **[Begin Verizon Proprietary] [End Verizon Proprietary]** level that the Ratepayer Advocate recommends.

7. Support Structure

. . . b. Structure Sharing

The Board should adopt the structure sharing percentage that reflects the most efficient allocation of costs to support structures. Verizon-NJ's witnesses initially appeared to support a "roughly 50 percent" structure sharing allocation as appropriate. T.948:14-17 (12/01/00); *see also* T.947:2-6 (12/01/00); Gansert Rebuttal at 30. Verizon-NJ's cost study, however, adds a further structure sharing reduction that includes 7.4% for sharing with cable TV providers. Exh. VNJ 26, Vol. 1, Sec. 3.4 , Verizon-NJ Cost Study. Verizon-NJ thus proposes a 42.6% sharing figure, accounting for 50% structure sharing with electric companies, and 7.4% sharing with cable TV companies. Verizon-NJ Initial Brief at 101. The Ratepayer Advocate does not oppose Verizon-NJ's figure, as it will decrease the price of the loop to the benefit of New Jersey competitors and consumers. The Board should therefore adopt a 42.6% structure sharing percentage.

c. Pole Placement Assumptions

Verizon-NJ proposes that the Board use pole placement assumptions that are based on embedded figures rather than an efficient network. Verizon-NJ Initial Brief 104; Ratepayer Advocate Initial Brief at 67. Instead, the Ratepayer Advocate suggests that the Board adopt the reasoned pole placement assumptions developed by the FCC in its *Universal Service Order*. Ratepayer Advocate Initial Brief at 66; *see Universal Service Order* ¶ 214. In the *Universal Service Order*, the FCC determined "to use the following values for the distance between poles: 250 feet for density zones 1 and 2; 200 feet for zones 3 and 4; 175 feet for zones 5 and 6; and 150 feet for zones 7, 8, and 9." *Universal Service Order* ¶ 214; Ratepayer Advocate Initial Brief at 67; *see* Fassett Direct at 51-52.

By using the FCC's *Universal Service Order*, the Board can be assured that it is using figures that are TELRIC compliant. In fact, Verizon agrees that the economic costing principles of the FCC's universal service model are meant to be "almost identical to TELRIC principles." *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, New York Public Service Commission Case 98-C-1357, Responsive Panel Testimony of Bell Atlantic-New York on Revised Costs and Rates for Unbundled Network Elements and Related Wholesale Services at 41 (attached to Ratepayer Advocate Initial Brief as Attachment 2).

Verizon-NJ's proposed pole placement distances are based on embedded figures. Verizon-NJ Initial Brief at 104. Verizon-NJ admits that it bases its assumptions for support structures on the judgment of its outside plant engineers and on the actual costs it incurs. Verizon-NJ Initial Brief at 97. Rather than satisfying its burden of proof for its pole placement assumptions, Verizon-NJ witness Gansert spends the entirety of his testimony attacking the Hatfield Model. Gansert Direct at 23-31; *see*

Local Competition Order ¶ 680; *supra* Section I. That the Hatfield Model may be wrong is hardly sufficient justification for the Board to endorse the Verizon-NJ cost model's pole placement assumptions. *Supra* Section I.

Further, Verizon-NJ attempts to confuse matters by stating that the "number of actual poles utilized by Verizon is 1.5 million." Verizon-NJ Initial Brief at 104. The actual amount of poles currently in use by Verizon-NJ is completely irrelevant for the purposes of determining the pole placement assumptions that should be adopted by the Board. Ratepayer Advocate Initial Brief at 67. Rather, the Board should adopt the pole placement spacing as developed in the FCC's *Universal Service Order*, which reflects parameters that are expected of an efficient provider of UNEs.

E. Switching Costs

. . . 2. Discount Weighting – New vs. Add-On Investment

Verizon-NJ incorrectly asserts that the switching discount that the Board should apply is the "growth" discount. Verizon-NJ Initial Brief at 111. Instead, the Board should adopt a 100% "new/replacement" discount that reflects the practices of an efficient competitor in a forward-looking environment. Ratepayer Advocate Initial Brief at 69; Lundquist Rebuttal at 40. Use of Verizon-NJ's discounted rate will improperly inflate the cost of switching and highlight Verizon-NJ's continued inefficient practices.

Verizon-NJ's "growth" discount analysis is based on embedded costs, as Verizon-NJ relies upon the vendor discounts it receives today. Verizon-NJ Initial Brief at 112. In a familiar refrain, instead of applying the most efficient possible discounts, Verizon-NJ adopts discounts that it claims "Verizon will actually incur in purchasing switch equipment now, and in the future." Verizon-NJ Initial

Brief at 113. As discussed above, the Board should not fall into the trap of following Verizon-NJ's "actual cost" approach and crediting its unsupported assumption that it is an efficient provider of UNEs. *Supra* Section III.A.2. Verizon-NJ's current switching configuration is irrelevant. Instead, the relevant question is what discount an efficient provider of UNEs can be expected to receive from a vendor. Ratepayer Advocate Initial Brief at 70.

Throughout this proceeding, moreover, new evidence has come forth that Verizon-NJ is receiving better vendor discounts than initially believed. Ratepayer Advocate Initial Brief at 74-75; *see* Prosini Rebuttal at 17-19 (revised Dec. 21, 2000). Verizon-NJ was required by the Board to submit its most current vendor discounts, but has failed to provide an analysis of how these new vendor discounts will affect Verizon-NJ's overall new/replacement and growth discounts. Ratepayer Advocate Initial Brief at 75; *see In the Matter of the Review of Unbundled Network Elements, Rates, Terms and Conditions of Verizon New Jersey, Inc.*, Docket No. TO00060356, Order on AT&T Motion for Order Directing Verizon New Jersey Inc. To Submit Witnesses for Deposition at 3-4 (April 12, 2001). In addition, Verizon-NJ refused several requests from the Ratepayer Advocate to rerun its SCIS/MO model to provide the Board with the quantitative effects of the new vendor contracts upon Verizon-NJ's switching costs. Ratepayer Advocate Initial Brief at 76.

In light of Verizon-NJ's unwillingness to assist the Board in updating its own flawed cost study to reflect the current effects of Verizon-NJ's vendor contracts, the Board should rely on the evidence on the record. Earlier in this proceeding, Ratepayer Advocate witness Lundquist estimated the port and local switching costs that would result from the new/replacement discount instead of Verizon-NJ's growth discount. Lundquist Rebuttal at 43. This analysis concluded that using the new/replacement

discount would reduce the total cost for ports by **[Begin Third Party Proprietary]** **[End Third Party Proprietary]** and the local switching by **[Begin Third Party Proprietary]** **[End Third Party Proprietary]**. *Id.* Unable to rerun the SCIS/MO model, and without any assistance from Verizon-NJ in this regard, the Ratepayer Advocate urges the Board to use these port and switching costs, reflecting the new/replacement discount, as the highest permissive port and switching costs that Verizon-NJ is allowed to recover. Ratepayer Advocate Initial Brief at 77.

Verizon-NJ takes issue with WorldCom's correct determination that in order to reach TELRIC rates, the Board should recognize the efficiencies of new equipment. Verizon-NJ Initial Brief at 57; *See also* Ankum Rebuttal at 18. WorldCom witness Ankum correctly states that as "equipment manufacturers compete, their quality improves and this improved quality translates to lower maintenance and repair costs." Ankum Rebuttal at 18. Verizon-NJ mischaracterizes WorldCom's conclusion — that new equipment, as required for the switching and port costs analysis, needs less maintenance on a forward-looking basis — as assuming a "static, perfectly new, never aging network." Verizon-NJ Initial Brief at 57; *See also* WorldCom Initial Brief at 35; Ankum Rebuttal at 18. Such a conclusion is not suggested by WorldCom. Neither should an old and obsolete network be assumed, as Verizon-NJ suggests. Rather, as WorldCom suggests, a proper cost study should assume the most efficient maintenance expenses based on the newest, most modern equipment.

In sum, the Board should follow the FCC's guidance and apply the "new/replacement" discount to the determination of the cost of switching in New Jersey. Further, the Board should use the

Ratepayer Advocate's proposed port and switching costs as a ceiling on those costs. In addition we urge the Board to reject Verizon-NJ's approach to maintenance costs.

IV. Non Recurring Cost Models

A. Summary of Models, Assumptions and Approach

. . . 3. Criticism of Competing Models

Verizon-NJ avers that the VZ NRCM "is fully compliant with the FCC's TELRIC requirements." Verizon-NJ Initial Brief at 122 (internal citation omitted). Yet, the key inputs and assumptions to the VZ NRCM are based on "today's methods of operations and [today's] work times." *Id*. at 130. Verizon-NJ then adjusted its inputs in a purported attempt to account for forward-looking mechanization. *Id.* at 131. Because Verizon-NJ admittedly bases the VZ NRCM on existing tasks, task time estimates and OSS, Verizon-NJ's claims that its nonrecurring rates comport with the TELRIC methodology are incorrect.

As shown in Section III.A.2, *supra*, today's methods of operation and work times, even if adjusted to reflect actual anticipated future change, are not the appropriate baseline for a TELRIC-compliant cost study. *See* Ratepayer Advocate Initial Brief at 21, 25-29, 83-107. Rather, as the federal district court in Delaware held in addressing so-called forward-looking adjustments, "[t]he mechanization of Bell's current internal service order processes is irrelevant to the legal standard for determining network element costs." *Bell Atlantic-Delaware* at 251. Thus, the VZ NRCM, by virtue of beginning "with the current state of affairs," Taylor Aff. ¶ 8, utilizes improper inputs and assumptions. In order to establish proper TELRIC-complaint nonrecurring rates, the Board should therefore adjust the VZ NRCM, if possible, to generate rates using a truly forward-looking, long-run baseline, or, if

such adjustment is not possible, rely on comparable TELRIC rates ordered by neighboring state commissions. *See* Ratepayer Advocate Initial Brief at 30-33, 105-107.

B. Discussion and Recommendations on Major Inputs and Assumptions

1. Forward-looking Network Assumptions

Verizon-NJ correctly states in its initial brief that the VZ NRCM should be "based upon assumptions consistent in every respect with those made" in the recurring cost model. Verizon-NJ Initial Brief at 122. Thus, the same changes that should be made to the network assumptions underlying the Verizon-NJ recurring cost model should also be made to the VZ NRCM. In particular, as demonstrated in greater detail in the initial brief of the Ratepayer Advocate and in this reply brief, Ratepayer Advocate Initial Brief at 51-57; *supra* Section III.C.5.a, the Board should adjust the VZ NRCM to account for 100% GR-303 rather than the copper/fiber DLC mix modeled by Verizon-NJ. Verizon-NJ Initial Brief at 142-146.

2. Role of OSS

a. Fallout rates

Verizon-NJ claims that its Operational Support Systems ("OSS") fallout rates, applied individually to each system rather than collectively to its OSS as a whole, and leading to charges for a large measure of manual activity, are forward-looking. Verizon-NJ Initial Brief at 151. Verizon-NJ is mistaken.

Verizon-NJ arrived at its fallout rates by assessing each of the tasks that occur today in the processing of a UNE order. *See id*. at 151-157. Verizon-NJ claims that it then adjusted its mechanized versus manual assumptions "to fully reflect the effects of planned mechanization efforts." *Id*. at 130-131.

In so doing, Verizon-NJ again started with an improper baseline — existing tasks and processes. *Id*. at 151-157. As demonstrated in Section III.A.2, relying on existing system operations and task assumptions, such as "the realistic expectations of [Verizon-NJ's] managers," Verizon-NJ Initial Brief at 152, is inappropriate in a forward-looking cost study. Indeed, as the *Bell Atlantic-Delaware* court correctly held, attempts to adjust an incumbent provider's existing OSS processes for anticipated future mechanization are "irrelevant" when determining UNE rates. *Bell Atlantic-Delaware* at 251. Therefore, the Board should reject Verizon-NJ's proposed fallout rates, and instead should order the 2% system-wide fallout rate proposed by various CLECs in this proceeding, and ordered by the Connecticut Department of Public Utility Control ("DPUC") and by the ALJ in New York. Stacy Rebuttal at 13-16; T.2910:3-6 (1/23/01); T.:2926:14-17 (1/23/01); *Application of the Southern New England Telephone Company for Approval of the Total Service Long Run Incremental Cost*

Studies and Rates for Unbundled Elements, Connecticut DPUC Docket No. 97-04-10, Decision at 48, 56 (May 20, 1998); *NY Recommended Decision* at 190; *see* Ratepayer Advocate Initial Brief at 90-95; AT&T Initial Brief at 188-190.

. . . 4. New Lines, Conversion and Migration

. . . b. Recurring Costs Included in the VZ NRCM

Verizon-NJ claims that any costs, including maintenance costs necessary to trouble shoot a CLEC order when Verizon-NJ fails to initially successfully provision a CLEC order, are properly included as nonrecurring costs because "these costs would not be incurred but for the CLEC request." Verizon-NJ Initial Brief at 124. This position reads all meaning out of the FCC's requirement that maintenance costs be recovered only through recurring, and not through nonrecurring, charges. *Local Competition Order* ¶ 745. When a CLEC places a loop order, it reasonably expects that the order will lead to the provisioning of a working loop. *See* Walsh Rebuttal at 5-8; AT&T Initial Brief at 184. If the loop does not work properly through no fault of the CLEC, then Verizon-NJ should be expected to perform the maintenance necessary to trouble shoot the order. This trouble shooting is no different than if Verizon-NJ was attempting to fill an order place by one of its end-user customers. As such, the trouble shooting is a standard maintenance function of the type that the FCC explicitly determined should be recovered only through recurring charges. *Local Competition Order* ¶ 745. Therefore, the Board should reject Verizon-NJ's claim that it be permitted to recover maintenance costs through nonrecurring rates.

5. Appropriate Methods to Estimate Time Required to Perform Required Work Functions

Just as it alleges that relying on its existing systems is the proper baseline for its proposed OSS fallout rates, so Verizon-NJ also alleges that the VZ NRCM reflects proper forward-looking costs by using a baseline of today's work times and today's work tasks. Verizon-NJ Initial Brief at 130-131, 166-173. Verizon-NJ was wrong with regard to its proposed OSS fallout rates, and it is wrong here.

Verizon-NJ repeatedly asserts that the proper starting point for determining the appropriate tasks and task times is its current activities. For example, in its initial brief, Verizon-NJ makes the unsupported assertion that "a credible cost study *must* begin with the way things are in order to estimate how things should be." *Id*. at 169 (emphasis added). Indeed, Verizon-NJ further stated:

> There is no better starting point for analysis than today's environment, since most of the forward-looking tasks performed in the non-recurring activities of the future will be similar to the tasks performed today. The same personnel within the same functional organizations will perform most of those tasks in the future. The operational work environment is not likely to change radically over any reasonable forward-looking period. Therefore, an accurate picture of today's environment is a reasonable way to begin the analysis of similar activities in the future.

Id. at 168. Thus, while claiming that it adjusted these work times for anticipated forward-looking efficiency improvements, Verizon-NJ indicated that it did not anticipate there would be any significant forward-looking changes in the amount of time it takes to perform a task. *See* T.1145:2-22 (12/18/2000). In other words, according to Verizon-NJ, while TELRIC requires rates be based on forward-looking, efficient assumptions, because the future will look much like the present, the forward-looking cost study should begin *and end* with today's existing, actual work time estimates.

Thus, Verizon-NJ has come full circle, assuming away differences that would exist in a forward-looking environment in order to again return to its tired argument that it should be permitted to recover its actual costs with a baseline of its existing network and its existing processes. *Supra*,

Section III.A.2. And, once again, Verizon-NJ shows that its attempt to recover actual costs is little more than a thinly veiled attempt to recover its embedded costs. *Id.*

The embedded cost nature of Verizon-NJ's existing network is not "a reasonable way to begin the analysis," rather, it is a completely inappropriate way to begin a TELRIC analysis. As the District Court in Delaware held, neither the existing network nor the network adjusted for anticipated changes over the next few years are relevant to a TELRIC analysis. *Bell Atlantic-Delaware* at 238; *supra* Section III.A.2. Instead, the Board should look to the tasks and task times that would be performed over the long-run, not by Verizon-NJ based on its existing business plan for its existing network, but by an efficient competitor utilizing a "reconstructed" network. *Local Competition Order* ¶ 685; *Bell Atlantic-Delaware* at 238; *supra* Section III.A.2. Consequently, the Board should reject Verizon-NJ's proposed work-time survey results because they are incompatible with the TELRIC methodology.

V. OTHER ISSUES

A. DSL

. . . 2. Line Sharing

a. Line Conditioning

Verizon-NJ claims that its proposed line conditioning charges "are consistent with FCC guidelines and are based on the TELRIC cost of loop conditioning." Verizon-NJ Initial Brief at 177. Both of these claims are in error.

First, while the FCC permits an incumbent local exchange carrier to recover loop conditioning charges in certain limited circumstances, these circumstances do not arise here. *UNE Remand Order*,

establishing dark fiber, subloops, and line sharing as new UNEs. *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking at ¶¶ 193-194 (rel. Nov. 5, 1999) ("*UNE Remand Order*"). Specifically, the Board should only permit Verizon-NJ to recover costs for loop conditioning if such costs "are in compliance with [the FCC's] pricing rules for nonrecurring costs." *Id*. ¶ 194. As shown by the Ratepayer Advocate in its initial brief, and as agreed to by Verizon-NJ in its initial brief, nonrecurring rates must be based on the same network design as recurring rates. Ratepayer Advocate Initial Brief at 83-85; Verizon-NJ Initial Brief at 122 ("The non-recurring cost model ('NRCM') filed by Verizon NJ is based upon assumptions consistent in every respect with those made in its Revised Cost Study ('recurring cost model')."). As witness Lundquist (and other witnesses) testified, and as the Ratepayer Advocate demonstrated in its initial brief and in Section IV.B.1, *supra*, both the recurring and the non-recurring cost studies should assume 100% GR-303 systems for all loop feeder plant, including for loops over 18,000 feet in length. Lundquist Direct at 14-17; Ratepayer Advocate Initial Brief at 51-57; *supra* Section III.C.5.a. Indeed, Verizon itself has recognized that its cost studies should assume a network design capable of supporting advanced services in testimony filed in other states:

> By designing a network that requires significant loop conditioning costs, the FCC Model ignores the fact that ILECs have one network for all services - basic and advanced. In its First Report and Order [the *Local Competition Order*], the FCC mandated that ILECs condition loops for data transmission if technically feasible. Therefore it is in the interest of both ILECs and their competitors that the forward-looking network used to provide both UNEs and basic service to be constructed in a manner that will minimize conditioning costs.

Maryland Public Service Commission, *Provision of Universal Service to Telecommunications Consumers*, Case No. 8745, Rebuttal Testimony of Francis J. Murphy on behalf of Verizon Maryland at 22 (May 21, 2001).

Second, Verizon-NJ failed to support the level of its proposed charges. While Verizon-NJ alleges that it can only condition one loop at a time, Covad and AT&T persuasively demonstrated that efficient, forward-looking engineering practices would lead to conditioning, on average, multiple loops at a time. Murray-Riolo Rebuttal at 128-135; Fassett Rebuttal at 21-26; *see* Ratepayer Advocate Initial Brief at 111-112. Moreover, Verizon-NJ has the burden of demonstrating that its proposed rates are consistent with forward-looking TELRIC principles. *Local Competition Order* ¶ 680; *supra* Section I. In New York, faced with a similar loop conditioning study, Administrative Law Judge Linsider found that Verizon-NY failed to justify its proposed conditioning charges. *NY Recommended Decision* at 195. The New York ALJ then required Verizon-NY to assume it would condition ten loops at a time. *Id*. Like Verizon-NY, Verizon-NJ failed to meet its burden of proof in New Jersey. The Ratepayer Advocate, therefore, recommends that the Board assume that Verizon-NJ will condition 25 loops at a time for cost study purposes. *See* Ratepayer Advocate Initial Brief at 111-112. This is the very result the Michigan Public Service Commission recently reached in analyzing Ameritech Michigan's proposed conditioning charges. *Application of Ameritech Michigan for Approval of Cost Studies and Resolution of Disputed Issues Related to Certain UNE Offerings;* Michigan Public Service Commission Case No. U-12540, Opinion and Order at 17 (Mar. 7, 2001) ("Ameritech Michigan ... shall assume that conditioning is done for 25 pairs at a time").

. . . c. Other Issues

(1) Splitter Installation/EF&I Factor

Verizon-NJ's proposed splitter installation fee overstates the cost of installing a splitter, and has no basis in TELRIC costing principles. Verizon-NJ applies the EF&I factor to determine its proposed rate for splitter installation fees. Verizon-NJ Initial Brief at 195-197. However, the EF&I factor does not capture splitter installation costs (even on a historic basis); nor does it rely upon any independent studies to identify the cost to install splitters. Ratepayer Advocate Initial Brief at 118-119. Verizon-NJ defends its use of the EF&I factor by arguing that the factor has been used for years. Verizon-NJ Initial Brief at 196. Yet, the purpose of this proceeding is for the Board to reach a determination based upon TELRIC methodology, not history.

Even if use of a factor like the EF&I were otherwise justified, using the factor here attributes to CLECs costs that Verizon-NJ either recovers elsewhere or simply does not incur in installing splitters. Ratepayer Advocate Initial Brief at 119-120. By using the factor, Verizon-NJ charges for engineering and furnishing the splitter, but engineering costs are at least partially recovered through collocation charges, and CLECs furnish their own splitters. Accordingly, the only task that should be compensated for is the installation of the splitter. Ratepayer Advocate Initial Brief at 119-120; Murray-Riolo Rebuttal at 58-59, 68, 70. Verizon-NJ has not met its burden of proof in showing this Board why these inputs should result in such large splitter installation fees. Ratepayer Advocate Initial Brief at 119; *see supra* Section I.

Moreover, Verizon-NJ uses the EF&I factor to determine splitter installation fees despite the fact it uses task time surveys to develop the majority of its nonrecurring costs. Ratepayer Advocate

Initial Brief at 118-119; Verizon-NJ Initial Brief at 195-197. While use of these surveys is an inappropriate way to determine rates (*supra* Section IV.B.5, Ratepayer Advocate Initial Brief at 100-105), Verizon-NJ nevertheless provides no viable explanation for why it used a different method to determine rates in this instance.

The Board should require Verizon-NJ to charge a rate for splitter installation that is based on a relatively direct measurement of forward-looking costs, not a cost factor, and that offers a viable option for CLECs in New Jersey. Ratepayer Advocate Initial Brief at 118-120. The Ratepayer Advocate asks the Board to reject Verizon-NJ's proposed splitter installation fee and its use of the EF&I factor. Ratepayer Advocate Initial Brief at 120.

(2) Splitter Administration and Support

Verizon-NJ argues that it should be permitted to levy a Splitter Administration and Support fee on both Option A and Option C CLECs. Verizon-NJ Initial Brief at 197. Verizon-NJ describes various expenses it incurs in connection with line sharing, and claims that these expenses should be recovered by this fee, but provides no explanation or justification for the methodology it uses to attribute these expenses to CLEC investments. As Verizon-NJ offers no support for the Splitter Administration and Support fees it presents, the Board should reject Verizon-NJ's Splitter Administration and Support charges that apply to Option A CLECs and adopt reduced charges for Option C CLECs. Ratepayer Advocate Initial Brief at 120-123; *see supra* Section I.

For Option A CLECs Verizon-NJ applies ACF factors to expenses and investments that are unrelated to Option A CLECs. Ratepayer Advocate Initial Brief at 121. Indeed, the application of this factor to Option A CLECs, which purchase and place splitters in their own collocation space, does not

make sense because there is no tenable connection between the costs attributed to the ACF factor and an Option A CLEC's splitter investment. *Id.* In addition, Verizon-NJ has yet to justify its decision to depart from its normal costing procedures and base this fee on the investments of other firms. *Id.* Further, the Splitter Administration and Support charge overstates maintenance charges — recoverable only from Option C CLECs — by using the EF&I factor, based on embedded costs, to determine a splitter investment. This methodology ignores the central fact that monthly maintenance costs are minimal. Ratepayer Advocate Initial Brief at 122; Verizon-NJ Initial Brief at 197.

Verizon-NJ's proposed Splitter Administration and Support charge is unsupported by its own or any proper cost methodology, and has been rejected by the vast majority of the state commissions that have considered the matter. Ratepayer Advocate Initial Brief at 122; *see Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements,* Case 98-C-1357, Order Denying Petition for Rehearing at 7 (rel. Oct. 3, 2000); *NY Recommended Decision* at 171-172; *Arbitration of Rhythms Links, Inc. and COVAD Communications Company vs. Bell Atlantic-Maryland, Inc., pursuant to Section 252(B) of the Telecommunications Act of 1996*, Case 8842 Phase II, Proposed Order of Arbitrator at 15 (Dec. 29, 2000) ("*Maryland Arbitration Decision*").

The Board should therefore prohibit Verizon-NJ from using the Splitter Administration and Support charge, a catch-all rate to include costs that either should not be passed on to CLECs or are recoverable elsewhere.

3. Line Splitting

Verizon-NJ has conceded that it is required under FCC rules to facilitate line splitting. Verizon-NJ Initial Brief at 185. The Ratepayer Advocate urges the Board to ensure that the timing, terms and conditions of that undertaking are such as to promote competition in this important area.

Perhaps the most important step the Board can take to insure sustainable competition through line splitting is to rule that Verizon must allow line splitting on UNE-P. Without line splitting on UNE-P, CLECs are at a severe, unjustified disadvantage in their efforts to compete with Verizon-NJ, because they cannot provide the price savings and convenience offered by the provisioning of voice and data over a single line. Fassett Direct at 68.

The FCC has said that "incumbent LECs have an obligation to permit competing carriers to engage in line splitting using the UNE-platform where the competing carrier purchases the entire loop and provides its own splitter." Exh. RPA-19, Federal Communications Commission, *Deployment of Wireline Services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order on Reconsideration in CC Docket No. 98-147, Fourth Report and Order on Reconsideration in CC Docket No. 96-98, Third Further Notice of Proposed Rulemaking in CC Docket No. 98-147, and Sixth Further Notice of Proposed Rulemaking in CC Docket No. 96-98 ¶ 19 (rel. Jan. 19, 2001) ("*Line Sharing Reconsideration Order*"). The FCC has also said "[t]hat an incumbent LEC must permit competing carriers providing voice services using the UNE-platform to either self provision necessary equipment or partner with a competitive data carrier to provide xDSL service on the same line." *Id*. ¶ 16.

However, having acknowledged this mandate, Verizon goes on to mischaracterize the *Line Sharing Reconsideration Order* as meaning that in order to line split a CLEC must replace its UNE-P with unbundled loop and unbundled port. Verizon-NJ Initial Brief at 186. Verizon argues that because a splitter is needed to facilitate line splitting and because a splitter requires collocation, UNE-P is by definition not possible since it does not use collocation. *Id*. at 186.

Verizon-NJ's position falls short for two reasons. First, Verizon-NJ's argument plainly flies in the face of the FCC's mandate, which unequivocally requires an ILEC to allow voice CLECs using UNE-P to also provide data. Exh. RPA-19 ¶¶ 16, 18, 19. Second, Verizon-NJ's argument has no legal basis, relying instead only on semantics to justify its position. In the face of these clear directives by the FCC, Verizon-NJ must allow line splitting on UNE-P, without further delay.

To further the goals of robust competition and high consumer satisfaction, the Ratepayer Advocate urges the Board to require Verizon-NJ to provide splitters to CLECs for line splitting on a per-line basis. *See* Ratepayer Advocate Initial Brief at 129. The efficiencies, both in terms of end user's costs and central office space, combined with the fluidity of customer transitions from one service provider to another, dictates that the Board adopt a regime in which Verizon-NJ provides splitters to CLECs. Any Verizon-NJ's arguments to the contrary have no basis in any objective evidence in the record.

Verizon-NJ asserts that due to the wide variety of splitters used by CLECs, each with a unique "signature," "there may be very limited opportunities for reuse of splitters among different line-sharing CLECs." Verizon-NJ Initial Brief at 188. However, as a wholesale provider of UNEs, Verizon-NJ

can very easily initiate a standard for splitter interoperability, or require CLECs using Verizon-NJ owned splitters to choose from a limited selection.

The efficiency savings of a Verizon-NJ owned splitter arrangement are such that any concerns regarding technical or administrative difficulties are minuscule in comparison. Nurse Direct at 15-18. By linking splitters to individual loops, instead of individual providers, the risk of customer disconnection during a transfer of service is significantly lowered, while the ease of transitioning from one service provider to another is heightened. *Id*. at 13.

Verizon-NJ further asserts "that the potential that splitter investment would be stranded would be very high if the ILEC were required to buy and install them." Verizon-NJ Initial Brief at 188. However, this claim ignores the fact that only properly documented forward-looking costs incurred in purchasing and installing splitters may be recovered. If these costs are as substantial as Verizon-NJ claims, Verizon-NJ should have no problem meeting its burden of quantifying them. *See Local Competition Order* ¶ 680; *infra* Section I.

Taken together, the benefits of Verizon-NJ provided splitters are so great, and the potential drawbacks so low, that the Ratepayer Advocate strongly encourages the Board to require that Verizon provide splitters to CLECs for line splitting on a per-line basis with all possible speed.

4. Wideband Testing

Verizon-NJ continues to improperly attempt to require all CLECs to bear the burden of duplicative, inefficient wideband testing. Verizon-NJ Initial Brief at 189-194. The wideband testing system is the product of a Verizon business decision, and was chosen for its retail unit, not its wholesale provision of UNEs. Ratepayer Advocate Initial Brief at 130; *see also* Verizon-NJ Initial Brief at 190.

The Board should permit Verizon-NJ to charge only those CLECs that request access to its wideband testing system.

Verizon-NJ claims that the wideband testing system is purely for wholesale use, but does not explain how a testing system purchased for retail purposes magically becomes an efficient choice for wholesale use on line sharing arrangements. Verizon-NJ Initial Brief at 193-194. Verizon never examined the suitability and efficiency of the system for that use and Verizon-NJ has offered no objective evidence that the wideband testing system is an efficient, forward-looking choice for the use that Verizon now propose. Ratepayer Advocate Initial Brief at 130. Verizon-NJ admits that the testing system was procured for use by Verizon's retail unit, Verizon-NJ Initial Brief at 190, and the evidence shows that **[Begin Verizon Proprietary]**

[End Verizon Proprietary]. Ratepayer Advocate Initial Brief at 130-131. Verizon-NJ claims that wideband testing will reduce costs, but makes no effort to substantiate that claim. Similarly, Verizon-NJ's argument that making the wideband testing system optional will cause end-user service to decline is wholly unsubstantiated, and disregards the ability of CLECs to do their own testing. Verizon-NJ Initial Brief at 190.

Verizon-NJ ignores the fact that many CLECs are indeed able and willing to do their own testing of line sharing arrangements. Ratepayer Advocate Initial Brief at 130. The FCC has established the right of CLECs to perform their own testing. 47 C.F.R. § 51.319(h)(7). Yet, Verizon-NJ envisions a scenario in which all CLECs will pay Verizon-NJ for wideband testing regardless of whether they plan to test for themselves. Verizon-NJ Initial Brief at 191. The result will be that CLECs that do their own testing will have to pay for two sets of tests, and CLECs that do not do their

own testing will have no incentive to develop their own testing methods. Ratepayer Advocate Initial Brief at 130.

Finally, many state commissions recognize a CLEC's right to have Verizon's wideband testing as an option, not a requirement. New York Public Service Commission, *Opinion and Order Concerning Line Sharing Rates*, Case 98-C-1357, Opinion No. 00-07, at 25-27 (May 26, 2000) ("*NY Line Sharing Order*"); Massachusetts Department of Telecommunications and Energy, *Investigation by the Department on its own motion as to the propriety of the rates and charges set forth in M.D.T.E. No. 17, filed with the Department by VZ-MA New England, Inc. d/b/a VZ-MA Massachusetts on May 5 and June 14, 2000, to become effective October 2, 2000*, DTE 98-57 (Phase III) at 118 (September 29, 2000) ("*Massachusetts Phase III Order*"); *Maryland Arbitration Decision* at 21; *see also NY Recommended Decision* at 162, n. 324. The Board should therefore permit CLECs the option to do their own wideband testing, and prohibit Verizon-NJ from charging CLECs that exercise this option for wideband testing. The Board should only permit Verizon-NJ to charge for wideband testing if a CLEC expressly chooses to use this optional Verizon-NJ testing.

5. Cooperative Testing

Verizon-NJ improperly proposes to charge CLECs for cooperative testing. Verizon-NJ Initial Brief at 194; Ratepayer Advocate Initial Brief at 132. Verizon-NJ argues that cooperative testing is an integral part of loop provisioning and that it was initiated at the CLECs' request. Verizon-NJ Initial Brief at 195. What Verizon-NJ fails to note is that the entire purpose behind cooperative testing is to correct Verizon's errors. Cooperative testing was initiated in New York, in response to an abnormally large number of loop installation failures due to Verizon error. Ratepayer Advocate Initial Brief at 132.

Further, CLECs already pay for their own involvement in cooperative testing, making it redundant for Verizon-NJ to require an additional charge for the testing. Ratepayer Advocate Initial Brief at 132. When faced with Verizon's request for cooperative testing, the Massachusetts Department of Telecommunications and Energy rejected Verizon's proposal. *Massachusetts Phase III Order* at 113. For all these reasons, the Board should prohibit Verizon-NJ from charging CLECs for cooperative testing.

VI. CONCLUSION

For the reasons stated above and in its Initial Brief, the Ratepayer Advocate respectfully requests that the Board adopt the rates set out in the Appendix to the Ratepayer Advocate's Initial Brief and the rate adjustments and other provisions set out in the Initial Brief and in this Reply Brief.

Respectfully submitted,

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