COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts	D.T.E. 01-20

MOTION OF AT&T TO DISMISS VERIZON'S RESALE AVOIDED COST STUDY

AND AT&T'S COMMENTS IN SUPPORT OF MOTION OF NETWORK PLUS, INC

TO HOLD PART B OF PROCEEDING IN ABEYANCE

On February 12, 2001, Verizon initiated Part B of this proceeding by filing its "Resale Avoided Cost Study," together with the Direct Testimony of Louis D. Minion (collectively, "Verizon Avoided Cost Study"). On February 27, 2001, Network Plus, Inc. ("Network Plus") filed "Motion Of Network Plus, Inc. To Hold Part B Of Proceeding In Abeyance" ("Network Plus Motion"). Pursuant to a February 27, 2001 Hearing Officer Memorandum, AT&T hereby files its comments regarding the Network Plus Motion. In addition AT&T moves that the Department dismiss the Verizon Avoided Cost Study on the grounds set forth below and in the Network Plus Motion. After the Department dismisses the Verizon Avoided Cost Study, it should require Verizon to file a new cost study that complies with the Department's January 12, 2001 order opening this docket. In the alternative, the Department should require Verizon to file a new cost study after the FCC issues its new avoided cost rules.

Comments and Argument

I. THE VERIZON AVOIDED COST STUDY DOES NOT COMPLY WITH THE DEPARTMENT'S ORDER OPENING THIS INVESTIGATION.

A. **The Department's Order Opening This Investigation Requires An Avoided Cost Study That Complies With The Avoided Cost Methodology Established In The First**

Local Competition Order, Pending An FCC Decision On Remand Of Its Pricing Rules.

As Network Plus noted in its motion, the Department was quite clear on the method for the establishment of the wholesale discount that it required the parties to follow. In its January 12, 2001, Vote and Order To Open Investigation ("Investigation Order"), the Department stated:

The Department has determined that, pending a FCC ruling on remand of its pricing rules or a higher court ruling overturning the Eighth Circuit's findings, it will maintain the status quo for UNE prices and the wholesale discount. The status quo in Massachusetts is use of the FCC's TELRIC and avoided cost methods, and despite regulatory uncertainty surrounding it, TELRIC and the avoided cost wholesale discount are the only viable methods to rely upon at this time.

Investigation Order at 5. There has been no "FCC ruling on remand" and "no higher court ruling overturning the Eighth Circuit's findings" with regard to avoided costs. [(1)] It follows, therefore, that Verizon (and any other party choosing to file) must file an avoided cost study that complies with the FCC's First Report and Order, FCC 96-325, *In the Matter of Implementation of the Local Competition Provisions on the Telecommunications Act of 1996*, CC Docket No. 96-98 (August 1, 1996) ("First Local Competition Order").

B. **The Verizon Avoided Cost Study Does Not Comply With The Avoided Cost Method Established By The FCC In Its First Local Competition Order.**

The Verizon Avoided Cost Study does not even purport to comply with the Department's requirement to follow the method established in the First Local Competition Order. In his pre-filed testimony filed in support of the Verizon Avoided Cost Study, Mr. Minion states explicitly that the study does not use the methodology from the First Local Competition Order. *See*, Minion Testimony at 3, lines 7-8. Mr. Minion claims that the study "is based on the Eighth Circuit Court's ruling concerning the type of analysis called for by the Telecommunications Act." *Id*. at 3, lines 11-12.

Verizon filed its study during the period that the FCC is revising its avoided cost method rules, precisely the time that the Department required a study based on the First Local Competition Order rules. Verizon's study should be dismissed because it is in blatant violation of the Department's order.

II. THE DEPARTMENT SHOULD NOT PERMIT PART B OF THIS PROCEEDING TO GO FORWARD ON THE BASIS OF A METHODOLOGY WHICH IS BASED ON UNIDENTIFIED AND UNSUPPORTED ASSUMPTIONS AND WHICH THERE IS NO REASON TO BELIEVE WILL BE CONSISTENT WITH THE METHODOLOGY REQUIRED BY THE FCC WHEN IT ISSUES ITS ORDER ON REMAND.

In purporting to implement the Eighth Circuit's abstract and broad pronouncements on "avoided cost," Verizon makes numerous assumptions that are not identified and may be inconsistent with assumptions the FCC will require to implement the Eighth Circuit's holding on remand.

A. **The Eighth Circuit's Broad And Abstract Holding Leaves Unanswered Many Issues And Leaves Unstated Many Assumptions That Must Be Resolved And Established In Order To Have A Clear Methodology That Can Be Consistently Replicated.**

In its July 18, 2000 decision, the Eighth Circuit, stated that "the phrase 'will be avoided' refers to those costs that the ILEC will actually avoid incurring in the future, because of its wholesale efforts, not costs that 'can be avoided.'" *Iowa Utilities Board v. FCC*, 219 F.3d 744, 754 (8th Cir. 2000), *petitions for certiorari granted in part*, 121 S. Ct. 877-878 (U.S. Jan. 22, 2001)(Nos. 00-511, 00-555, 00-587, 00-590, 00-602). In implementing the Eighth Circuit's decision, however, it becomes readily apparent that the holding leaves unanswered many questions. The Eighth Circuit does not say what period of time the ILEC is given to adjust its operations to the loss of certain retail volumes. The Eighth Circuit does not say whether the ILEC will be efficient or inefficient in adjusting its operations to avoid retail costs. The Eighth Circuit does not say whether the ILEC will adjust its operations in response to a very large incremental loss of retail business or a very small incremental loss of retail business. The costs that "will be avoided" cannot be determined until those questions are answered.

B. **The Verizon Avoided Cost Study Unfairly Resolves The Critical Issues And Assumptions In Its Favor.**

As Network Plus noted in its motion, Verizon does not wait for the FCC to address the unanswered questions in the Eighth Circuit's decision. Verizon preempts the FCC by filing a cost study that resolves those questions in its own favor. Verizon has decided that it will estimate only the costs that it will avoid in the *short run* assuming *small increments* of avoided retail activity and assuming that it will be very *inefficient* in the way that it adjusts to those incremental losses of retail function. For example, in estimating the avoided cost of operator services, Verizon recognizes as an avoided cost the cost the salaries of the operators necessary to provide operator services. It does not, however, include as an avoided cost any costs for the building in which those operators work (2/22/01 Technical Session Tr. 54-55),(2)

and may not include costs for the computer equipment that they use, costs for the furniture in their offices, costs of the salaries of the management personnel to whom the representatives report (or, for that matter the furniture, office equipment and building costs necessary to support the management personnel), costs of the salaries of the Human Resources personnel required to support and monitor the sales representatives (or their associated office costs), or costs of the salaries of the accounting and finance personnel responsible for processing sales representative expense requests and associated functions (as well as their associated office costs).

The problem with Verizon's analysis is that it fails to recognize that long run incremental costs require an assumption that a sufficient amount of time has passed that the firm can adjust ***all*** of its factors of production to the most efficient level. Economists have often noted that "in the long run, all costs are variable." Another problem with Verizon's study is that it implicitly assumes that the increment of retail loss will be very small so that only the costs directly or indirectly associated with a specific unit is lost. If a substantial loss in Verizon's retail functions will occur (a fact that has not yet been determined), then it will have an impact on Verizon's executive and planning functions as well (assuming that Verizon will be efficient).

In order to implement the Eighth Circuit's decision, Verizon has made specific assumptions regarding the time over which it will respond in order to avoid costs, the size of the increment of retail function that is lost and the degree of efficiency it will deploy. All of these assumptions are in Verizon's favor. There is no reason to believe that the FCC, when it promulgates rules to implement the Eighth Circuit's decision, will agree with such a one-sided position.

C. **Use Of The Verizon Avoided Cost Study Is At Best Premature, Because There Is No Reason To Believe That The FCC Will Resolve The Open Issues In The Same One-Sided Manner That Verizon Has Done.**

As the Network Plus Motion stated, it is not Verizon's role to define the methodology that the Department should apply in determining the wholesale discount. That role is for the FCC. The FCC will develop rules that establish presumptions that guide the decision regarding the time frame of the analysis, the size of the increment to be used in the analysis and the level of efficiency to be assumed in the analysis. The FCC will almost certainly not leave it to the ILECs to develop those rules, "since ILECs will be 'able to game their accounting systems and business practices to minimize actually 'avoided' expense.'" Network Plus Motion, at ¶ 10, quoting First Local Competition Order, at ¶ 884. When the FCC promulgates its rules, it will likely establish presumptions that properly allocate the burden of proving costs that "will be avoided." Those presumptions will recognize the superior control of the ILECs over their own cost information. They will guide the parties and the Department in a fair determination of the costs that "will be avoided." Moreover, those rules will likely be issued by the FCC shortly.(3)

As noted above, there is no reason to believe that the FCC rules will permit the assumptions regarding time frame, increment size and efficiency that Verizon has employed in the instant case. It makes no sense to go forward on the basis of a methodology that is neither consistent with the status quo method that the Department required nor consistent with the method that the FCC will promulgate. Moreover, to use a methodology developed from Verizon's "wish list" of guiding principles will undoubtedly prejudice the outcome of this proceeding in Verizon's favor. The Department should not permit Verizon to consume the scarce resources of the Department and the parties litigating a non-compliant and unbalanced avoided cost methodology. The Department should dismiss Verizon's February 12, 2001 cost study and require Verizon to file one that complies with its Investigation Order. Alternatively, the Department should dismiss the February 12, 2001 cost study and hold in abeyance Part B of the proceeding until the FCC promulgates its new rules.

Conclusion

For the foregoing reasons, AT&T requests that the Department grant the Network Plus Motion and grant this motion to dismiss. After the Department dismisses the Verizon Avoided Cost Study, it should require Verizon to file a new cost study that complies with the Department's January 12, 2001 order opening this docket. In the alternative, the Department should require Verizon to file a new cost study after the FCC issues its new avoided cost rules.

Respectfully submitted,

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1. 1 Since the Department issued its Investigation Order, the Supreme Court denied certiorari with respect to the avoided cost issue. As a result, there will not be a higher court ruling overturning the Eighth Circuit's decision with respect to avoided costs.

2. 2 Mr. Minion contends that the buildings in which the operators had previously worked will not be avoided. He says:

The buildings are going to be there. Unless we totally got out of the operator services and removed all those operators and all other functions being supported by those buildings, those buildings are still going to be standing.

Id. In treating the cost of buildings in this way, Verizon has made a critical assumption. It has assumed that it will inefficiently adjust to its loss of operator services by leaving the buildings empty. Mr. Minion tries to avoid that implication by arguing that they will be used for "other products and services." *See*, 2/22/01 Technical Session Tr. 55. If, however, Verizon were to be so efficient as to use the building for a different purpose, the result would be cost savings as a result of a reduction in the volume of retail operator services. The free space available in the areas where the operators formerly worked makes it possible for Verizon to avoid the procurement of additional space and buildings for the "other products and services."

3. 3 As Network noted in its motion, the issues raised by the July, 2000, Eighth Circuit's decision in regard to resale pricing are significantly less complicated than those with which the FCC had to deal in its UNE Remand Order, and the FCC took only five months to issue that order from the date that the Eighth Circuit issued its mandate to the FCC. Again, as Network suggested, it would be surprising if the FCC does not issue new rules by the summer.