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**BY ELECTRONIC AND OVERNIGHT MAIL**

Mary L. Cottrell, Secretary  
Department of Telecommunications & Energy  
Commonwealth of Massachusetts  
One South Station, Second Floor  
Boston, MA 02110

**Re: D.T.E. 06-61**

Dear Ms. Cottrell:

On behalf of Broadview Networks, Inc.; DSCI Corporation; Eureka Telecom, Inc., d/b/a InfoHighway Communications; Metropolitan Telecommunications of Massachusetts, Inc., d/b/a MetTel; New Horizon Communications; and One Communications (collectively "the CLEC Coalition"), enclosed for filing in the above-reference proceeding is an original of the public version of the Reply Brief of the CLEC Coalition. A hard copy of the confidential page in the Reply Brief, which contains Verizon Protected Material, is being provided to Verizon Massachusetts and Hearing Officer Chin in a sealed envelope marked confidential.

An extra copy of the public version of this filing is also attached. Please date stamp and return this extra copy in the enclosed self-addressed envelope.

Please call the undersigned if you have any questions.

Very truly yours,

/s/

Philip J. Macres

CC: DTE 06-61 Service List

**BEFORE THE  
COMMONWEALTH OF 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 the following tariff: M.D.T.E. No. 14, filed with the Department on June 16, 2006, to become effective July 16, 2006, by Verizon New England, Inc. d/b/a Verizon Massachusetts.	<b>D.T.E. 06-61</b>
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**REPLY BRIEF OF THE CLEC COALITION**

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Dated: December 6, 2006

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**BEFORE THE  
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**REPLY BRIEF OF THE CLEC COALITION**

In its Initial Brief, the CLEC Coalition<sup>1</sup> showed that Verizon's approach to setting § 251(c)(4) resale discount rates (or otherwise referred to as the avoided cost discount rates) is fundamentally flawed. Neither the record in this case nor the arguments in Verizon's Initial Brief (herein after "Verizon Brief") justifies Verizon's proposal to halve the resale discount rate. The Department should substantially<sup>2</sup> reject Verizon's proposal and instead should adopt the CLEC Coalition's proposed adjustments.

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<sup>1</sup> The CLEC Coalition includes Broadview Networks, Inc.; DSCI Corporation; Eureka Telecom, Inc. d/b/a InfoHighway Communications; Metropolitan Telecommunications of Massachusetts, Inc. d/b/a MetTel; New Horizon Communications; and One Communications.

<sup>2</sup> The CLEC Coalition does not contest every aspect of Verizon's proposed approach. Rather, the CLEC Coalition has identified numerous shortcomings that require correction.

## DISCUSSION

### **I. Verizon's Criticisms of the CLEC Coalition's Resale Discount Calculations Are Unfounded and Should be Rejected**

#### **A. Verizon's Policy-Based Jurisdictional Approach in Determining the Avoided Cost Discount is Improper**

##### **1. The Department's 1996 *Phase 2 Order* that "Costs Will Not Be Avoided Based on Jurisdiction" Remains Good Law and Should be Followed in the Verizon Cost Study**

As the CLEC Coalition demonstrated, Verizon improperly limited its cost study supporting proposed avoided cost rates to policy-based jurisdictionally intrastate costs.<sup>3</sup> Verizon's approach is in direct violation of the Department's *Phase 2 Order* that required examination of total Verizon costs without regard to jurisdictional separations.<sup>4</sup> The *Phase 2 Order* remains legally and analytically consistent with applicable federal law. The Department should continue to follow it in setting the Massachusetts resale discount rates.

Verizon's principal argument is that the *Phase 2 Order* jurisdictional holding should be deemed reversed by subsequent legal developments.<sup>5</sup> Even if Verizon's argument is not barred outright by collateral estoppel and *res judicata* principles,<sup>6</sup> it does not withstand scrutiny. The FCC has never held that § 251(c)(4) resale discount rates must be determined using only policy-based jurisdictionally intrastate costs.<sup>7</sup> Moreover, the *Iowa II* decision does not require

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<sup>3</sup> CLEC Coalition Brief at 7-8.

<sup>4</sup> D.P.U. 96-73/74, 96-75, 96-80/81, 96-83, 96-94 -- Phase 2, Phase 2 Order, at 31-32 (Dec. 3, 1996) ("*Phase 2 Order*").

<sup>5</sup> Verizon Brief at 9-10.

<sup>6</sup> See CLEC Coalition Brief at 8 (citations and footnotes omitted).

<sup>7</sup> Verizon also argues that in the *Virginia Arbitration Order*, the FCC's Wireline Competition Bureau implicitly accepted Verizon's separated revenues and expense methodology. Verizon Brief at 10 (citing *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited*

reconsideration of this aspect of the *Phase 2 Order*.<sup>8</sup> Verizon argues that (1) the Department's approach to establishing the avoided cost discount in the Department's *Phase 2 Order* was based on the 'wholesale company' assumption, (2) the 'wholesale company' assumption was rejected in *Iowa II*, and (3) the Department's determination that "costs will not be avoided based on jurisdiction" must therefore be revisited.<sup>9</sup> This argument is a *non sequitur*. *Iowa II* only added precision to the types of retail costs that can be included in the numerator of the avoided cost calculation. It did not directly or indirectly hold that policy-based interstate costs could not be considered "avoided" under § 252(d)(3).

Second, Verizon contends that including "interstate expenses into the equation" would "conflict with the requirements of § 252(d)(3)."<sup>10</sup> This argument is doubly incorrect. Verizon must determine wholesale resale discount rates in accordance with the requirements of Section 252(d)(3):

(3) WHOLESALE PRICES FOR TELECOMMUNICATIONS SERVICES- For the purposes of section 251(c)(4), a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any

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*Arbitration*, CC Doc. Nos. 00-218, 00-251, Memorandum Opinion and Order, 18 FCC Rcd 17722, DA 03-2738, ¶ 678 (Wireline Bureau rel. Aug. 29, 2003) ("*Virginia Arbitration Order*"). Notwithstanding the fact that this decision is not binding on the Department, *see* DTE 02-45, 2002 Mass. PUC LEXIS 65 \*21, and that Verizon has specially stated that the "Wireline Competition Bureau's approach...is irrelevant to this proceeding", *see* DTE-VZ 4-3, the Wireline Competition Bureau did no such thing. In accordance with Section 252(b)(4), it was only focused on resolving the issues raised by the parties and the propriety of Verizon's jurisdictional approach was not one of the issues. *Virginia Arbitration Order*, ¶ 25. Relatedly, Verizon's claim that its jurisdictional approach is consistent with the results of several of the post-2000 resale proceedings (Verizon Brief at 7) is both misleading and incorrect because the jurisdictional issue was not specially addressed by state commissions in post-2000 resale proceedings.

<sup>8</sup> *Iowa Utilities Board v. FCC*, 219 F.3d 744, 754-56 (8th Cir. 2000) ("*Iowa II*").

<sup>9</sup> Verizon Brief at 10.

<sup>10</sup> Verizon Brief at 9.

marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.<sup>11</sup>

Nowhere does this section of the Act specify that wholesale resale discount rates be based on policy-based jurisdictionally assigned revenue and expenses, as Congress has required elsewhere in the Act.<sup>12</sup> Furthermore, Verizon's position is also inconsistent with Section 252(d)(3) in that it fails to consider the term "portion *thereof* attributable to any marketing, billing, collection, and other costs that will be avoided."<sup>13</sup> While Verizon places great emphasis on the term "thereof",<sup>14</sup> Verizon itself inappropriately fails to exclude in its avoided cost discount study the totality of the costs attributable to "marketing, billing, collection, and other costs."<sup>15</sup> Rather, Verizon's avoided cost study only includes the "portion *thereof*" that it believes represents its *intrastate* costs.<sup>16</sup> There is no statutory support for Verizon's action.

## **2. Verizon's Use of Separated Costs and Revenues Is Unsound**

Even if the Department were to consider changing the position taken in the *Phase 2 Order*, it should not do so. Verizon's approach fails to consider that the jurisdictional separations process under 47 C.F.R. Part 36 *is distinct* from the process of identifying whether a revenue or expense is retail or wholesale in nature.<sup>17</sup> Jurisdictional separations procedures assign plant investment, revenue and expenses to either the interstate or intrastate jurisdictions based largely on federal and state regulatory policy objectives that are unrelated to those at issue

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<sup>11</sup> See 47 U.S.C. § 252(d)(3) (underlining added).

<sup>12</sup> CLEC Coalition Brief at 9 (discussing the doctrine of *expressio unius est exclusio alterius*).

<sup>13</sup> See 47 U.S.C. § 252(d)(3) (emphasis added).

<sup>14</sup> Verizon Brief at 9.

<sup>15</sup> See 47 U.S.C. § 252(d)(3).

<sup>16</sup> CC Exh. 3, DTE-CC 2-1 at 2.

<sup>17</sup> CLEC Coalition Brief at 10.

under Section 252(d)(3). In contrast, the process of identifying costs that support a company's retail services and that are avoided if those retail services are no longer sold is specific to the service and hinges on the question of whether the service is sold at retail. That process certainly does not hinge on a policy-based jurisdictional assignment of the service's associated costs. Verizon's insistence on applying these regulatory-based cost allocation rules obfuscates the core issue of identifying the costs that are avoided when other telecommunications carriers resell Verizon's retail services and improperly reduces the size of the avoided cost discount.

As an illustration of the inaccuracies caused by Verizon's misuse of separated costs, Verizon attempts to justify using separated revenue and expenses through an analysis of four primary company functions<sup>18</sup> within its avoided cost study, which identifies expenses that are either retail, wholesale or shared between both retail and wholesale functions at the sub-account level within its general ledger.<sup>19</sup> In each of these analyses, Verizon identifies specific retail dollar amounts it considers actually avoided when services are resold without regard to the jurisdictional classification of these expenses. Thus, in Work Papers 4-7 of Verizon Direct Exhibit 1, Verizon identifies costs as either retail, wholesale or shared by both functions based on the functional nature of its expenses at the sub-account level.<sup>20</sup> Given Verizon's position that the retail services, which are subject to resale at a wholesale discount, are jurisdictionally intrastate services,<sup>21</sup> then by definition the expenses Verizon has identified as retail in its detailed

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<sup>18</sup> This includes the following company functions: (1) Customer trouble reports within its Testing Expense account (6533); (2) Market management expenses within its Product Management account (6611); (3) Sales expenses within its Sales Expense account (6612); and (4) Customer service and billing and collection costs within its Customer Service account (6623).

<sup>19</sup> CC Exh. 3, DTE-CC 2-1 at 2.

<sup>20</sup> CC Exh. 3, DTE-CC 2-1 at 3.

<sup>21</sup> VZ Exh. 2, VZ Reb. Test. at 4 lines 17-18.



analyses are also jurisdictionally intrastate.<sup>22</sup> Verizon thereby *eliminated* the need to apply a jurisdictional separations factor to the expense because expenses identified as retail should already be jurisdictionally consistent with the retail services they support. If none of Verizon's retail services are interstate services, none of the retail costs it has identified are interstate costs. Consequently, there is no need to apply a separations factor to expenses that Verizon has already functionally separated by matching them with the services they support.<sup>23</sup> The resulting reduction to these identified retail costs to reflect a portion classified as interstate for FCC separations purposes is an unfair and inappropriate reduction in avoidable retail costs that are inherently intrastate in nature.<sup>24</sup>

### **3. Verizon's Claim that the CLEC Coalition's Analysis Results in a Mismatch of Costs and Revenues is Unfounded.**

Finally and contrary to Verizon's assertions,<sup>25</sup> the CLEC Coalition's adjustments do not result in an inconsistency between the avoided costs included in the numerator of the avoided cost discount calculation and the denominator of the calculation.<sup>26</sup> The CLEC Coalition agrees that the denominator should consist of revenue associated with retail services subject to resale at the wholesale discount. As a practical matter, this revenue is predominantly intrastate revenue

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<sup>22</sup> CC Exh. 3, DTE-CC 2-1 at 3; *see also* CC Exh. 3, DTE-CC 2-5, 2-6, & 2-7.

<sup>23</sup> Ultimately, Verizon is applying jurisdictional cost separations against costs that are already intrastate in nature and should not be subjected to jurisdictional separations. Moreover, since Verizon offers no interstate services on a resale basis, the "avoided resale costs" Verizon inappropriately assigns to the interstate jurisdiction are never translated into a "interstate resale discount"; in effect, these avoided retail costs (Verizon assigns to the interstate jurisdiction) become an inappropriate windfall for Verizon.

<sup>24</sup> CC Exh. 3, DTE-CC 2-1 at 3. Verizon also re-labeled certain calculations in its avoided cost analyses to support its position; however, this relabeling has no meaningful impact on the avoided cost calculation. This is because virtually all of Verizon's retail revenue is classified as intrastate. *See* CC Exh. 3, DTE-CC 2-1 at 4.

<sup>25</sup> Verizon Brief at 9 & 11.

<sup>26</sup> CC Exh. 3, DTE-CC 2-1 at 4.

because, as reflected in its ARMIS 43-04 report and discussed above, Verizon Massachusetts has virtually no retail interstate services. Likewise, the numerator should consist – as it does in the CLEC Coalition’s calculations – of the avoided retail expenses, which Verizon admits are intrastate.<sup>27</sup> Given this, there is no inconsistency between the numerator and denominator of the avoided cost calculation.

**4. The Department Should Reject Verizon’s Alternative Proposal to Add Unseparated Revenues to the Denominator Even if Non-Retail**

Verizon speciously asserts that “if the Department nevertheless decides to use unseparated, interstate expenses, consistency requires that it use unseparated revenues as well.”<sup>28</sup> As the CLEC Coalition explained, this outlandish claim has no bearing on the adjustments made by the CLEC Coalition to Verizon’s avoided cost discount calculation.<sup>29</sup> The CLEC Coalition’s analysis properly focused on two questions: (1) what are the total avoided costs when Verizon resells its retail services to other carriers? and (2) what is the total revenue from services subject to resale?

By starting with Verizon’s own identification of retail costs that are avoided when services are resold and then making adjustments to ensure that all avoided costs are included in the avoided cost discount calculation, the CLEC Coalition has maintained consistency between the numerator and denominator of the avoided cost discount calculation. If all or essentially all of Verizon’s retail services subject to resale are intrastate in nature, then all or essentially all of the retail costs that support these services also are intrastate in nature.

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<sup>27</sup> VZ Exh. 2, VZ Reb. Test. at 4 lines 17-18; *see also* CC Exh. 3, DTE-CC 2-1 at 4.

<sup>28</sup> Verizon Brief at 11-12.

<sup>29</sup> CC Exh. 3, DTE-CC 2-1 at 5; *see also* CC Exh. 3, DTE-CC 2-3.

Conversely, Verizon fails to support its contention that all regulated interstate revenue must be added to the denominator of the calculation to maintain consistency.<sup>30</sup> Since the adjusted avoided costs identified by the CLEC Coalition only include costs attributable to resold services, adding revenue from non-resold services such as switched and special access would create the very inconsistency that Verizon decries. Access is a wholesale service and therefore, Verizon did not, and could not, have identified any actual avoided expenses attributed to access service.<sup>31</sup> Moreover, Verizon's alternative proposal defies § 252(d)(3) because it only permits revenues derived from "retail rates" in the denominator of the avoided cost equation. The Department should accordingly reject Verizon's alternative recommendation.<sup>32</sup>

**B. Verizon Improperly Reduces the Resale Discount Percentage by Counting Revenue from Services Not Subject to Resale**

Apart from the mismatch caused by Verizon's use of policy-based separated costs, Verizon asserts that if the revenues from certain services (which the CLEC Coalition identified

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<sup>30</sup> Verizon Brief at 11-12.

<sup>31</sup> In its Initial Brief, Verizon distorts the CLEC Coalition's arguments, erroneously claiming that the CLEC Coalition's position is that exchange access services are subject to resale. Verizon Brief at 7-8. The CLEC Coalition fully recognizes that exchange access services are not available for resale. The point the CLEC Coalition was making in its Rebuttal Testimony referenced by Verizon is that the avoided cost discount does not apply exclusively to intrastate retail services but also applies to interstate *retail* services. See CC Exh. 1, CC Reb. Test. at 21; see also CC Exh. 3, DTE-CC 2-1 at pages 2-5.

<sup>32</sup> Verizon also submits that its proposed alternative approach was taken in other jurisdictions, namely Florida, California and Indiana. Verizon Brief at 12. At the same time, it further submits that every other state recognized the jurisdictional approach and did not require the use of interstate and intrastate expenses and revenues. While these decisions are not binding on the Department, Verizon's claims are contradictory should not be afforded any weight. See DTE 02-45, 2002 Mass. PUC LEXIS 65 \*20 (explaining that the "Department does not find other state commission decisions to be dispositive on proceedings conducted in Massachusetts" and that the "Department 'ordinarily place[s] little weight on the decisions reached in other states, since we rely for our decisions on the record presented here'") (citations omitted). Moreover and in any event, the orders that established the resale discount rates of Verizon's affiliates in these states are not clear as to whether the alternative Verizon proposes was adopted in them or even litigated.

are not available for resale) are removed from the denominator, then expenses associated with those services must be removed from the numerator.<sup>33</sup> It submits that “removing the associated expenses for these contested services at a ratio precisely equal to the revenue ratio yields the same results as if there removal had not been done in the first place.”<sup>34</sup> As the CLEC Coalition explained, Verizon’s position that the same ratio that is applied to the denominator should be applied to the numerator of the avoided cost calculation is entirely unsupported and has no basis in law or fact.<sup>35</sup> Further, Verizon fails to recognize that avoided costs included in the numerator are presumed avoided unless Verizon can rebut this presumption with “substantive support,”<sup>36</sup> which it has not done. The Department should accordingly hold that no adjustment to the expenses or the numerator of the avoided cost discount calculation is necessary when the revenues from non-retail services are removed from the denominator of the calculation.

### **C. Verizon Has Understated the Sales Expenses that Are Avoided**

Verizon also contends that only 82.84% of Sales expenses in Account 6612 should be considered avoided and that this percentage is both empirically justified and consistent with *Iowa II*.<sup>37</sup> But Verizon has failed to provide any substantive support for the “special study” from which it claims this percentage derives.<sup>38</sup> In the *Local Competition Order*, the FCC specifically

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<sup>33</sup> Verizon Brief at 26-27.

<sup>34</sup> Verizon Brief at 27.

<sup>35</sup> CLEC Coalition Brief at 13-15.

<sup>36</sup> *Phase 2 Order* at 20 (rejecting Verizon’s unsupported assertions); *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98 & 95-185, First Report and Order, 11 FCC Rcd 15499, FCC 96-325, ¶¶ 917-18 (Aug. 8, 1996) (“*Local Competition Order*”) (subsequent history omitted).

<sup>37</sup> Verizon Brief at 16.

<sup>38</sup> CLEC Coalition Brief at 16-19.

held that all sales expenses are presumed avoidable.<sup>39</sup> While *Iowa II* changed the standard from the “avoidable” to the “avoided” standard, the presumption remains that the costs are avoided unless Verizon provides “substantive support” that they are not.<sup>40</sup> Verizon has not rebutted this presumption and so its adjustment should be rejected.

In addition, Verizon’s assertion that its “special study” was “conservative[]” in assuming “all retail amounts from Account 6612 to have been avoided” rings hollow.<sup>41</sup> Verizon’s 2001 filings in Massachusetts, Virginia and the District of Columbia<sup>42</sup> made no mention that Verizon’s classification of all amounts in Account 6612 as fully avoided was intended to be “conservative.” Nor did Verizon claim at the time that this sub-classification should be done, but that Verizon had insufficient time or resources or some other such reason. Verizon previously did not propose to reduce amounts from Account 6612 because such an adjustment made no sense. The Department should not adopt it here.

Moreover, at the time of those studies, there was much more demand for resale than there is currently.<sup>43</sup> Adjustments to the resale discount then would have had much greater dollar consequences to Verizon than they do today. Accordingly, Verizon had every incentive to reduce the resale discount as much as possible in 2001. The fact that Verizon did not attempt to do so casts serious doubt on its claim that it has refined its thinking today.

Therefore, the Department should treat 100% of Verizon’s sales expenses in USOA Account 6612 as avoided and require that the entire amount be included in the numerator of the

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<sup>39</sup> *Local Competition Order*, ¶ 917

<sup>40</sup> *See Phase 2 Order* at 20 (rejecting Verizon’s unsupported assertions).

<sup>41</sup> Verizon Brief at 15.

<sup>42</sup> *See* VZ Exh. 4, DTE-VZ 2-8 Attachments II-IV.

<sup>43</sup> *See* CC Exh. 1, CC Reb. Test. at 12-14 (confidential version).

avoided cost calculation.

**D. Verizon Improperly Ignores the ARMIS Report 43-03 for Account 6623 that It Files with the FCC which Already Identifies the Retail/Wholesale Split**

Verizon proffers another input to its avoided cost calculation that is based on a different non-state specific “special study.” In support of it, Verizon claims that the CLEC Coalition’s reliance on the *Federal-State Joint Conference on Accounting Issues Recommendations Report*<sup>44</sup> is improper because the FCC rejected that aspect of the Joint Conference report.<sup>45</sup> Verizon asserts that “the specific (alternative) recommendation of the Joint Conference was creation of wholesale/retail subaccounts for Account 6623, which the FCC specifically opted not to do.”<sup>46</sup>

Verizon misconstrues the Joint Conference’s Recommendations Report and the FCC’s *Accounting Order*.<sup>47</sup> The FCC explained that the Joint Conference recommended “the consolidation of Accounts 6621 and 6622 and retention of Account 6623 as a separate account with wholesale and retail subaccounts for Account 6623 only.”<sup>48</sup> It also suggested, “as *another alternative*, modification of ARMIS reporting to provide wholesale/retail percentages for Account 6623 instead of subaccounts.”<sup>49</sup> With respect to the latter proposal, the Joint Conference explained that:

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<sup>44</sup> See CLEC Coalition Brief at 19-23; CC Exh. 2, DTE-CC 1-11A, at 14-15 (attaching *The Federal-State Joint Conference Recommendation*, WC Doc. No. 02-269, at 14-15 (quoting 47 U.S.C. § 251(c)(4)(A)) (footnotes omitted) (emphasis added)).

<sup>45</sup> Verizon Brief at 19.

<sup>46</sup> Verizon Brief at 19.

<sup>47</sup> *Federal-State Joint Conference On Accounting Issues; 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Reporting*, WC Doc. No. 02-269, CC Docket Nos. 00-199, 80-286, & 99-301, Report and Order, 19 FCC Rcd 11732, FCC 04-149, ¶ 14 (rel. June 24, 2004) (“*Accounting Order*”).

<sup>48</sup> *Accounting Order*, ¶ 9

<sup>49</sup> *Accounting Order*, ¶ 9 (emphasis added).

[b]ecause ARMIS Report 43-02 is reported on an operating company basis, ILECs should be required to report the wholesale/retail percent on an individual state basis. The wholesale/retail percentage would be determined annually on a study basis ILECs already use in UNE proceedings...This will provide information used in determining UNE rates, [and] developing the discount for resale rates....<sup>50</sup>

The FCC specifically adopted this Joint Conference proposal. In doing so, the FCC noted that this proposal was consistent with its earlier determination in the *Phase II Report and Order*.<sup>51</sup> Verizon is simply incorrect in asserting that the FCC rejected the Joint Conference's finding that the state-specific splits would assist states in determining the appropriate resale discount rate or that the FCC limited the use of the state-specific splits to state utility commission determinations of UNE rates.<sup>52</sup>

As the CLEC Coalition has demonstrated,<sup>53</sup> Verizon should be required to use the percentage of retail-related expenses for Account 6623 that appears in the publicly available ARMIS Report 43-03 that Verizon filed with the FCC. The Department should not permit Verizon to use a significantly lower percentage of retail related expenses based on a non-state specific "special study."<sup>54</sup>

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<sup>50</sup> See Exh. 2, DTE-CC 1-11A at 15 (underlining added).

<sup>51</sup> See *Accounting Order*, ¶ 14 (referencing the *Phase II Report and Order*).

<sup>52</sup> CLEC Coalition Brief at 22.

<sup>53</sup> CLEC Coalition Brief at 19-23.

<sup>54</sup> As explained in the CLEC Coalition's Initial Brief, the percentages derived from Verizon's special study are not Massachusetts-specific and therefore not appropriate in establishing a resale discount rate that is specific to Massachusetts. CLEC Coalition Brief at 22. Nor has Verizon provided empirical support that an overall nation-wide percentage should apply in Massachusetts. *Id.* at 23. Moreover, while Verizon is obviously partial to its self-serving special study because it serves to reduce the resale discount rate, Verizon admitted that "[i]t would be practically and theoretically correct" to use the retail/wholesale percentage from the "USOA Account 6623 on the ARMIS 43-03 report." *Id.* at 23 (citing VZ Exh. 5, DTE-VZ 3-11).

### **E. Verizon Improperly Omits Indirect Expenses that Are Avoided**

As the CLEC Coalition has shown, a reduction in direct expenses in determining an avoided cost discount will also lead to a reduction in related indirect expenses.<sup>55</sup> For example, when Verizon needs fewer personnel for sales, market management, customer services, and billing activities, etc. as the result of customers lost to resellers (the expenses for which Verizon admits it will avoid), there will necessarily be some reduction in the activities and costs associated with supporting departments and other indirect expenses categories (*e.g.*, fewer sales agents should mean fewer desks, computers, office space needs, etc.).<sup>56</sup> In the *Local Competition Order*, the FCC recognized this and explained that certain indirect expenses “are presumed to be avoided in proportion to the avoided direct expenses.”<sup>57</sup> Yet contrary to common sense and FCC prescription, Verizon ignores *all* indirect expenses avoided as a result of avoided direct expenses.<sup>58</sup> None of Verizon’s arguments for retaining all indirect costs has merit.

Verizon incorrectly claims that the CLEC Coalition’s argument is a “slight variation on the ‘avoidable’ cost standard rejected by the Eighth Circuit” in *Iowa II* because it requires the Department to use an unlawful forward-looking standard.<sup>59</sup> But *Iowa II* is based on a forward-looking standard. The Court specifically stated that “‘*will be avoided*’ refers to those costs that the ILEC will avoid incurring in the future” and that “those continuing costs of providing retail telephone service which will be avoided by selling the competitor the services it requests . . . are

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<sup>55</sup> See CLEC Coalition Brief at 23-29.

<sup>56</sup> *Id.*

<sup>57</sup> *Local Competition Order*, ¶ 918.

<sup>58</sup> See CC Exh. 1, CC Reb. Test. at 41 (discussing VZ Exh. 1, Dir. Test., at 11).

<sup>59</sup> Verizon Brief at 22.



to be excluded.”<sup>60</sup> In applying this standard, the Eighth Circuit required that state commissions quantify direct and related indirect costs that “*will be avoided...in the future.*”<sup>61</sup> As the CLEC Coalition explained, absent substantiation to the contrary, the Department must assume that a utility will act prudently and will not wastefully incur future indirect expenses to support direct expenses that Verizon admits it will not incur.<sup>62</sup>

Verizon also claims that ¶¶ 673-74 of the Wireline Bureau’s *Virginia Arbitration Order*<sup>63</sup> support its position. To the contrary — the *Virginia Arbitration Order* supports the CLEC Coalition’s position. In particular, the Wireline Bureau specifically agreed with AT&T that,

just as Verizon identifies 100 percent of the expenses associated with Sales (Account 6612) as expenses that are avoided, all of the costs associated with the people who perform the sales functions - e.g., their salaries, office equipment, office space, and the human resources support to hire and fire them - should be avoided. These indirect expenses are reflected in the Office Equipment and the Human Resources accounts (Accounts 6123 and 6723).<sup>64</sup>

The Wireline Bureau’s determination also is consistent with paragraph 918 of the *Local Competition Order* that such indirect expenses are, in proportion, “presumed avoided.” The CLEC Coalition’s identification of the indirect costs that Verizon will avoid is generally based on the approach Verizon and its District of Columbia and Virginia affiliates took previously.<sup>65</sup>

Verizon further asserts that no correlation exists between its indirect expenses and the number of access lines it serves and that CLECs have offered no evidence refuting or even

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<sup>60</sup> *Iowa II*, 219 F.3d at 755 (emphasis added).

<sup>61</sup> *See id.*

<sup>62</sup> CLEC Coalition Brief at 25.

<sup>63</sup> *Virginia Arbitration Order*, ¶¶ 673-74.

<sup>64</sup> *Virginia Arbitration Order*, ¶ 693.

<sup>65</sup> Relatedly, it warrants emphasizing that the CLEC Coalition’s position is not that all indirect costs are avoided, but rather only a portion of them are, as Verizon previously recognized.

contesting these facts.<sup>66</sup> Contrary to Verizon's claims, the CLEC Coalition has offered such evidence. In response to DTE-CC 2-1, the CLEC Coalition demonstrated that Verizon's analysis showing the historical relationship of Verizon's volumes in Massachusetts (switched access lines and revenues) to certain indirect expenses is flawed and that Verizon's use of correlation coefficients to support its statement that certain indirect expenses will not be avoided is invalid.<sup>67</sup>

In addition, Verizon claims – absurdly – that computer expenses, human resources, executive expenses and general and administrative expenses are not avoided when services are offered for resale.<sup>68</sup> Verizon's position defies both ¶ 918 of the *Local Competition Order* that certain indirect costs associated with certain accounts are avoided and common sense.<sup>69</sup> Verizon cannot credibly contend that it continues to buy office equipment (Account 6123) and computers (Account 6124) and incur general and administrative expenses (Account 6728) for employees performing retail functions who are no longer employed by Verizon as a result of losing customers to reselling CLECs. Nor is it credible that Verizon employs executives (Account 671105/671115) and human resource personnel (Account 6723) to manage and support such non-existent employees.<sup>70</sup>

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<sup>66</sup> Verizon Brief at 22.

<sup>67</sup> See CC Exh. 3, DTE-CC 2-1 at 6-7.

<sup>68</sup> Verizon Brief at 23-25.

<sup>69</sup> CLEC Coalition Brief at 27-29.

<sup>70</sup> Verizon references Account 47 C.F.R. § 32.6720 in its reply brief. Verizon Brief at 25. The CLEC Coalition did not refer to the entirety of that Account but rather its analysis focused on specific general ledger accounts, *i.e.*, Accounts 671105, 671115, 6723, and 6728, that are a subset of Account 6720 that Verizon's provides in its ARMIS 43-03 Report. See VZ Exh. 6, CC-VZ 1-10; see also CC Exh. 1, Reb. Pan. Test., at Exh. AA/WF-3 page 28-30. Verizon also contends that "if anything, executive expenses arguably increase where Verizon must manage both its existing retail structures and the required reselling activities by CLECs." Verizon Brief at 24. This is unsupported nonsense. Verizon ignores the fact that it no longer is providing retail services, so there is less "retail structure" to manage.

Finally, Verizon asserts that such retail costs are not avoided because they are still used to support wholesale services. This assertion is fallacious as well. The costs associated with computers, office furniture, human resources etc. that support wholesale services are already accounted for. The Department should accordingly rule that the indirect expenses identified by the CLEC Coalition are avoided and should be included in the numerator of the avoided cost calculation.

## **II. Other Measures Show That Verizon's Proposed Resale Discount Is Excessively Low**

As shown in the CLEC Coalition's Initial Brief,<sup>71</sup> comparing Verizon's proposed discount rates to Verizon's sales agent commissions confirms that Verizon's proposed rates are excessively low and inconsistent with the pro-competitive goals of the Act. Verizon's sales agent commissions should not be **[BEGIN VERIZON CONFIDENTIAL]** **[END VERIZON CONFIDENTIAL]** than the resale discount rate.<sup>72</sup>

Verizon contends that the CLECs' argument presents an "apples-to-oranges" comparison "between the simple avoidance of retailing costs associated with the loss of a retail customer on the one hand with the cost and benefits associated with use of sales agents on the other."<sup>73</sup> It also argues that outside sales agents do not simply replace Verizon's marketing efforts but "augment" them and thus "outside sales agent commissions do not act to avoid expenses that Verizon would otherwise incur."<sup>74</sup> Verizon further claims that its outside sales agents are often compensated for providing services that are not subject to resale and that several classes of

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<sup>71</sup> CLEC Coalition Brief at 30.

<sup>72</sup> CLEC Coalition Brief at 30-36.

<sup>73</sup> Verizon Brief at 31 (quoting Rebuttal Testimony at 26).

<sup>74</sup> Verizon Brief at 31.

service offered by outside agents do not result in commission to an agent.<sup>75</sup>

The Department can quickly reject Verizon's arguments. The level of commissions that Verizon pays its independent (*i.e.*, external, non-employee) sales agents provides an important "sanity test" or "litmus test" that the Commission may employ to assess the reasonableness of Verizon's alleged avoided costs.<sup>76</sup> A comparison of Verizon's proposed resale discounts to its sales agent commissions clearly shows the lack of credibility in Verizon's proposed resale discount rate.<sup>77</sup> Indeed, (a) CLECs perform many more retail related activities than Verizon's sales agents (which accounts for more avoided costs) and (b) commissions are volume driven and CLECs generally resell much higher volumes than individual agents.<sup>78</sup> Therefore, any suggestion that the costs Verizon avoids when CLECs resell Verizon's service are less than Verizon sales agents' maximum commissions is suspect.<sup>79</sup> Not only that, it reflects Verizon's attempt to discriminate based on price which is inconsistent with 47 U.S.C. § 202 and Massachusetts law.<sup>80</sup>

For these reasons and as shown in the CLEC Coalition's Initial Brief, the Department should use Verizon's sales agent commissions as a litmus test and recognize that the resale discount percentage with OS/DA should "not be lower than the sales agent commissions."<sup>81</sup>

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<sup>75</sup> Verizon Brief at 32.

<sup>76</sup> CLEC Coalition Brief at 30.

<sup>77</sup> CLEC Coalition Brief at 30.

<sup>78</sup> *Id.* at 31-32.

<sup>79</sup> *Id.* at 32.

<sup>80</sup> See 47 U.S.C. § 202; *see also* G.L. c. 159, §§ 14 & 17.

<sup>81</sup> CC Exh. 3, DTE-CC 2-9 at 3.

### **III. The Resale Mode of Competitive Entry Under Section 251(c) Would Be Rendered Meaningless if the Resale Discount Rate Dropped By Fifty Percent**

As the CLEC Coalition explained, should the Department agree to reduce the resale discount rate by fifty percent, as Verizon recommends, the resale mode of competitive entry would be rendered virtually meaningless.<sup>82</sup> Contrary to Verizon's contentions, this is not a forbidden policy argument,<sup>83</sup> but a suggestion that the Department should construe Sections 251(c)(4) and 252(d)(3) in a manner that fulfills their meaning and the purpose Congress envisioned.<sup>84</sup> The purpose of Sections 251(d)(4) and 252(d)(3) would be eviscerated and rendered meaningless if Verizon's proposed rates were adopted. The Department should not allow that to happen.

Verizon also asserts that the CLEC Coalition's arguments "ignore today's vibrant multimodal competition in which traditional wireline carriers vie for market share against cable and Internet-based telephony, wireless solutions and, indeed, against new, nontraditional forms of communication (like instant and text messaging)" and that "competition is flourishing in Massachusetts."<sup>85</sup> Verizon's assertions are unsupported in the record. Moreover, unlike the CLEC Coalition's position, which relates to the express language in § 252(d)(3) and how it should be construed to give it the meaning that Congress envisioned and intended,<sup>86</sup> Verizon's

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<sup>82</sup> CLEC Initial Brief at 36.

<sup>83</sup> When the FCC stated in paragraph 914 of the *Local Competition Order* that "[a]n avoided cost study may not calculate avoided costs based on non cost factors or policy arguments", the FCC was making the point that states must have substantive support for establishing the resale discount rates based on a strict application of Section 252(d)(3) as the FCC interpreted it. *See Local Competition Order*, ¶ 914. The FCC's point was that the avoided cost discount could not be set arbitrarily based on non-cost factors. *Id.*

<sup>84</sup> CLEC Coalition Brief at 37.

<sup>85</sup> Verizon Brief at 29.

<sup>86</sup> The Act specifically contemplates three separate paths of entry into the local market - the construction of new networks, the use of unbundled network elements of the incumbent's

argument is precisely the type of policy argument that the FCC prohibits the Department from considering when setting the resale discount rate.

Finally, contrary to Verizon's position, the CLEC Coalition is not suggesting that the Department arbitrarily "adjust the discount to manipulate the level or profitability of resale market entry."<sup>87</sup> Rather, as explained, the CLEC Coalition is asking that the Department adopt the resale discount rates proposed by the CLEC Coalition because they are (i) fully supported, (ii) consistent with the pro-competitive framework of the Act, and (iii) interpret Sections 251(c)(4) and 252(d)(3) in a manner consistent with the Congressional intent in enacting them.

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network and resale. *Local Competition Order*, ¶ 12. "Congress has made clear that all three forms of local entry must be treated in a competitively neutral manner" to foster competition in the local market. *In the Matter of Federal-State Joint Board on Universal Service, Report to Congress*, 13 FCC Rcd 11501, ¶ 164 (1998).

<sup>87</sup> Verizon Brief at 30 (quoting the *Virginia Arbitration Order*, ¶ 670).

## **CONCLUSION**

For the foregoing reasons and as demonstrated in the CLEC Coalition's Initial Brief, the Department should reject Verizon's proposal and instead should adopt the CLEC Coalition's proposed changes to Verizon's avoided cost study and the resulting resale discount rates.

Respectfully submitted,

/s/

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Dated: December 6, 2006

## CERTIFICATE OF SERVICE

I certify that on this 6th day of December, 2006 in DTE 06-61, the attached public version of the Reply Brief of the CLEC Coalition, which includes Broadview Networks, Inc.; DSCI Corporation; Eureka Telecom, Inc., d/b/a InfoHighway Communications; Metropolitan Telecommunications of Massachusetts, Inc., d/b/a MetTel; New Horizon Communications; and One Communications have been sent to the individuals on the DTE 06-61 service list via postage prepaid first-class mail and electronic mail (unless otherwise noted below) as follows: (1) overnight mail in lieu of first class mail (if noted with one asterisk); or (2) via electronic mail only (if noted with two asterisks). A hard copy of the confidential page in the Reply Brief, which contains Verizon Protected Material, is being provided to Verizon Massachusetts and Hearing Officer Chin in a sealed envelope marked confidential.

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