COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Public Utilities on its own motion regarding (1) implementation of Section 276 of the Telecommunications Act of 1996 relative to Public Interest Payphones, (2) Entry and Exit Barriers for the Payphone Marketplace, (3) New England Telephone and Telegraph Company d/b/a NYNEX's Public Access Smart-Pay Line Service, and (4) the rate policy for operator service providers	**D.P.U./D.T.E. 97-88/18 (Phase II)**

REPLY COMMENTS OF VERIZON MASSACHUSETTS

Verizon Massachusetts ("Verizon MA") responds to comments filed by the New England Public Communications Council (the "NEPCC") on April 24, 2003, regarding the Company's development of Total Element Long-Run Incremental Cost ("TELRIC") based rates for Public Access Line ("PAL") and Public Access Smart-pay Line ("PASL") services. As described below, NEPCC's comments are replete with factual errors, incorrect assumptions, and miscalculations relating to Verizon MA's April 15, 2003, revised filing, which updates the Company's payphone rates on a TELRIC basis in accordance with Department directives. Because of these many inaccuracies and misstatements, the Department should disregard the arguments made by NEPCC as totally unfounded.

I. SUMMARY OF VERIZON MA'S POSITION

Contrary to NEPCC's claims, Verizon MA does not propose that the Department adopt TELRIC-based rates used in pricing *wholesale* unbundled network elements

("UNE") for *retail* payphone services. NEPCC's Initial Comments, at 8, 13. Indeed, *no* change in Verizon MA's existing payphone service rates is required to establish compliance with the Federal Communications Commission's ("FCC") "new services" test under the *Payphone Orders* and *Wisconsin Orders*.

As demonstrated in this proceeding, Verizon MA's current payphone service rates are fully supported by a Total Service Long-Run Incremental Cost ("TSLRIC") study. As the FCC recognized, this forward-looking cost methodology satisfies its "new services" test, and appropriately reflects the *retail* functionality provided by incumbent local exchange carriers ("LEC") to payphone service providers ("PSP"). Verizon MA's Initial Comments, at 3-4 (filed April 24, 2003). Accordingly the Department should find that Verizon MA's existing, approved payphone rates comply with FCC requirements.

However, if the Department determines that TELRIC-based rates should now apply to payphone services,[1] Verizon MA's April 15th filing would reasonably inform the Department of the projected TELRIC-based rates and revenues, pending a final decision in D.T.E. 01-20 (Phase I). Contrary to NEPCC's claims, Verizon MA updated its TELRIC-based payphone rates in that filing using Massachusetts specific payphone data (including density zone weightings) as previously filed with the Department in this proceeding. Verizon MA also correctly applied the TELRIC-based port rates filed in D.T.E. 01-20, and included a retail expense factor to capture the retail costs (*e.g.*, billing, administrative and customer service expenses) attributable to its provision of payphone

[1] In accordance with D.T.E. 01-31, the Department should also allow Verizon MA to offset any revenue impact resulting from the introduction of TELRIC-based rates. Verizon MA's Initial Comments, at 12.

services to PSPs in accordance with the FCC's *Wisconsin Order*. Verizon MA's Initial Comments, at 9-10.

Finally, NEPCC's claim that PSPs are entitled to a retroactive refund from Verizon MA dating back to April 15, 1997, under the FCC's *Payphone Orders* and *Wisconsin Orders* is erroneous. Verizon MA's existing payphones rates were previously approved by the Department as just and reasonable. Nothing in the record alters the Department's prior findings that those rates are lawful. Nor has NEPCC shown that Verizon MA's existing rates, which are supported by the TSLRIC methodology, fail to comply with the FCC's new services test. Thus, even if the Department decides to modify Verizon MA's PAL and PASL rates *prospectively* to coincide with forthcoming rate changes once new TELRIC-based prices are approved, Verizon MA should *not* be required to refund any monies to PSPs based on the current PAL and PASL rates.

II. ARGUMENT

A. The Department's Approval of Verizon MA's TELRIC-Based Rates Is Not At Issue in This Proceeding and Should Have No Effect on the Department's Determination that Verizon MA's Existing Payphone Rates Comply with FCC Requirements.

NEPCC criticizes the TELRIC-based payphone rates contained in Verizon MA's April 15th filing because they are based on UNE prices that the Department has not yet approved in D.T.E. 01-20 and are the "subject of serious challenge." NEPCC's Initial Comments, at 7. That argument is a red herring.

First, Verizon MA's April 15th filing complies with the Department's directives to update payphone rates using TELRIC-based prices contained in the Company's compliance filings in D.T.E. 01-20 (Phase I). Verizon MA's Initial Comments, at 1-2.

The fact that the Department has not yet approved those TELRIC-based rates has no bearing on Verizon MA's compliance with the Department's request in this proceeding.

Second, to the extent that the Department's final order in D.T.E. 01-20 results in any changes in the TELRIC-based rates contained in Verizon MA's compliance filings in that proceeding, the Company would update the payphone rates in its April 15th filing to reflect those modifications, if directed by the Department. However, this is premature and not even relevant if the Department finds - as it should - that TSLRIC is the appropriate forward-looking cost methodology for pricing payphone services.

In the most recent *Wisconsin Order*,[2] the FCC stated that the TSLRIC methodology often used by state regulatory commissions "is consistent with the *Local Competition Order* … to develop the direct costs of payphone line service costs" in compliance with the FCC's new services test. As the record evidence shows, Verizon MA's TSLRIC study supports the current PAL and PASL rate levels. Verizon MA's Initial Brief, at 6-9 (filed December 12, 2001). Accordingly, the Department should ignore NEPCC's comments on Verizon MA's TELRIC methodology, which is not at issue in this proceeding, and affirm Verizon MA's existing, TSLRIC-based payphone rates as compliant with applicable FCC requirements.

[2] CCB/CPD No. 00-01, FCC 02-25, Memorandum Opinion and Order, 17 FCC Rcd 2051, ¶ 49 (Jan. 31, 2002).

B. Contrary to NEPCC's Claims, Verizon MA's Updated Payphone Rates Are Based On Density Zone Weightings Specific to PAL Services in Massachusetts As Reflected in the Company's Prior Department Filings.

NEPCC contends that Verizon MA's April 15th filing includes updated PAL rates that do not reflect density zone weightings specific to payphone service in Massachusetts. NEPCC's Initial Comments, at 8. NEPCC is wrong.

NEPCC recalculates the TELRIC-based, measured PAL loop rate as $15.19 using the density zone weightings from Verizon MA's January 29, 2001, compliance filing in this proceeding. NEPCC's Initial Comments, at 8 n.27, citing Verizon MA Exhibit 44, and Exhibit 4. Verizon MA, however, updated those density zone weightings for Massachusetts payphone services in its Panel Rebuttal Testimony, filed October 16, 2001. Verizon MA Exhibit 47, Attachment II; Verizon MA's Initial Brief, at 13-14. Verizon MA appropriately uses the more recent density zone distributions to determine TELRIC-based PAL rates in its April 15th filing.[3] Accordingly, Verizon MA's projected TELRIC-based, measured PAL (loop) rate of $15.55 is correct, and NEPCC's recalculation is wrong.[4]

NEPCC makes a similar argument that Verizon MA fails to apply the density zone weightings previously filed in this proceeding in developing its projected TELRIC-based, unlimited PAL (loop) rate for its April 15th filing. NEPCC's Initial Comments, at 9. Once again, NEPCC is mistaken.

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3 Verizon MA used this same density data for payphone services in its D.T.E. 01-31 filings.

4 NEPCC also includes the wrong port rate – using the $2.63 coin port rate, rather than the $2.73 PAL port rate, as contained in Verizon MA's TELRIC tariff compliance filing. NEPCC's Initial Comments, at 8; *see also* Verizon MA's April 15, 2003, Filing, at Tab B, Att. IV, col. (b) and (f).

Verizon MA utilizes the same density zone distributions for Massachusetts payphone services contained in Attachment II of its Panel Rebuttal Testimony, and weights them based on those Massachusetts exchanges where flat-rated PAL service is available. Verizon MA's April 15, 2003, Filing, at Tab B, Att. IV, col. (b) and (f), and Workpaper. As a result of those weightings, Verizon MA projects a TELRIC-based loop rate of $17.15 for unlimited PALs,[5] which is slightly higher than the measured PAL loop rate of $15.55. *Id.* That differential is reasonable because flat-rated PAL service is not available in any "Metro" exchanges and only in some "Urban" exchanges, where TELRIC loop costs are lower.[6]

Third, NEPCC contends that Verizon MA's development of a *separate* TELRIC-based loop rate for flat-rated PAL service, using geographic payphone line distribution, is not a cost-based approach. NEPCC's Initial Comments, at 9-10. NEPCC states that it is based solely on Verizon MA's "unilateral choice" not to offer that service statewide, and has nothing whatsoever to do with PAL service costs. NEPCC's Initial Comments, at 11. NEPCC's argument is unfounded.

Clearly, Verizon MA established the TELRIC-based, unlimited PAL (loop) rate using a cost based approach. Those costs appropriately reflect the actual geographic distribution of the service offering. Verizon MA should not be prohibited from recovering its directly attributable costs because of "decisions regarding the rate structure it will offer," as NEPCC erroneously claims. NEPCC's Initial Comments, at 11.

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5 In addition to a loop and port charge, the unlimited PAL customer would also incur a charge for flat-rated usage. In its April 15th filing, Verizon MA calculates that flat-rated usage component using a projected TELRIC-based per minute rate [Tab B, Att. IV, col. (b) and (f)].

6 In its Initial Brief, Verizon MA indicated that, for the August 2001 study period, 2,016 of the 9,470 PALs in Massachusetts were unlimited, flat-rated PALs. Verizon MA's Initial Brief, at 14, 27 n.27, citing NEPCC Exhibit 201.

Finally, the Department should reject NEPCC's blatant attempt – for the first time in this proceeding – to effect a change in Verizon MA's existing PAL rate structure by expanding the Company's flat-rated PAL service to a statewide offering. NEPCC's Initial Comments, at 11 n.31. This is not only inconsistent with Verizon MA's current *retail* rate structure for other business lines, but also conflicts with its *wholesale* UNE tariff.[7] Moreover, nothing in the record supports any PAL rate restructure, and the FCC's new services test certainly does not require it.

C. NEPCC's Proposed Port Rate Is Arbitrary and Not Cost-Based.

NEPCC proposes that the combined loop and port rate for PALs with no coin functionality should be $15.39. NEPCC's Initial Comments, at 12. This is based on a $15.19 loop rate that NEPCC establishes using incorrect weightings, as explained above, and a $0.20 port rate that is seriously flawed.

In developing the $0.20 port rate, NEPCC uses a cost differential that is arbitrarily derived from the TSLRIC study for payphone line rates filed in 2001 in this proceeding and the UNE port cost methodology approved by the Department in the *Consolidated Arbitrations* (D.P.U./D.T.E 96-73/74, 96-75, 96-80/81, 96-83, 96-94). NEPCC's Initial Comments, at 12; Verizon MA's Initial Brief, at 11. In particular, NEPCC averages the difference between Verizon MA's TSLRIC costs for a "Loop with Coin Control ($14.57) and a "Loop without Coin Control" ($12.01) and the difference between the Company's UNE rates for a PAL port ($4.62) and a coin port ($6.92) from the *Consolidated*

7 By definition, wholesale UNEs do not include a flat-rated usage component; usage is offered on an unbundled basis. Therefore, although the Department may consider payphone services in the *nature* of wholesale services, the Department should continue to tariff payphone services as retail service offerings. Verizon MA's Initial Comments, at 8. This would enable Verizon MA to continue to offer unlimited PALs (with flat-rated usage), where available. It also conforms to the FCC's *retail* classification of payphone services in its *Payphone Orders*. *Id*.

Arbitrations. NEPCC's Initial Comments, at 12; Verizon MA's Initial Brief, at 11-12, 16; Verizon MA's Reply Brief, at 10-12 (filed December 31, 2003). This produces a "cost differential" of $2.43, which NEPCC subtracts from Verizon MA's TELRIC-based coin port rate of $2.63 to derive a $0.20 port rate. NEPCC's Initial Comments, at 12.

NEPCC's characterization of the $2.43 figure as a "cost differential" is clearly a misnomer. It is not cost-based at all. Indeed, NEPCC's mixing of rates and costs in this context is totally inappropriate and self-serving.

NEPCC's recommended $0.20 PAL port rate is substantially below – approximately 93 percent below – the TELRIC-based cost of $2.73 contained in Verizon MA's compliance filing in D.T.E. 01-20 (Phase I). Pricing below TELRIC-based costs contravenes applicable state cost standards and federal guidelines under the FCC's new services test. Therefore, the Department should summarily deny NEPCC's port rate proposal.

D. Contrary to NEPCC's Claims, Verizon MA's Projected TELRIC-Based Local Usage Costs for PALs Are Properly Developed and Provide No Evidence of Gross Overcharges.

NEPCC contends that Verizon MA provides no explanation for new local usage assumptions used to develop its projected TELRIC-based local usage costs for measured and unlimited PALs. NEPCC's Initial Comments, at 13-14. NEPCC's argument is without merit.

The Department directed Verizon MA to file updated PAL and PASL rates based on the Company's February 13, 2003, TELRIC filing in D.T.E. 01-20 (Phase I). Verizon MA's Initial Comments, at 1-2. The measured PAL local usage of 182 minutes and flat-rated PAL local usage of 453 minutes used in Verizon MA's April 15th compliance filing in this proceeding reflects the average minutes of use included in the Company's compliance filing in D.T.E. 01-31. By applying the same PAL local usage assumptions,[8] Verizon MA ensures consistency with these Department proceedings. Thus, it would not be correct to use Verizon MA's previously filed measured PAL usage assumption of 424 minutes, as NEPCC erroneously suggests.[9] NEPCC's Initial Comments, at 14.

Likewise, NEPCC's claim that Verizon MA's TELRIC-based PAL usage rates demonstrate that Verizon MA has grossly overcharged PSPs over the years is unfounded. Throughout this proceeding, NEPCC has failed to show that it is entitled to any retroactive refund. Moreover, NEPCC's use of *newly developed* TELRIC-based rates to calculate an alleged refund amount, *dating back* to April 15, 1997, is questionable and must be disregarded. NEPCC's Initial Comments, at 13.

E. Verizon MA's Inclusion of a Retail Expense Factor in Developing its TELRIC-Based Payphone Rates Is Reasonable and Consistent with FCC Rulings.

NEPCC contends that Verizon MA is precluded from applying a retail expense factor to payphone rates because it contravenes the Department's classification of payphones services as wholesale offerings. NEPCC's Initial Comments, at 14. NEPCC also argues that Verizon MA's introduction of this factor at this stage in the proceeding is untimely and should not be allowed. NEPCC's Initial Comments, at 14. NEPCC is wrong on both counts.

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8 The source of the 182 minutes of local use for measured PALs is a special study in D.T.E. 01-31, based on actual billed quantities for the annual period of May 2001 through April 2002. That analysis provides the supporting documentation for Verizon MA's June 5, 2002, D.T.E. 01-31 compliance filing (Tab B, Attachment IV). The source of the 453 minutes of local use for flat-rated PALs is Verizon MA's Business Service Profile, which was the supporting documentation for the Company's price floor calculations in its September 15, 1995, compliance filing in D.T.E. 95-83.

9 The 424 average minutes of use is based on June 1997 data from D.T.E. 98-67 (Fourth Annual Price Cap Filing). Verizon MA's Reply to NEPCC Record Request 2, dated September 13, 1999.

First, Verizon MA's inclusion of a retail expense factor to capture the retail costs (*e.g.*, billing, administrative and customer service expenses) attributable to its provision of payphone services to PSPs is clearly permissible under the FCC's *Wisconsin Order*. Verizon MA's Initial Comments, at 9-10. The FCC ruled that incumbent LECs may appropriately include a retail expense factor because such retail functions are not available to competitive local exchange carriers ("CLEC") and, therefore, are excluded from *wholesale* UNE prices. *FCC Wisconsin Order*, at ¶ 50.

NEPCC suggests that the Department's finding that payphone services are in the *nature* of wholesale services would somehow negate the FCC's ruling in the *Wisconsin Order* regarding the recovery of retail expenses. NEPCC's Initial Comments, at 14. It would not. As the FCC recognized, Verizon MA is entitled to recover its payphone related costs, including those associated with retail functions provided by the Company to PSPs. Likewise, the Department cannot supersede the FCC's decisions that payphone services are considered retail offerings. Verizon MA's Initial Comments, at 8.

Second, NEPCC mischaracterizes Verizon MA's omission of retail expenses in its March 3rd compliance filing as an admission by the Company to exclude retail costs. NEPCC's Initial Comments, at 14-15. It is not. Verizon MA's inclusion of retail costs in its April 15th filing is consistent with the Company's position throughout this proceeding that retail expenses incurred in the provision of payphone services should be reflected in payphone rates.[10] Verizon MA's Initial Brief, at 15.

[10] NEPCC's statement that Verizon's own witness testified that there is no basis for differentiating between PAL services and other wholesale services regarding retailing expenses is simply untrue. NEPCC's Initial Comments, at 15. NEPCC provides no support for its assertion because it cannot be substantiated from the record evidence.

Third, NEPCC suggests that Verizon MA's introduction of its payphone specific retail factor of 8.27 percent is untimely. As indicated above, the FCC's *Wisconsin Order* expressly provides for the recovery of retail marketing costs when the TELRIC methodology is used. *FCC Wisconsin Order*, at ¶ 50. Verizon MA developed the 8.27 percent retail factor for its April 15th filing in compliance with the Department's directives on February 21, 2003, to update its projected TELRIC-based payphone rates to reflect the effects of the *Wisconsin Order.* That retail factor is based on payphone related, retail marketing costs that were excluded from the Company's TELRIC studies filed in D.T.E. 01-20 because they relate to non-network *retail* functions (such as retail marketing, billing and customer care services) and are not incurred in a wholesale environment. Verizon MA's Initial Comments, at 9-10.

Contrary to NEPCC's claims, Verizon MA's retail expense factor is not a new rate element. NEPCC's Initial Comments, at 15. Those retail expenses are reflected as costs associated with the PAL or PASL loop rate. Should the Department determine that TELRIC rates apply to payphone services, Verizon MA is entitled to recover those retail costs under the FCC's *Wisconsin Order.*[11] A comparable resale discount of 8.27 percent off the retail rates would also apply to resellers subscribing to PALs because (unlike PSPs) the retail functionality and associated expenses would be assumed by the reseller. Accordingly, the Department should disregard NEPCC's claims on this issue.

[11] As illustrated in the April 15th filing, Verizon MA's existing measured PAL line rate consists of the dial tone line rate of $13 plus the $7.13 federally mandated subscriber line charge ("SLC") – which reflects the allocation of the loop costs - for a total of $20.13. A "like" comparison of the projected TELRIC-based measured PAL line rate consists of the loop rate of $15.55 plus the port rate of $2.73 plus the retail costs of $1.55 per line, for a total of $19.83. This "line" comparison does not include any charges for local usage, directory assistance or other payphone features.

F. There is No Basis for the Department to Direct Verizon MA to Make a Retroactive Refund to PSPs.

NEPCC reiterates its claim that a retroactive refund should apply to PAL rates dating back to April 15, 1997, because Verizon MA's rates do not satisfy the FCC's new services test. NEPCC Initial Comments, at 16-20. NEPCC's arguments are erroneous.

First, Verizon MA's current rates are consistent with TSLRIC studies, an accepted forward-looking cost methodology to demonstrate compliance under the FCC's new services test. Verizon MA's Initial Brief, at 33-34. Second, the FCC does not require a retroactive refund, and other state commissions have rejected similar claims. Verizon MA's Initial Comments, at 11. While the Department may consider *prospective* rate changes to coincide with the adoption of new TELRIC prices, there is no basis for awarding PSPs retroactive refunds. Verizon MA has lawfully charged PSPs for payphone services based on existing PAL rates previously approved by the Department as just and reasonable.[12]

By contrast, NEPCC has presented no cost study to support its claims that Verizon MA's existing payphone rates are non-compliant. NEPCC's analysis estimating the level of the rate refund also appears to contain a number of errors.[13] NEPCC's Initial Comments, at 19, Exhibits 8 and 9. However, even if NEPCC had accurately calculated the magnitude of its projected refund, this would not change the fact that a refund is

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12 It should be noted that Verizon MA filed tariff revisions in May 1997, modifying Curb-A-Charge features that were applicable to all customers, and creating PAL specific Curb-A-Charge features (Direct Dial Screening, Operator Number Screening and Terminating Number Screening) in accordance with the FCC's *Payphone Orders* and its new services test. Verizon MA's Initial Brief, at 3 (filed October 12, 1999).

13 For example, in some cases, NEPCC uses the wrong SLC for the period in question. NEPCC also mismatches the data, applying projected, TELRIC-based rates for past time periods.

completely unwarranted. Accordingly, the Department should find that NEPCC's claims are specious and should be rejected.

III. CONCLUSION

For the foregoing reasons, the Department should reaffirm the reasonableness of Verizon MA's payphone rates and find them in compliance with the FCC's new services test. Those rates are supported by a forward-looking cost (TSLRIC) methodology accepted by the FCC. Therefore, no change in Verizon MA's current payphone rates is necessary to satisfy federal requirements.

Contrary to NEPCC's claims, PSPs are not entitled to any retroactive refund. The Department has approved Verizon MA's existing rates, and it would be unfair and unreasonable for the Department now to impose a refund based on rates previously deemed lawful. Should the Department, however, decide to establish prospectively TELRIC-based rates for payphone services provided to PSPs in conjunction with other upcoming rate changes, Verizon MA should be allowed to include payphone related retailing expenses and apply appropriate weightings and density zone distributions, as contained in the Company's April 15th filing.

Respectfully submitted,

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