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 (Part A)

REPLY COMMENTS OF WORLDCOM, INC. IN FURTHER SUPPORT OF ITS MOTION FOR RECONSIDERATION OF JULY 11, 2002 ORDER

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I. Introduction

WorldCom, Inc. ("WorldCom") hereby submits these reply comments in response to the comments filed by Verizon in opposition to WorldCom's motion for partial reconsideration. For the reasons stated below and in WorldCom's motion, WorldCom respectfully requests the Department to reduce Verizon's cost of capital and remove UDLC from the forward-looking network construct.

II. Argument

A. Verizon has failed to justify the high cost of capital set by the Department

In opposing WorldCom's motion for reconsideration with respect to cost of capital, Verizon first challenges WorldCom's interpretation of the evidence, defending the Department's conclusions concerning the competitive state of the telecommunications market. For instance, in response to WorldCom's observation that CLEC collocation arrangements are in decline (WorldCom Motion at 9-10), Verizon muses that such a decline "does not mean that

other CLECs, who maintain their collocation arrangements, or who have their own facilities, are not capturing those existing customers." Verizon Comments at 5. As Verizon's competitors return literally hundreds of collocation arrangements to Verizon[1], could it be the case that all (or even most) of the affected customers become the customers of another CLEC? However unlikely, the possibility theoretically does exist. Is there any evidence in the record to support Verizon's idle speculation? Absolutely not. Thus, Verizon has failed to provide specific evidence that this alarming trend is not weakening competition in Massachusetts.

Verizon also cites to a July 23, 2002 report by the FCC to support its claim that its "actual line count has declined." Verizon Comments at 5, citing *2002 Local Telephone Competition Report* referred to in footnote 5. First, Verizon's fixation on line count sidesteps the fact that most of the customers that have migrated to CLECs have done so via UNE-based connectivity or special access circuits – competitive modes that both result in the continued use of Verizon facilities. [2] *See* WorldCom Motion at 12-14. Second, and more important, Verizon fails to put its "line count" argument in context. Specifically, Verizon failed to inform the Department that during the same one-year period in which the ILECs line count declined, nearly 2 million new subscribers signed up for DSL service. Indeed, the same day the FCC released the *2002 Local Telephone Competition Report* cited by Verizon, it also released its *2002 High-Speed*

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1 *See* WorldCom Motion at 9-10; RR-DTE-1.

2 Even the *2002 Local Competition Report* makes clear that "CLEC" lines are more often than not via the use of ILEC facilitities: "CLECs reported providing about 22% . . . of ***their*** switched access lines ***by reselling the services of other carriers*** and about 47% [of their switched access lines]. . . ***by means of unbundled network element (UNE) loops, including the UNE-Platform, leased from other carriers***. The ***remainder*** of CLEC lines was provided over local-loop facilities owned by the CLECs." *2002 Local Competition Report* (covering *News* release) at 1-2 (emphasis added). Stated another way, the report cited by Verizon confirms that almost 70 percent of CLEC switched access lines are actually ILEC lines leased by CLECs.

Services for Internet Access Report.[3] That report shows that from December 2000 to December 2001, there were 1.97 million new DSL subscribers nationwide. It is not unreasonable to assume that many (and perhaps most) of those new DSL subscribers are consumers who formerly had second lines into their homes for dial-up Internet access. Thus, much of the line-count decline of which Verizon speaks is likely *not* attributable to loss of customers to CLECs, but rather to the "cannibalization" of its own second-line business as consumers with two phone lines surrender one of them upon becoming DSL subscribers.

In the *Order*, the Department framed its competition analysis in terms of what it perceived to be a discernable "trend" revealed by the evidence. *See Order* at 71. The trend revealed by the data in the *2002 High-Speed Services for Internet Access Report* is that the ILECs will be generating *greater* revenues despite the fact that they may be using *fewer* lines to do it. During the six-month period from January to June 2001, DSL lines in service shot up from nearly 2 million to 2.7 million lines, a 36 percent increase.[4] During the latter half of 2001, the rate of increasing DSL subscribership accelerated – more than 1.2 million additional DSL lines were in service, causing the total to jump from 2.7 million to over 3.9 million lines. That represents an increase of an incredible 47 percent during the second half of 2001.[5] Not surprisingly, Verizon and the other Regional Bell Operating Companies are reaping most of the

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[3] *See* Wireline Competition Bureau, Industry Analysis and Technology Division, *High-Speed Services for Internet Access: Status as of December 31, 2001*, accessible at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/hspd0702.pdf (July 23, 2002)("*High-Speed Services for Internet Access Report*").

[4] *See High-Speed Services for Internet Access Report* at Table 1.

[5] *See id*.

benefits from this increase, as they collectively control over 90 percent of the ADSL market, with over 3.5 million lines in service as of December 31, 2001.[6]

The implications of this trend for purposes this case are profound. Although beyond the scope of WorldCom's motion for reconsideration, the recent and rapid increase in DSL subscribership suggests strongly that Verizon's continued use of a 2-lines per zoned living unit standard to determine the total number of distribution pairs in its loop plant is hopelessly outdated and artificially inflates costs for CLECs by including unnecessary copper distribution cable in the forward-looking outside plant. Be that as it may, the trend toward increased DSL usage and reduced second-line usage also drives home the fact that stranded facilities are not, in and of themselves, an appropriate barometer of investor or lender risk. Although increased DSL usage and fewer second lines does mean that there will be an increase in the amount of stranded plant in Verizon's embedded network as "dial-up" lines are disconnected, stranded plant is relevant to the cost of capital only insofar as it signals a diminished capacity to achieve a profitable return on the investment in the plant. The risk that investors take is *not* that a portion of capital expenditures will lie fallow; the risk that investors take is that there may not be sufficient revenue to make the overall investment profitable. With the advent of their burgeoning DSL business, the revenue and profits generated by the ILECs' will be more than sufficient to offset the lost revenue from disconnected dial-up phone lines.

What Verizon needs to have proved – but has not proved – is that the "actual line count" decline that ILECs have experienced is directly attributable to facilities-based competitors

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6 *See id.* at Table 5.

using their own loop facilities or other technologies to reach former ILEC customers. The bare fact that there has been a decline means little, especially given the coincident rise in ILEC DSL business.

Verizon also claims that "competition tends to *increase* after section 271 approval." Verizon Comments at 6 (emphasis in original, footnote citing statistics from New York and Texas omitted). What Verizon fails to mention is that those increases are due in large part to WorldCom's own MCI unit, which is offering service in both states via the UNE-platform. The statistics Verizon cites are skewed because they do not capture *facilities-based* competition only, but *all* competition, the substantial majority of which is UNE-P. Thus, for purposes of measuring the risk of stranded facilities, Verizon's assertions and statistics regarding increased competition are meaningless.

Verizon also continues to harp on a footnote in the FCC's brief to the Supreme Court, and continues to misrepresent its meaning. *See* Verizon Comments at 7 (citing Exh. VZ-55 at 12, n.8). WorldCom has already thoroughly explained why Verizon's interpretation of the "risks associated with the regulatory regime to which a firm is subject" is dead wrong. *See* WorldCom Reply Brief at 21-25. But Verizon's explication of the phrase's import in its comments requires a brief rejoinder. What Verizon seems to be saying is that the TELRIC construct itself – costing based on a reconstructed network using efficient technologies – creates risk significant enough to require a high cost of capital high to offset the (presumably low) network costs developed by TELRIC. The perverse scenario advocated by Verizon is that *because* TELRIC is designed to generate low UNE costs and foster UNE-based competition, the cost of capital must be set high enough to offset those low costs and retard UNE-based

competition. Verizon thus looks at cost of capital as a catchall category, the purpose of which is to erase the benefits to competition resulting from the "regulatory regime to which [Verizon] is subject," *i.e.*, TELRIC. As a matter of simple logic it cannot be right that the FCC purposely inserted into its costing methodology a cost-of-capital mechanism designed to undo the methodology's goal of generating low UNE rates.

Verizon also finds fault with WorldCom's advocacy in favor of a cost of capital that is lower for loops than for other UNEs. To be clear, WorldCom is not opposed to single cost-of-capital approach, and in fact advocated for a single cost of capital applicable to all UNEs. *See* WorldCom Initial Br. at 9. The point of WorldCom's reconsideration motion is that while the Department's selected cost of capital is inappropriately high as a general matter, it is particularly inappropriate for loops. And it is important to remember that Verizon and WorldCom approach this issue with differing burdens.

At the outset, it is important to remember three points. First, "the risk adjusted cost of capital need not be uniform for all elements." *Local Competition Order* ¶702. Second, Verizon presented no evidence, nor did it suggest, that the cost of capital for some of its unbundled network elements is higher than for others in Massachusetts. Tr. 47-48 (Vol. 1, Jan 7, 2002). And third, in arriving at a "weighted average" cost of capital, the Department balanced debt, equity and return on investment levels to arrive at a percentage applicable to all UNEs, but it did not perform any weighting to balance the fact that different UNEs possess different levels of risk. Thus, while Verizon has the burden of proving that its proposed cost of capital is appropriate for all unbundled network elements, WorldCom's "burden" on reconsideration, to the extent it can be characterized as such, is to direct the Department's attention to the evidence

showing that the selected cost of capital is a mistake, *i.e.*, that it is too high. In pursuing reconsideration, WorldCom has focused primarily on cost of capital as it applies to loops. Given that Verizon had the opportunity to pursue separate costs of capital for individual UNEs but chose not to do so, its across-the-board cost of capital *should be* only as high as the lowest UNE-specific cost of capital supported by the evidence. As such, if the evidence "proves" that the cost of capital for loops should be lower, then that lower cost of capital should apply across-the-board since Verizon itself failed to establish that its cost of capital for some unbundled network elements is higher than for others.

WorldCom's argument that the cost of capital for all UNEs should be lower, but that the cost of capital for loops should be lower still, is actually an argument that benefits Verizon in that it permits a cost of capital higher than the one appropriately applicable to loops to apply to all UNEs other than loops. If Verizon is opposed to the tiered costs of capital suggested in WorldCom's original motion, the result should be that the lower cost of capital applicable to loops then applies to all UNEs.

In sum, Verizon has failed to discredit WorldCom's arguments in support of a reduction in the cost of capital chosen by the Department in the *Order*. WorldCom's motion for reconsideration should therefore be granted.

B. Verizon has failed to support its claim that UDLC is required in the forward-looking network

There were three component parts to WorldCom's motion for reconsideration as it relates to IDLC loop unbundling. Of these, the first component was an analysis of the language

used in the FCC's *Local Competition Order*, the purpose of which was to show that the Department was wrong in concluding that the FCC had "clearly distinguished" between the technology assumptions of the first and third approaches to costing (in ¶¶ 683 and 685, respectively). *See* WorldCom Motion at 15-19. For the most part, Verizon simply points to the language in the *Local Competition Order* and the FCC's rules and, without any in-depth analysis to refute WorldCom's detailed discussion of the meanings of critical terms, proclaims that WorldCom's analysis is faulty. Since Verizon has provided so little substance to respond to in that regard, WorldCom respectfully refers the Department back to the analysis in WorldCom's motion for support for the conclusion that the FCC's chosen costing methodology does not require the use of a technology "currently being deployed." *See id.*

Verizon also cites to dicta from the Supreme Court's recent decision in *Verizon Communications, Inc. v. FCC*, 122 S.Ct. 1646 (2002), in support of its position that a technology must be "built and in use" to qualify as TELRIC compliant. *See* Verizon Comments at 18 & n.9. But the technology *has been* built and *is* in use. Alcatel's Lightspan 2000 IDLC equipment has been deployed by Verizon and many other carriers, and is clearly commercially available. What has yet to be developed are the business rules (for instance, regarding "security, administration and testing" (*see* Tr. 3527 (Vol. 17, Feb. 7, 2002)) and software packages necessary for applying the existing functionality of that equipment in a multi-carrier environment.

The Department has an independent obligation to interpret and apply the FCC's rules in this case. WorldCom submits that the most logical interpretation of the *Local Competition Order* and the FCC's rules, both from the standpoint of the language used and the

policy goals being implemented, requires a finding that a technology does not need to be "currently deployed" to qualify as TELRIC compliant.

The second component of WorldCom's motion with respect to IDLC loop unbundling addressed the issue of technical feasibility. On this score, Verizon throws out the terms "operational" and "technological" concerns (Verizon Comments at 19), but in doing so, Verizon fails to address, let alone distinguish, the FCC's extremely broad definition of "technically feasible" in ¶203 of the *Local Competition Order*, which definition makes clear that the "operational" and "technological" concerns to which Verizon points are not an impediment to a finding that IDLC loop unbundling is "technically feasible" and thus TELRIC compliant. *See* WorldCom Motion at 20-21.

Finally, the third component of WorldCom's motion with respect to IDLC loop unbundling addressed why UDLC is not necessary in the forward-looking network. The evolution of Verizon's position as it relates to GR-303 and IDLC loop unbundling in this regard has been truly remarkable. Verizon first claimed IDLC loop unbundling was "not technically feasible." Exh. VZ-38-A-P (Recurring Panel Surreb.) at 31. At the hearings, after having been confronted with the Telcordia document specifically stating that IDLC loop unbundling was "technically feasible" (*see* DTE RR 81 at 12-53), Verizon witness Joseph Gansert tried to redefine the question to avoid a discussion of technical feasibility and to focus instead on whether "the equipment [is] available and the software [is] available that can support the kind of environment that's needed for unbundled loops". Tr. 3527 (Vol. 17, Feb. 7, 2002). Now, when confronted with its own documentation stating unequivocally that non-switched services can be electronically routed via GR-303, Verizon states without explaining that this capability applies to

"only a subset of non-switched services, *i.e.*, those circuits interfacing the IOF networks in large volumes." Verizon Comments at 21.

The fact that unbundling applies – even "hypothetically" – to *any* services Verizon offers is directly contrary to Verizon's initial position, and it completely undermines Verizon's credibility on this issue. Verizon also tries to distance itself from the unbundling references in its Outside Plant Engineering Guidelines, Exh. ATT-VZ-3-5, by stating that those passages are "solely with reference to non-switched *specials* and not non-switched services generally." Verizon Comments at 21 (emphasis added). But again, Verizon seeks to make a distinction and then fails to explain its significance.

What is unquestionably significant is the fact that internal Verizon documents created *not* by professional witnesses, and *not* in the context of litigation make it clear that IDLC loop unbundling is more than just in the "idea" stage. The technical feasibility of IDLC loop unbundling is beyond question. Applying the appropriate legal standard to this technology, in accordance with the terms of the *Local Competition Order*, should result in the technology being found to be TELRIC-compliant for the entirety of the fiber-fed loop plant in the forward-looking network.

III. Conclusion

For all the foregoing reasons, and for the reasons stated in WorldCom's August 14, 2002 motion for partial reconsideration of the Department's July 11, 2002 *Order* in this proceeding, WorldCom respectfully requests the Department to grant WorldCom's motion.

Respectfully submitted,

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Dated: New York, New York
September 6, 2002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing upon each person designated on the service list in this proceeding by either U.S. mail, overnight courier, facsimile or email.

Dated: New York, New York
September 6, 2002

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