

I. PRELIMINARY STATEMENT AND EXECUTIVE SUMMARY

A. Preliminary Statement

The Board of Public Utilities' ("Board" or "BPU") decision in this proceeding is of critical importance to the viability of local exchange competition in the State of New Jersey. There can be no dispute that the promise of robust competition embodied in the federal Telecommunications Act of 1996 has yet to be realized in New Jersey. Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56, codified at 47 U.S.C. § 153, *et seq.* (1996) ("1996 Act"). Entrenched monopolists continue to dominate the local telecommunications market to the exclusion of competitive providers and to the detriment of consumers.

At the national level, incumbent local exchange carriers ("ILECs") are successfully driving competitors out of the marketplace, and in turn substantially limiting consumer choice. The ILECs have been so successful in resisting implementation of the 1996 Act that there is the danger that none of the competitive local exchange carriers ("CLECs") will be able to survive. Nationwide, competitive carriers serve only 7.2% of lines in the local telecommunications market. Martha McKay, "Local Competition Still Elusive After the 'Revolution,'" *The Record* (Feb. 8, 2001). (See Attachment 5).

Competition is even more stunted in New Jersey. *See id.* (Verizon controls 6.5 million loops in New Jersey, compared to only 219,929 loops controlled by other companies); *see also* Martha McKay, "Delay Looming in Local Phone Competition?" *The Record*, Jan. 23, 2001 at L-8; Anthony Birritteri, "Clarity Needed in Telecommunications Competition Rollout," *NJ Business*, Oct. 2000, at 58. (See Attachment 5). The discouraging competitive landscape is not due to a lack of willing new entrants. Rather, the slow development of competition is due to the continued high wholesale costs that

Verizon New Jersey (“Verizon-NJ”) charges for Unbundled Network Elements (“UNEs”). As explained by Ratepayer Advocate Blossom A. Peretz:

Dozens of prospective competitive local exchange carriers have lined up, eager to begin actively marketing and providing local exchange service in New Jersey. Despite their interest, these companies cannot yet afford to compete. One of the primary barriers to a competitive local exchange telecommunications marketplace in New Jersey is the high cost of Unbundled Network Elements. With current UNE rates priced so high, companies stand to lose money on every customer they sign up.

Exh. RPA-1 at 1. The Board itself has found that limited access to UNEs is a major barrier to competition in New Jersey. *See* New Jersey Board of Public Utilities, *Status of Local Telephone Competition: Report and Action Plan*, Docket No. TX98010010 (July 1998) (“*BPU Competition Report*”) at 13. This barrier to competition parallels recent developments in the deregulated energy market in New Jersey where high wholesale costs are driving competitors from the market. *See* Kevin G. DeMarrais, “New Supplier Exiting N.J.’s Electric Market,” *The Record*, Nov. 8, 2000, at B-1; David P. Willis, “Brownout,” *Asbury Park Press*, July 23, 2000, at B-1; Tom Johnson, “High Prices Heating Up Deregulation,” *The Star Ledger*, June 4, 2000, at 1. (See Attachment 5).

Competition in the market for advanced telecommunications services is also suffering. Stories of customers seeking digital subscriber line (“DSL”) service and failing to receive it are well documented. *See* Roben Farzad, “SMARTMONEY.COM: My Kingdom For A DSL Line,” *Dow Jones News Service*, Mar. 28, 2001. (See Attachment 5) Though there is great consumer demand, advanced services such as DSL are simply not being deployed. Moreover, what competition there was is now declining, and this decline has been detrimental to consumers in New Jersey. *See* Martha

McKay, "DSL Shutoff a Nightmare, Businesses Struggle Without Fast Internet Link," *The Record*, Apr. 6, 2000, at B-1. (See Attachment 5).

Consumer welfare is best served by the encouragement and development of a competitively vibrant telecommunications market. To this end, the Ratepayer Advocate urges the Board to set UNE prices at forward-looking economic cost. If prices continue to be set above economic cost, competitors, if they can afford to compete at all, will be forced to subsidize the incumbent. This, in turn, "will result in large numbers of residential and small business customers having no choice in selecting a local exchange carrier, since no competing carrier will be able to justify the high cost in order to compete against the incumbent." Exh. RPA-1 at 2. New Jersey consumers deserve better. The only way in which this Board will develop a truly competitive telecommunications market in New Jersey is to establish forward-looking, cost-based UNE rates that will encourage competitive entry.

B. Executive Summary

In this proceeding the Board is examining the rates for UNEs in light of the New Jersey District Court's decision concerning the Board's Generic Order, *In the Matter of the Investigation Regarding Local Exchange Competition for the Telecommunications Market*, Docket No. TX95120631, Telecommunications Decision and Order (December 2, 1997) ("*Generic Order*"). The parties agree that rates in this proceeding are to be determined under the Total Element Long Run Incremental Cost ("TELRIC") principles established by the FCC and adopted by the Board. *Id.*; see also *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order ¶¶ 618-766 (rel. August 8, 1996) ("*Local Competition Order*"). The TELRIC methodology requires that costs and prices be based on the use

of the most efficient technology available and the lowest-cost network configuration, given existing wire center locations, and forbids consideration of embedded costs. The major methodological issues in this case include Verizon-NJ's reliance on embedded conditions rather than forward-looking, efficient conditions in its cost models and its erroneous use of inconsistent network models for determining recurring and nonrecurring costs.

Verizon-NJ and AT&T filed cost studies in this proceeding. While Verizon-NJ states that it has made some changes in its recurring cost model, that model is largely the same as the model that it presented in the prior phase of this case. However, Verizon-NJ's nonrecurring cost model is different from the model it used in the prior phase. AT&T submitted HAI model 5.2a for recurring rates and the AT&T Nonrecurring Cost Model ("AT&T NRCM") for nonrecurring rates. AT&T and Verizon-NJ each claims, incorrectly, that its cost model is consistent with the TELRIC methodology. Verizon-NJ's cost models do not follow TELRIC methodology, largely because they are based on an embedded network design that is not forward-looking. As a result of this and other flaws in its model, Verizon-NJ's proposed rates will likely lead to over-recovery, a matter of great concern to the Board during the hearings. Like the Verizon-NJ cost model, the AT&T cost model fails to use TELRIC-compliant inputs and assumptions, and therefore fails to generate TELRIC rates.

To bring competition to New Jersey consumers, UNE rates under the TELRIC methodology must fall in a range so that they are low enough to permit new entrants, but not too low so as to distort competition. The Verizon-NJ and AT&T models are not likely to generate rates that fall within the TELRIC range. The evidence supports many, but not all, of the corrections to the Verizon-NJ model that would be necessary for it to yield UNE rates that fall within an acceptable range. Conversely,

there is little evidence of corrections to the AT&T cost model that would generate rates within that range. Therefore, the Board should not base rates on the AT&T model and should identify the changes to the assumptions and inputs necessary to enable the Verizon-NJ model to move toward rates that are in an acceptable TELRIC range. As an additional safeguard, and to provide guidance where the record does not yield a definite, TELRIC-compliant result, the Board should ensure that the rates it establishes are comparable with those established pursuant to TELRIC standards in neighboring states.

Cost of capital and other inputs

Book values are the appropriate basis for calculating Verizon-NJ's cost of capital. The Ratepayer Advocate urges the Board to adopt an 8.8% cost of capital. Verizon-NJ proposes a flawed cost of capital analysis based on the faulty premise that it participates in a competitive market, rather than being a monopoly provider of wholesale UNEs. State commissions across the Verizon region have rejected this approach. T.32:7-10 (11/28/00); T.33:2-34:2 (11/28/00); *Joint Complaint of AT&T Communications of New York, Inc.*, Opinion 97-2, Opinion and Order Setting Rates for First Group of Network Elements at 38 (April 1, 1997) (“*NY UNE Case*”); *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, New York Public Service Commission Case 98-C-1357, Recommended Decision on Module 3 Issues at 79 (May 16, 2001) (“*NY Recommended Decision*”); *Joint Petition of Nextlink Pennsylvania, Inc.*, Pennsylvania Public Utility Commission, Docket Nos. P-00991648 and P-00991649, Opinion and Order at 73 (September 30, 1999) (“*Pennsylvania Global Order*”); *Approval of Agreements and Arbitration of Unresolved Issues Arising Under § 252 of the Telecommunications Act*, Maryland Public Utilities Commission Order No. 73707 at 27 (Sept. 1997)

(“MD UNE Order”); *Ex Parte: To Determine Prices Bell Atlantic-Virginia, Inc. Is Authorized to Charge Competitive Local Exchange Carriers*, Virginia State Corporation Commission Case No. PUC970005, Final Order at 8 (April 15, 1999) (“VA UNE Order”); *Findings*, Delaware Public Service Commission Docket No. 96-324, Opinion & Order No. 4542 at 14-15 (July 8, 1997) (“DE UNE Order”); *Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F. Supp.2d 218, 240-241 (Del. Dist. Ct. Jan. 6, 2000) (“Bell Atlantic-Delaware”) (attached hereto at Attachment 1). The Ratepayer Advocate proposes a 10% cost of equity based on a combination of the Discounted Cash Flow (“DCF”) and the risk premium/Capital Asset Pricing Model (“CAPM”) methods, and opposes Verizon-NJ’s use of a comparison group of Standard & Poor’s (S&P) 500 companies to support its cost of equity proposal. The Ratepayer Advocate proposes an 8.07% cost of debt. The Board should recognize the realities of Verizon-NJ’s position and adopt a 60.94% debt to 39.06% equity ratio based on book value.

The Board should adopt the depreciation rates and lives in Verizon-NJ’s January 2000 Rate Update, and reject Verizon-NJ’s proposal to use GAAP lives. In addition, the Ratepayer Advocate recommends that the Board adopt a common overhead factor that does not exceed 10%.

Loop inputs

Verizon-NJ’s loop cost proposals are overstated. Verizon-NJ’s cable cost calculations are based on embedded conditions rather than a forward-looking model, and Verizon-NJ makes an unwarranted assumption, already rejected by the Board, that distribution cable lengths are one-half the maximum length of a distribution cable. *Prosini Aff.* ¶ 23; *Generic Order* at 45. In addition, Verizon-NJ’s cost study overstates loop costs by assuming that the vast majority of unbundled loops served

over digital loop carrier (“DLC”) systems use costly and inefficient universal equipment rather than GR-303 technology. Lundquist Rebuttal at 14. This is a further example of the cost study’s reliance on embedded technology. The evidence shows that GR-303 is the most efficient and forward-looking approach, and refutes Verizon-NJ’s claim that use of that technology is not technically feasible.

Verizon-NJ’s proposed fill factors for the loop also improperly inflate costs. Verizon-NJ’s fill factor for distribution cable is based on embedded conditions, and asks consumers to pay for future capacity sufficient to satisfy Verizon-NJ’s “ultimate demand” for subscriber loops, an unacceptable approach that the FCC has specifically rejected. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Forward-Looking Mechanism For High Cost Support for Non-Rural LECs*, CC Docket No. 97-160, Tenth Report and Order, FCC 99-304 (rel. Nov. 2, 1999) (“*Universal Service Order*”). The Ratepayer Advocate urges the Board to adopt a distribution fill factor of **[Begin Verizon Proprietary]** **[End Verizon Proprietary]**. Verizon-NJ’s proposed fill factors for copper feeder, fiber feeder and loop electronics are all based on embedded conditions, and ignore conditions that will cause these factors to increase on a forward-looking basis. The Ratepayer Advocate recommends that the fill factors for copper feeder, fiber feeder and loop electronics be set at 85%.

The Ratepayer Advocate proposes several corrections to Verizon-NJ’s costs for support structure, the poles and conduit used in providing loop plant. We recommend a structure sharing percentage of 50% to account for Verizon-NJ’s cost savings in sharing support structure with other utilities. The Board should adopt the forward-looking pole spacing parameters developed by the FCC and reject Verizon-NJ’s embedded figure. *Universal Service Order* ¶ 2. Finally, the Ratepayer

Advocate recommends that the Board adopt a \$733.67 unit cost for poles, based on the application of the NYNEX-Massachusetts UNE Cost study brought forward to the year 2000 and applying Verizon-NJ's Telephone Plant Index inflation factors. Lundquist Rebuttal at 34.

Based on the Ratepayer Advocate's evidence concerning distribution fill factors, the use of GR-303 technology, the unit price of poles, the cost of capital and depreciation rates, the Ratepayer Advocate recommends that the Board's average cost for unbundled POTS loops should not exceed **[Begin Verizon Proprietary]** **[End Verizon Proprietary]** per month.

Switching costs

Verizon-NJ overstates its switching costs by using vendor discounts that are inconsistent with TELRIC methodology. Even though TELRIC requires modeling of a reconstructed network, Verizon-NJ uses the vendor discounts for additions to switches in its embedded network, and ignores the far greater discounts available when purchasing new or replacement switches. Verizon-NJ's approach has been rejected by the FCC and the courts. *Universal Service Order* ¶ 317; *See generally, Bell Atlantic-Delaware*. Verizon-NJ compounds this error by using its embedded mix of switch types and ignoring the superior discounts that are available from certain manufacturers. Finally, Verizon-NJ fails to take into account the increased purchasing power it gained as a result of the Bell Atlantic-GTE merger.

Transport/IOF costs

Again in the case of the transport UNE, Verizon-NJ incorrectly bases costs on its embedded network, when a forward-looking analysis would have assumed more efficient high-capacity facilities. In addition, Verizon-NJ's use of embedded values led it to use an excessively low fill factor, further

inflating prices, and Verizon-NJ has double-counted the cost of some central office equipment in determining transport and loop costs. Baranowski Rebuttal at 8.

Nonrecurring cost model

Verizon's nonrecurring cost model relies on non-TELRIC-compliant inputs and assumptions, and, as a result, generates overstated nonrecurring rates. Three key errors underlie the Verizon nonrecurring cost model ("VZ NRCM"). First, as with the recurring cost model, the VZ NRCM relies on embedded network assumptions. For example, the VZ NRCM fails to assume 100% GR-303 systems. Second, the VZ NRCM erroneously relies on work-time estimates that are based on the average amount of time it takes employees to perform tasks in the embedded network. Moreover, the work-time surveys contain numerous other flaws and upward biases. Third, the VZ NRCM fails to assume the proper forward-looking electronic Operational Support Systems ("OSS"), instead assuming that orders other than small numbers of the most basic UNEs will be processed manually. For these and other reasons, the VZ NRCM produced inflated nonrecurring rates. To compensate for these flaws, the Ratepayer Advocate recommends that the Board adopt the best comparable nonrecurring rates from neighboring states, or, if there is no such comparable, to adjust the Verizon-NJ proposed rates to correct for the flaws identified in this Brief.

DSL

Verizon-NJ's proposed rates, terms and conditions for DSL providers threaten to deprive consumers of competition in the provision of advanced services. Verizon-NJ's proposed conditioning charges suffer from the same flaws as other results of its nonrecurring cost study. The ISDN conditioning charge is a clear example of double recovery as a result of using inconsistent network

assumptions. Verizon-NJ's proposed charges for removal of load coils and bridged taps seriously overstate work times and resulting costs because they do not reflect least-cost, efficient methods. Thus, Verizon-NJ does not consider the efficient practice of conditioning multiple loops at a time, and generally overstates work times for conditioning. The Ratepayer Advocate recommends that the Board adopt conditioning costs based on a combination of the more conservative aspects of the alternative proposals offered by Covad and AT&T.

Verizon-NJ's loop qualification rate is also based on current, inefficient methods and thus violates TELRIC principles. Verizon-NJ should charge competitors a minimal dip charge associated with efficient electronic access to LFACS, its database of loop makeup information, rather than charging for cumbersome manual processes that are the consequence of its failure to follow its own practices. In addition, the Board should order Verizon-NJ to promptly provide electronic access to LFACS, as it has testified it will do. T. 3796:23-3797:11 (2/18/01).¹

Other charges, terms and conditions that Verizon-NJ proposes would also hamper DSL competition. Verizon-NJ has seriously overstated its cost for splitter installation by using an accounting factor that is not based on the realities of this task. Verizon-NJ also proposes an entirely unwarranted splitter administration and support charge that would be based on the cost of splitters that are owned, maintained and installed by CLECs. Murray-Riolo Rebuttal at 60-62. As several other state commissions have held, this charge should be rejected. *Arbitration of Rhythms Links, Inc. and COVAD Communications Company vs. Bell Atlantic-Maryland, Inc., pursuant to Section 252(B) of the Telecommunications Act of 1996*, Case 8842 Phase II, Proposed Order of Arbitrator at 15

¹ Hearing transcripts are cited to by page number:line number - page number:line number (and date).

(Dec. 29, 2000) (“*Maryland Arbitration Decision*”); New York Public Service Commission, *Proceeding on Motion of the Commission to Examine New York Telephone Company’s Rates for Unbundled Network Elements*, Case 98-C-1357, Order Denying Petition for Rehearing (rel. Oct. 3, 2000) at 7; *NY Recommended Decision* at 171-172. Verizon-NJ also proposes to apply nonrecurring POT Bay and Cable & Frame Termination charges to line sharing competitors in a way that ignores the efficient practice of locating splitters at the Main Distribution Frame. The company would carry over to line sharing arrangements existing tariffed rates for charges related to service orders, when the evidence shows that those rates recover costs that are simply not present in line sharing situations.

Line splitting (the ability of two CLECs to share a loop for voice and data services) is a major competitive concern. To ensure that CLECs have a full opportunity to compete for consumers interested in the line sharing offerings of Verizon-NJ and data CLECs, the Board should order Verizon-NJ to fulfill its commitment to facilitate line splitting, and should also order Verizon-NJ to provide splitters to CLECs on a per-line basis.

Verizon-NJ proposes to impose on CLECs a wideband testing system, even though those CLECs have an FCC-established right to perform their own testing. Verizon-NJ’s claim that its wideband testing system is an efficient choice is refuted by evidence concerning Verizon’s purchase of the Hekimian system. The Ratepayer Advocate recommends that the Board join three other state commissions and declare Verizon-NJ’s wideband testing system optional for CLECs. New York Public Service Commission, *Opinion and Order Concerning Line Sharing Rates*, Case 98-C-1357, Opinion No. 00-07, at 25-27 (May 26, 2000) (“*NY Line Sharing Order*”); Massachusetts

Department of Telecommunications and Energy, *Investigation by the Department on its own motion as to the propriety of the rates and charges set forth in M.D.T.E. No. 17, filed with the Department by VZ-MA New England, Inc. d/b/a VZ-MA Massachusetts on May 5 and June 14, 2000, to become effective October 2, 2000*, DTE 98-57 (Phase III) at 118 (September 29, 2000) (“*Massachusetts Phase III Order*”); *Maryland Arbitration Decision* at 21; *see also NY Recommended Decision* at 162, n. 324. In addition, the Board should, like other state commissions, rule that Verizon-NJ may not impose on its competitors the cost of cooperative testing, since these tests would not be necessary if Verizon delivered loops as it should. *Massachusetts Phase III Order* at 113.

As the network evolves, the provision of advanced services through remote terminals will become increasingly important to consumers. The Ratepayer Advocate urges the Board to recognize the major deficiencies in Verizon-NJ’s current offerings for access to consumers served through remote terminals. In the view of the Ratepayer Advocate, the Board should actively monitor the progress of Verizon-NJ’s PARTS proposal for remote terminal access, and order Verizon-NJ to specify within 60 days the particular terms, conditions and rates associated with its PARTS proposal. In addition, the Ratepayer Advocate recommends that the Board take steps to improve Verizon-NJ’s existing remote collocation offering and require Verizon-NJ to facilitate line card collocation.

House and riser cable

The parties disagree as to some terms and conditions under which Verizon-NJ will provide access to house and riser cable, and as to the rates for such access. See Exh. VNJ-26, Attachment 1R at 2 (Revised Oct. 12, 2000); Kahn Rebuttal at 8-9, 9-10, 17-20; Stern Aff. ¶ 39. As for rates, the

Board should permit Verizon-NJ to assess terminal charges only for the number of terminal connections specifically requested by the CLEC, not for an indivisible block of 50 connections. Such single pair interconnection is technically feasible and, therefore, must be made available to CLECs. In addition, the Board should disallow Verizon-NJ's proposed Time and Materials charges for dispatches to perform cross-connections between the Verizon-NJ network and the CLEC terminal block, which amount to unknown Individual Case Basis prices.

Access to Verizon-NJ's house and riser cable is key to the provision of competitive services to occupants of multiple tenant units. Verizon-NJ's proposal is anticompetitive because it would require CLECs to purchase and install their own separate 50-pair terminal block to access house and riser cable, and to connect to this in 50-pair block increments. Instead, the Ratepayer Advocate recommends that the Board permit CLECs to either obtain their own terminal blocks or share terminal blocks among themselves.

Dark Fiber

The Board should adopt rates for dark fiber that use the same long-run forward-looking cost basis used to price any UNE. Verizon's proposed rates for dark fiber violate the FCC's methodology because they include both investment costs and embedded costs. Murray-Riolo Rebuttal at 182-183. Moreover, Verizon's proposed rates for New Jersey are higher than those proposed in our neighboring jurisdiction, Pennsylvania. The Board should be vigilant to ensure that competitors are not faced with higher rates for dark fiber in New Jersey than those being offered in Pennsylvania. Verizon-NJ should also be required to provide a subloop dark fiber offering based on rates that Verizon has offered in New York. New York Telephone Company Tariff, P.S.C. 914, § 5.20.4 (A) (May 17, 2000).

Verizon-NJ's terms and conditions for dark fiber also require attention. Based on the FCC's definition of dark fiber, the Board should provide for a CLEC's ability to run interoffice facility through central office space where it is not collocated, to splice its own interoffice facility, and to splice its own dark fiber. In addition, the Board should reject Verizon-NJ's restrictions on the availability of dark fiber, in particular, its attempt to improperly reserve dark fiber for itself.

Subloop unbundling and remote terminal collocation

Verizon-NJ proposed an incomplete set of rates for unbundled subloops, restricting its evidence to rates for distribution subloops. Those rates, moreover, suffer from the same flaws as Verizon-NJ's loop rates generally, and exceed the rates Verizon itself proposed in Pennsylvania. *Further Pricing of Verizon Pennsylvania Inc.'s Unbundled Network Elements*, Recommended Decision, Dockets Nos. R-00005261 and R-00005261C001 Appendix A at 2 (March 22, 2001) ("*Pennsylvania Recommended Decision*"). The Ratepayer Advocate recommends that the Board adopt rates no higher than those proposed by Verizon in Pennsylvania for application to the distribution subloop. *Id.*

Verizon-NJ's remote terminal collocation offering is one method of gaining access to subloop elements. Verizon-NJ has proposed individual case basis rates as nonrecurring rates for this element and the rates in its interim tariff for central office collocation for recurring rates. In the Ratepayer Advocate's view, individual case basis rates are inherently unreasonable and anticompetitive, since they make it virtually impossible for competitors to develop business plans, and should be rejected by the Board.