Decision 03-03-033 March 13, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish A Framework for Network Architecture Development of Dominant Carrier Networks.	Rulemaking 93-04-003 (Filed April 7, 1993)
Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.	Investigation 93-04-002 (Filed April 7, 1993) (Verizon UNE Phase)

INTERIM OPINION ESTABLISHING INTERIM RATES FOR NETWORK ELEMENTS OF VERIZON CALIFORNIA, MODIFYING INTERIM PRICE FLOOR FORMULA ADOPTED IN DECISION 99-12-018, AND ADOPTING NONRECURRING PRICES

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I. Summary

This decision in the "Verizon Unbundled Network Element (UNE) Phase" of the above-captioned rulemaking adopts interim monthly prices for a subset of network elements that Verizon California Inc. (Verizon) sells to competitive local exchange carriers (CLCs). Specifically, this decision establishes interim monthly rates for the following UNEs: 2-wire loops, 4-wire loops, 2-wire port, Centrex Port, DS-1 port, end office switching per minute of use, tandem switching per minute of use, and switch features. All other UNE prices remain at the levels adopted in Decision (D.) 97-01-022 or as determined by interconnection agreements. We find that interim rates are necessary due to the lengthy delays in this case and the fact that current rates for Verizon were not set based on a forward-looking cost methodology.

Specifically, this decision adopts the proposal presented by AT&T Communications of California, Inc. (AT&T), WorldCom Inc. (WorldCom), (collectively, "Joint Commenters") and The Utility Reform Network (TURN) to base interim prices on UNE rates recently adopted for Verizon in New Jersey. The New Jersey rates are adjusted based on the Federal Communications Commission's (FCC's) Synthesis Model and deaveraged into two zones for loops.[1] For unbundled loops, the 2-wire interim loop rate is $10.56 in Zone 1 and $22.37 in Zone 2. The Zone 1 rate represents a 37% decrease from Verizon's

[1] Zone 1 rates apply to the areas formerly served by GTEC prior to its merger with Contel of California, Inc. (Contel) and Zone 2 rates apply in the areas formerly served by Contel.

current statewide average 2-wire loop rate of $16.81. The Zone 2 rate represents a 33% increase to the current loop rate. For unbundled switching, we adopt interim end office and tandem switching rates that are 60% and 31% less than current rates, respectively. We adopt a basic port rate of $2.12 that is 54% less than the current rate. The complete list of adopted interim rates is set forth in Appendix A.

We decline to adopt Joint Commenters' proposal to alter the markup for shared and common costs embedded in current UNE rates. The markup included in Verizon's UNE rates shall remain at 22% as adopted in D.97-01-022, rather than the 8% proposed by Joint Commenters.

This proceeding will remain open to set final UNE rates for Verizon. The interim UNE rates adopted in this order are subject to adjustment, either up or down, from the effective date of this order until final rates are adopted.

As part of its interim rate proposal, Verizon requested that the Commission review the interim pricing flexibility it was granted for Category II services[2] in D.99-12-018. In response, this decision modifies the interim price floor formula adopted for Verizon in D.99-12-018. In calculating price floors for Category II retail services, Verizon should use the interim UNE rates adopted in this order and incorporate other changes to the price floor formula, as discussed in this order, to reflect the lower UNE rates adopted today. Ultimately, any interim price floors that are set for Verizon through tariffs or contracts using this updated formula will be replaced, on a prospective basis, with permanent price

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[2] "Category II" refers to discretionary or partially competitive services for which Verizon retains significant, though perhaps declining, market power. (*See* D.89-10-031, 33 CPUC 2d 43.)

floors as determined in the next phase of this proceeding. We decline to institute any true-up mechanism for these interim price floors. Nevertheless, we will require Verizon to make clear in any contracts that it enters into with customers based on these interim Category II price floors that the prices in the contract are subject to change upon adoption of final price floors by the Commission in the later phase of this case.

Finally, today's decision sets prices for the initial fees that competitors pay Verizon to order and provision the use of network facilities, otherwise known as "nonrecurring prices." The Commission previously established nonrecurring costs for Verizon in D.98-12-079. Today's order applies a 22% markup for shared and common costs to Verizon's nonrecurring costs and orders Verizon to make several changes in how it has combined these costs to form the nonrecurring prices competitors will pay. Today's order directs Verizon to file a revised list of its nonrecurring charges complying with the changes set forth in this order.

II. Background and Procedural History

The Commission opened this rulemaking, commonly known as the "OANAD proceeding," almost ten years ago with the intent of setting rates for the "basic network functions," or BNFs, now more commonly known as UNEs, that make up the network of California's two largest incumbent local phone companies, Pacific Bell Telephone Company (Pacific) and GTE California (GTEC), now known as Verizon.[3] The Commission achieved its intent with

[3] This decision refers to GTEC as the incumbent local exchange carrier (ILEC) that existed at the time this proceeding was initiated and prior to GTE's merger with Bell Atlantic. The decision refers to Verizon as the successor to GTEC, following the merger with Bell Atlantic in July 2000.

respect to Pacific Bell, but has encountered numerous obstacles in its efforts to set rates for Verizon.

In D.95-12-016, the Commission adopted principles to govern the development of cost studies for the unbundled BNFs of the local exchange networks of Pacific and GTEC. These principles, known as the Consensus Costing Principles (CCPs), are based on the Total Service Long Run Increment Cost (TSLRIC) methodology for performing cost studies.[4] In D.96-08-021, the Commission adopted TSLRIC cost studies for Pacific, but found that GTEC's cost studies, which were filed in December 1995 and January 1996, did not adequately conform with the TSLRIC principles adopted by the Commission in D.95-12-016. (D.96-08-021, *mimeo.*, p. 91.) Specifically, the Commission stated:

> …GTEC chose not to make enough forward-looking adjustments to its models and data bases to conform its studies to the Consensus Costing Principles.
>
> In order to deal with this shortcoming, we have decided to order specific but broad-ranging adjustments to GTEC's studies to *approximate* conformance with the Consensus Costing Principles. We recognize that, given sufficient time, GTEC can perform new cost studies that will conform with our adopted TSLRIC principles more closely than the existing studies with the adjustments we order. In fact, we are ordering GTEC to file new cost studies conforming to TSLRIC principles within one year after the effective date of this decision. However, if tariffs for unbundled BNFs and services are to be in place during the first quarter of 1997, there will not be

[4] The CCPs state that: "TSLRIC means the cost of providing an entire function or output should be studied, not just the cost of serving some small increase in demand. TSLRIC requires that all necessary outputs to provide service are based on costs that reflect the entire quantity of outputs." (D.95-12-016, Appendix A, p. 2.)

time for GTEC to perform new studies. (D.96-08-021, *mimeo.*, p. 70.) (Emphasis added.)

Thus, the Commission found the need to make modifications to GTEC's inadequate TSLRIC cost studies, using certain aspects of Pacific's studies as proxies, in order to meet a January 1997 deadline for having tariffs in place for competitors to purchase unbundled network components.[5] Shortly thereafter, the Commission reviewed GTEC's compliance with these modifications when it approved an interconnection agreement between AT&T and GTEC in D.97-01-022. Appendix A to that order sets forth the UNE prices that are still in effect today for Verizon.

In September 1997, GTEC filed a new cost model, known as the Integrated Cost Model (ICM), to comply with D.96-08-021. GTEC's ICM was based on the Total Element Long Run Incremental Cost (TELRIC) methodology,[6] set forth in the August 8, 1996 First Report and Order[7] of the FCC. At the same time, AT&T

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5 For example, D.96-08-021 required GTEC to mirror Pacific's cost studies regarding cost of capital, asset lives, income tax rate, and utilization factors, as well as several other items. (D.96-08-021, *mimeo*, p. 92.)

6 The TELRIC of a network element is the "forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's provision of other elements." (47 CFR 51.505 (b).) TELRIC should be measured "based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." (47 CFR 51.505 (b)(1).)

7 *In the Matter of the Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, FCC 96-325, CC Docket No. 96-98, 11 FCC Rcd 15499, rel. August 8, 1996. (Hereinafter, "first Report and Order.") In the First Report and Order, the FCC directed the States to use the TELRIC rather than the TSLRIC methodology in determining the costs for UNEs.

and MCI Telecommunications Corporation (MCI,)[8] competitors to GTEC, filed the Hatfield Model Release 4.0 as an alternative to ICM. Parties then reviewed the two models and filed extensive comments on ICM and Hatfield in May and June of 1998.[9]

In July 2000, the 8th Circuit for the United States Court of Appeals cast doubt over the future of the TELRIC methodology when it vacated and remanded to the FCC its rule regarding the TELRIC methodology set forth in FCC Rule 51.505(b)(1). Shortly thereafter, the FCC and AT&T filed with the Supreme Court for review of the 8th Circuit's decision. The Supreme Court granted review and in May 2002, the Supreme Court issued its decision upholding the FCC's TELRIC methodology.[10]

The Verizon UNE phase of OANAD was reassigned from Administrative Law Judge (ALJ) McKenzie to ALJ Duda in March 2000. Despite uncertainty at that time regarding the future of the TELRIC methodology, Assigned Commissioner Duque and ALJ Duda held a prehearing conference on August 1, 2000 to discuss the scope and schedule for moving forward with this phase. On November 6, 2000, Commissioner Duque and ALJ Duda issued a

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8 MCI subsequently merged with WorldCom. Hereinafter, we will refer to the merged entity as WorldCom.

9 Comments were filed in May 1998 by AT&T and MCI, GTEC, the Commission's Office of Ratepayer Advocates (ORA), the Facilities-Based Coalition, and The Utility Reform Network (TURN). The Facilities-Based Coalition consisted of Teleport Communications Group, ICG Telecom Group, NEXTLINK California LLC, MGC Communications, Inc., and the California Cable Television Association. Reply comments were filed in June 1998 by AT&T/MCI, GTEC, the Facilities-Based Coalition, and ORA.

10 *See Verizon Communications v. FCC*, 122 S.Ct. 1646 (2002).

ruling on the scope for this phase and set technical workshops for further discussion of the ICM and Hatfield models. The workshops were held on December 12 and 13, 2000. The Commission took no further action on this case in 2001 due to competing telecommunications priorities.

On January 4, 2002,[11] Tri-M Communications Inc. (TMC) moved to intervene in this proceeding and requested a ruling establishing an expedited schedule for the case that would consider interim rates for Verizon's UNEs.

On May 31, Commissioner Duque and ALJ Duda issued a ruling granting TMC's request for an expedited schedule and inviting interim relief proposals. The ruling noted the unfortunate delays in the proceeding and stated that relief in the form of interim UNE prices was clearly in order given the five year delay in the proceeding and the ongoing need to set final rates for Verizon.[12] At a prehearing conference on June 28, parties discussed potential interim relief proposals and a schedule for filing them with the Commission. Commissioner Duque and ALJ Duda stated at the prehearing conference that they were not inclined to adopt rates from another Verizon state when other interim pricing options existed, such as use of the FCC's Synthesis Model. (Reporter's Transcript, 6/28/02, at 1673.)

On July 30, AT&T and WorldCom (collectively Joint Commenters) filed their proposal for interim UNE rates. On July 31, Verizon filed its own interim

[11] All dates are 2002 unless otherwise noted.

[12] *See Assigned Commissioner's and ALJ's Ruling Granting Motion of Tri-M Communications Inc. (TMC) to Intervene, Granting Motion of TMC in Part, and Scheduling Prehearing Conference*, May 31, 2002, p. 4.

UNE rate proposal.[13] Joint Commenters, M-Power Communications Corporation (M-Power), Z-Tel Communications Inc. (Z-Tel) and Verizon filed comments on these two proposals on August 20.

On August 23, Commissioner Duque and ALJ Duda issued a ruling reversing their earlier statements from the June prehearing conference limiting proposals based on UNE rates in other states. In their ruling, the ALJ and Assigned Commissioner noted the numerous objections to the two proposals filed in July and the need for further scrutiny of these objections. They also stated that in order to have a complete record from which to make a decision on interim rates, they were persuaded to lift their earlier limitation on proposals involving UNE rates from another Verizon state. The ruling specifically solicited comments on whether the Commission should consider rates recently adopted for Verizon in other states. In response to the ruling, Joint Commenters and TURN filed an additional proposal on September 9, based on Verizon rates in New Jersey. Joint Commenters, ORA, TURN and Verizon filed a final round of reply comments on all three proposals on September 20, and the interim phase of this case was deemed submitted.

On October 25, Verizon filed a petition to reopen the record in this proceeding for the limited purpose of taking official notice that the Florida Public Service Commission (PSC) had adopted new UNE rates for Verizon in Florida. Official notice of the UNE rates adopted by the Florida PSC is granted, and discussed further in Section IV below.

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[13] Verizon filed a motion requesting a one-day extension to file its proposal, which is herein granted.

Despite the different approaches to interim ratemaking offered by the parties, the parties agreed that interim pricing should apply to the following UNE rate elements: 2-wire loops, 4-wire loops, 2-wire port, Centrex Port, DS-1 port, end office switching per minute of use, and tandem switching per minute of use. Parties were unable to agree on whether interim pricing should apply to switch features. Therefore, we will address this issue in our discussion of the three interim pricing proposals.

III. Interim Rates are Warranted

Before we examine the parties' three proposals for interim rates, we affirm the May 31 ruling of the Assigned Commissioner and ALJ that concluded interim relief is warranted for Verizon. We agree that it is abundantly clear that interim rates are necessary for Verizon's UNEs. The current rates that Verizon charges for its UNEs were not set using a TELRIC-based, forward-looking cost methodology. Rather, they are the product of a TSLRIC cost study that was filed in late 1995 and early 1996, rejected by the Commission in D.96-08-021 as not adequately conforming to forward-looking costing principles, and then modified by the Commission in order to have UNE rates in effect for Verizon by the beginning of 1997. (D.96-08-021, *mimeo.*, p. 70 and p. 92.)

In late 1996, the Commission was faced with a deadline of January 1, 1997 for the opening of local exchange competition in California. (*See* Pub. Util. Code § 709.5.) The Commission also had before it several arbitrations over interconnection agreements between ILECs and CLCs, including an arbitration between GTEC and AT&T. Thus, the Commission found the need to have rates for GTEC's unbundled services in place by the first quarter of 1997. Faced with this deadline, the Commission ordered "specific but broad ranging adjustments to GTEC's studies to *approximate* conformance with the Consensus Costing

Principles." (D.96-08-021, *mimeo.*, p. 70.) (Emphasis added.) At the same time, the Commission ordered GTEC to file new, forward-looking cost studies within one year, that is, by September 1997. (*Id.*) Subsequently, in GTEC's arbitration with AT&T, the Commission adopted GTEC's TSLRIC rates, as modified by D.96-08-021. (*See* D.97-01-022.) These rates have avoided scrutiny or alteration ever since. Given the Commission's obvious intent to review new cost studies for GTEC in 1997, the Commission intended at the time that any rates emanating from D.96-08-021 would apply only on an interim basis until replaced by new cost studies. It is fair to say the Commission never imagined that the rates it adopted based on "approximate" conformance with costing principles, and ultimately based on a flawed TSLRIC cost study, would still be in place over five years later. The time has come to update these rates to reflect the most recent forward-looking cost information available for Verizon.

We certainly wish that the intervening events, which have kept the Commission from conducting a proper review of GTEC's 1997 cost filing, had not occurred. Without dwelling on these various policy priorities and resource constraints, and without assigning blame to any particular source, it should suffice to say we have not had the ability to conduct a thorough review of GTEC's 1997 cost filing and the numerous objections to it. In the intervening years since GTEC's 1997 cost filing, we have adopted TELRIC-based UNE prices for Pacific and we have even found sufficient preliminary evidence to adjust some of Pacific's UNE prices downward, on an interim basis, given undisputed evidence of cost declines for loop and switching inputs.

In contrast to current rates for Pacific that are based on TELRIC cost studies, Verizon's rates are clearly based on TSLRIC cost studies filed in late 1995 and early 1996, which are based on data from the 1994 and 1995 time period.

Joint Commenters contend that the same cost declines for loop and switching equipment, which were relied on in D.02-05-042 to update Pacific's UNE rates, also impact Verizon's UNE costs. Verizon does not dispute that loop and switching equipment costs have declined. We agree with Joint Commenters that it is reasonable to assume that these recent equipment cost declines would impact Verizon's forward-looking UNE rates in the same manner that Pacific's forward-looking costs were impacted. Verizon's current rates are based on cost studies from the same vintage as Pacific's original rates that we found sufficient justification to update in D.02-05-042, and indeed, the cost studies supporting Verizon's current rates were based on aspects of Pacific's original cost studies. Therefore, because we have found sufficient justification to adjust Pacific's TELRIC prices on an interim basis, it is reasonable to adopt interim UNE prices for Verizon as well.

IV. Interim UNE Pricing Proposals

Given our intent to set interim rates for at least some of Verizon's UNEs, we now turn to the three interim pricing proposals presented by Verizon, Joint Commenters and TURN.

A. Verizon's Proposal Based on Florida Trend Analysis

We shall first examine Verizon's proposal, which proposes a percentage adjustment to Verizon's current UNE rates based on a trend analysis of costs for Verizon in Florida.

Verizon believes that the Commission does not need to set interim rates, but should keep Verizon's current UNE rates in place pending the completion of this proceeding. Verizon argues that the Commission set these rates in D.97-01-022 after extensive proceedings. Nevertheless, Verizon provided an interim pricing proposal in the interest of avoiding extensive litigation regarding interim rates. According to Verizon, its proposals for interim UNE loop and switching rates are voluntary and due process requires that the Commission may not reduce rates beyond these proposals without a full and fair proceeding that would undoubtedly overlap with the permanent phase of this case. Verizon's proposal entails a 35% to 52% reduction in its UNE switching rates and no change in its UNE loop rates. On September 9, Verizon modified its original position and proposed a reduction in its UNE loop rates of 15.1%.

Verizon's proposed switching rate reductions are based on a trend analysis it performed of switching costs for Verizon's Florida operations. For each switching rate element, Verizon compared cost studies it filed with Florida regulators in 1996 and 2001 and calculated a percentage difference between the two filings. Verizon then applied this percentage difference, which amounted to a 35% to 52% reduction, to its current California switching rate elements to arrive at an interim price.[14]

Verizon does not propose interim rates for switch features because they are not included in its trend analysis using Florida. According to Verizon, its current prices and volumes for switch features are very low and it would be too great a burden to change its billing systems to track these elements for possible later true-up.

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[14] Verizon explains that its trend analysis shows increases in tandem switching costs over the time period examined because of significant cost methodology changes between the 1996 and 2001 Florida studies. Verizon states that increasing tandem switching rates using the trend analysis is inappropriate. Instead, Verizon proposes to decrease tandem switching rates by the same 44% percent reduction found for end office switching costs because it expects similar cost trends for end office and tandem switching. (Collins Declaration, 7/30/02, para. 9.)

Verizon justifies its use of a Florida trend analysis for switching by arguing that trends in Florida switching costs over the 1996-2001 time period represent a good estimate of the trend that could be expected in California over the same period. First, Verizon notes that the 1996 Florida proposals were prepared in the same year and using the same methodology as Verizon's 1996 study used as the basis for its current California rates. Second, Verizon asserts the 2001 Florida study reflects current, forward-looking switching information. Third, Verizon contends that California and Florida have a similar (but not identical) switching infrastructure, including switch mixes. (Collins Declaration, 7/30/02, paragraph (para.) 7.) Finally, Verizon contends that its trend analysis is similar to the approach used by the Commission recently to set interim UNE prices for Pacific Bell,[15] but is actually superior because it is "based on real ILEC data and more accurately reflects Verizon's forward-looking costs." (Verizon Proposal, 7/30/02, p. 4.)

With regard to interim loop rates, Verizon initially proposed no change in its UNE loop rates and justified this by claiming that its current California loop rates should be increased, not decreased. As support for this contention, Verizon states that its current loop rates are below the costs it submitted in California in its 1997 cost studies and are below the loop rates it has recently proposed in Florida. Further, Verizon stated that several significant loop cost drivers, such as material costs for copper and fiber cable, have increased since 1996. (Collins Declaration, 7/30/02, para. 12.)

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[15] *See* D.02-05-042 in A.01-02-024 and consolidated cases.

On September 9, Verizon updated its interim UNE loop proposal and proposed to reduce its existing loop rates by the same 15.1% discount applied to Pacific Bell in its interim rate proceeding, subject to adjustment once final rates are set in the permanent phase of this case. This translates into a reduction in the current statewide average 2-wire loop rate from $16.81 to $14.27. Verizon explains that it makes this updated offer solely to bring this interim phase of the case to an expeditious conclusion so that the permanent phase involving review of cost studies can begin. Verizon notes that it does not agree with the Commission's basis for reducing Pacific Bell's loop rates by 15.1%, but it would allow this reduction to its current rates as an interim measure to avoid extensive litigation on interim rates.

Verizon opposes deaveraging its loop rates at this time because it has not been able to make a detailed proposal for deaveraging due to the expedited schedule for this interim phase of the case. (Verizon Reply Comments, 9/20/02, p. 7.) If the Commission chooses to deaverage loop rates for the interim, Verizon suggests that the rate for the former Contel areas that Verizon now serves should be $40.37 based on the data contained in GTEC's September 1997 cost filing. (*Id.*, p. 8, n. 9.)

B. Joint Commenters' Proposal Based on Pacific's Interim Rates

Joint Commenters request that the Commission set interim UNE rates for Verizon based on the interim prices adopted for Pacific in D.02-05-042, with appropriate adjustments to reflect cost differences between Verizon and Pacific as indicated by the FCC's Synthesis Model.[16] They maintain that interim relief is warranted because Verizon's current prices are based on TSLRIC cost studies, which rely heavily on 1994 base year data, and were filed by GTEC in OANAD prior to the adoption of the Telecommunications Act of 1996. They also ask that the Commission take official notice of the evidence of cost reductions for key inputs for unbundled loops and switching since the 1994 time frame, as found in D.02-05-042, because these cost reductions impact Verizon as well as Pacific. Further, they highlight the merger of GTEC and Bell Atlantic in 2000 that led to the formation of Verizon, and contend that this merger provides ample reason to anticipate Verizon has experienced cost reductions and greater economies of scale since the time that its rates were set by the Commission.

For unbundled loops, Joint Commenters recommend interim prices based on two geographic zones – one corresponding to the former GTEC service territory and the other corresponding to the former Contel of California Inc. (Contel) service territory, which GTEC acquired in mid-1996.[17] Joint Commenters propose that the loop price in each of these zones should equal the current loop price for Pacific, adjusted by the percentage difference in costs identified by the FCC's Synthesis Model. Specifically, the 2-wire loop price for the former GTEC territory should equal Pacific's interim statewide average price multiplied by the ratio of the Synthesis Model cost result for the former GTEC zone to the Synthesis Model cost result for Pacific. Joint Commenters then

[16] Joint Commenters used the Synthesis Model and all necessary components and directions from the FCC's website, provides the Synthesis Model results and work-files that the FCC created in 2000 (using 1998 data). (Murray Declaration, 7/30/02, para. 13.)

[17] GTEC's acquisition of Contel was approved by the Commission in D.96-04-053.

remove the 19% shared and common cost markup incorporated into Pacific's rates,[18] and replace it with 8%.[19] The resulting rate for the former GTEC territories is $9.35, or a 44.4% reduction from Verizon's current average loop rate of $16.81. A similar calculation is performed to set the 2-wire loop price for the former Contel territory. The proposed rate for that zone is $17.20, or a 2.3% increase to the current average loop rate.[20]

Joint Commenters support their Synthesis Model adjustment to Pacific's interim loop rates by explaining that the FCC itself has used the *relative* UNE costs reported by the Synthesis Model to assess the relative costs of unbundled loops and switching between ILECs in different states. Specifically, the FCC has used this test to gauge whether an ILEC's UNE rates are within a range of reasonableness for TELRIC compliance. (Murray Declaration 7/30/02, paras. 10-12.) Joint Commenters explain that although the FCC originally developed the Synthesis Model to calculate the forward-looking costs of providing universal service, the forward-looking economic cost criteria that the

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[18] In D.02-09-049, the Commission approved an increase in Pacific's markup from 19% to 21%, but this change has not yet been reflected in Pacific's rates. For this reason, we will continue to refer to the markup as 19% in this order.

[19] Joint Commenters' reasoning for this modification to the shared and common cost markup is discussed more fully in Section V below.

[20] Joint Commenters use a slightly different approach to calculate an interim 4-wire loop price because Pacific has no interim price for this rate element. They recommend adjusting Verizon's current 4-wire loop rate by the same 44.4% decrease and the 2.3% increase used to adjust Verizon's current 2-wire loop price. This results in adjusting Verizon's current statewide average 4-wire loop rate of $31.85 into interim rates of $17.72 and $32.59 for the former GTEC and former Contel service areas respectively. (Murray Declaration, 7/30/02, para. 18, no. 24.)

FCC applied are consistent with, and largely identical to, the forward-looking economic cost criteria that the FCC has adopted for UNEs. (*Id.*, para. 10.)

For unbundled switching, Joint Commenters recommend that the Commission set prices for Verizon equal to the interim switching prices established for Pacific in D.02-05-042, translated into Verizon's current rate structure.[21] Similar to their interim loop proposal, Joint Commenters also decrease the current markup in Pacific's switching rates from 19% to 8%. In contrast to Verizon, Joint Commenters include switch features in their proposal for interim switching rates because, they argue, switch features are an integral part of the unbundled switching UNE established by the FCC. Further, they contend that excluding switch features would create complications for using their methodology, which is anchored to Pacific's interim switching prices and includes switch features. (Joint Commenters' Proposal, 7/30/02, p. 3.) Joint Commenters also propose that the Commission use an analogous process to establish interim prices for all Verizon's port rate elements, mirroring any port discounts applied to Pacific's rates. (*Id.*, p. 10, n. 27.)

To support the reasonableness of their proposal, Joint Commenters note that the Commission has twice before relied on Pacific's rates and cost models in other proceedings. In an arbitration proceeding involving Roseville Telephone Company and Covad Communications, the Commission found it did not have sufficient cost data on which to base a reasonable estimate of forward-looking costs for Roseville. Thus, the Commission relied on Pacific's adopted UNE prices

[21] Verizon currently charges a port charge plus a single minute of use (MOU) charge, in contrast to Pacific's switching rate structure which charges separate rates for intraoffice and interoffice calls, call setups and duration, and originating and terminating usage.

as a proxy for Roseville's loops and other UNEs. (*See* D.01-02-042, *mimeo.*, pps. 11-12; affirmed by D.01-06-089). Also, when the Commission set Verizon's nonrecurring costs in an earlier phase of OANAD, the Commission rejected GTEC's cost model and used Pacific's cost model, with adjustments, to set GTEC's nonrecurring costs. (*See* D.98-12-979, *mimeo.*, pps. 27-29.)

Finally, Joint Commenters maintain that reliance on Pacific's interim rates is reasonable because of three main similarities between Verizon and Pacific: 1) both companies operate in California and are subject to the same economic conditions statewide and the same labor and material costs; 2) both companies have enjoyed similar increases to their economies of scale and scope as a result of recent mergers; and 3) public data shows that Pacific and Verizon are comparable with regard to line densities and certain switching variables such as switched lines per central office and the percent of host versus remote switches. (Murray Declaration, 7/30/02, paras. 25-32.) Joint Commenters contend that any network differences that do exist between Pacific and Verizon are captured by the Synthesis Model comparisons that Joint Commenters have used to adjust their proposed interim rates. In addition, Joint Commenters note that their proposal for separate, deaveraged loop rates for the former GTEC and former Contel service areas accounts for network differences between Pacific and Verizon.

Z-Tel, Mpower, and ORA support Joint Commenters' proposal to use Pacific's interim rates adjusted by the Synthesis Model.

C. Joint Commenters' and TURN's New Jersey Proposal

In response to the August 23 ruling allowing interim pricing proposals based on rates in Verizon-affiliated states, Joint Commenters and TURN reiterate their view that Pacific's interim loop and switching rates, adjusted by the

Synthesis Model, are appropriate as interim rates for Verizon. Nevertheless, Joint Commenters and TURN state that if the Commission prefers to use rates from another Verizon jurisdiction, the Commission should set interim loop and switching rates for Verizon based on the most recently adopted New Jersey TELRIC-based UNE rates.[22] Joint Commenters further suggest that if New Jersey rates are used for California, the Commission should use the Synthesis Model to develop adjustment factors to reflect the loop and switching costs differences identified by the Synthesis Model between Verizon California and Verizon New Jersey. Specifically, Joint Commenters apply the same adjustment methodology suggested in their initial proposal based on Pacific's interim UNE rates. Finally, Joint Commenters and TURN propose that the Commission adjust the 10% shared and common cost markup embedded in Verizon New Jersey rates to the 8% level suggested previously.

With regard to interim loop rates, Joint Commenters indicate that according to the Synthesis Model, Verizon California's statewide-average loop costs are 6% higher than loop costs for Verizon New Jersey. If the comparison of loop costs is done on a deaveraged basis, loop costs in the former GTEC service territories areas are .83% lower in California than New Jersey, while in the former Contel California service territory, loops costs are 82.39% higher than New Jersey loop costs. (Murray Declaration, 9/9/02, para. 15.) Joint

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[22] The New Jersey Board of Public Utilities adopted UNE rates on March 6, 2002, and revised these rates in part on July 15, 2002. (*See In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc.*, New Jersey Board of Public Utilities, Decision and Order, Docket No. TO00060356, March 6, 2002, hereinafter "New Jersey UNE Order," as modified by transcript of public meeting, Docket No. TO00060356, July 15, 2002.)

Commenters propose deaveraged loop rates for the former GTEC and former Contel service areas that are .83% lower and 82.39% higher than New Jersey rates, respectively. The proposed rates, including an adjustment of shared and common costs to 8%, are $9.27 and $17.05 for the former GTEC and former Contel service areas, respectively.

With regard to switching, the Joint Commenters' analysis using the Synthesis Model indicates Verizon California's costs are 3% lower than costs for Verizon New Jersey. (Murray Declaration, 9/9/02, para. 10.) Therefore, Joint Commenters propose switching rates that are 3% lower than switching rates in New Jersey.[23] For switch features, Joint Commenters point out that Verizon New Jersey includes features costs in the UNE port charge and prices only a few switch features individually. Therefore, Joint Commenters propose switch features priced similarly in California, *i.e.*, individual prices for those features that are individually priced in New Jersey, and all other features included in the port rate. (Joint Commenters' Ruling Response, 9/9/02, p. 7, n. 16.) The proposed feature rates are 3% lower than New Jersey rates.

Although UNE rates were also recently adopted for Verizon in New York, Joint Commenters and TURN propose basing interim California prices on New Jersey rates for several reasons. First, they stress that the New Jersey rates reflect the most recent TELRIC based, forward-looking cost information from another Verizon state. Newly adopted New Jersey rates reflect

[23] Joint Commenters propose that interim tandem switching prices for Verizon be based on the indexed relationship between Verizon New Jersey and the former GTEC territories of Verizon California because of anomalies in the Synthesis Model for tandem switching in the former Contel California territories. (Joint Commenters' Ruling Response, 9/9/02, p. 7, n. 15.)

conditions following the GTE and Bell Atlantic merger. Second, the rates for New Jersey were fully litigated before adoption by New Jersey regulators in contrast to rates for Verizon New York, which emerged from a settlement. Third, Joint Commenters and TURN contend that New Jersey's cost modeling criteria and assumptions are more consistent with this Commission's prior rulings than New York rates.[24]

In comments on the various proposals, ORA prefers the proposal to use Pacific's interim rates for Verizon. Nevertheless, ORA contends it is also reasonable for the Commission to look to other Verizon jurisdictions, such as New Jersey, that have recently set forward-looking, TELRIC-compliant rates. ORA notes that Verizon's own interim proposal and supporting declarations contradict its concerns about the validity of using rates of another Verizon jurisdiction for comparison.

D. Discussion

1. Verizon's Proposal Rests on a Flawed Foundation

We find that Verizon's proposal does not withstand the criticism leveled by Joint Commenters, namely that the proposal rests on an imperfect foundation because it recommends discounts from TSLRIC-based rates that date back to 1996.

The primary problem with Verizon's proposal for interim loop and switching rates is that it involves a percent reduction from Verizon's current UNE rates. Thus, the proposal rests on the presumption that current prices

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[24] For example, Joint Commenters contend that New York cost studies assume a 100% fiber feeder distribution network, whereas New Jersey assumes a fiber and copper mix similar to California. (Klick Declaration, 9/9/02, paras. 8-10.)

reasonably reflect forward-looking economic principles. This is not the case. As explained above, Verizon's current rates are based on unsatisfactory, non-forward-looking cost studies that the Commission concluded "do not adequately conform with the TSLRIC principles adopted in D.95-12-016." (D.96-08-021, *mimeo.*, p. 91.) It is not reasonable to leave these rates in place while we evaluate cost studies in the permanent phase of this case. Although the Commission attempted in 1996 to remedy the flaws that it found, this was a temporary measure and it is time to revisit Verizon's rates. Thus, for the same reasons that interim rates are warranted, we find that it would be improper to use these TSLRIC based rates as a starting point for any interim rates.

Verizon defends its proposal with several arguments. First, Verizon contends that its current rates are an appropriate base from which to calculate interim rates because they were extensively litigated and there is no basis to abandon them. Second, Verizon argues that the Commission's 1997 order significantly adjusted GTEC's TSLRIC cost studies, which makes Verizon's current UNE rates forward-looking. Third, Verizon argues that the Commission did not find flaws with the switching portion of GTEC's 1996 cost filing.

We disagree on all points. We do not find it reasonable to use Verizon's current rates as a basis for interim rates simply because a lot of time was spent litigating adjustments to GTEC's non-forward-looking TSLRIC model. The fact that parties and the Commission spent a lot of time litigating these adjustments does not mean we are bound to these rates. Since the time that GTEC performed its original TSLRIC analysis, the Commission and the entire country have moved to the TELRIC approach to UNE ratesetting. It is now time for Verizon's rates to be based on a TELRIC approach as well. Furthermore, we do not agree that the adjustments ordered in D.96-08-021 and implemented in

D.97-01-022 suffice today to call Verizon's current rates forward-looking. These adjustments were not intended to be in place for six years, particularly when the Commission ordered new cost studies to be filed in 1997. Further, we have found ample reason to adjust Pacific's forward-looking rates, which were set later than Verizon's. The fact that Verizon's rates may have been considered forward-looking in 1996 does not mean they are still forward-looking today, particularly when Verizon does not dispute the cost declines that led us to lower Pacific's rates in D.02-05-042. Finally, we do not agree that the Commission did not find flaws with GTEC's switching model. The Commission ordered GTEC to file new cost studies in 1997 for all of its UNEs and did not exempt switching from this directive. Given all of these factors, we find sufficient justification to avoid using Verizon's current UNE rates as a basis for any interim rates that we will set in this order.

Verizon also maintains that the Commission must fully consider Verizon's proposal, and that it cannot adopt anything but the Verizon proposal without extensive further proceedings. We disagree. Given that this case involved four rounds of comment on interim pricing proposals, Verizon has been given ample opportunity to explain its interim proposal and have its due process rights protected. While we appreciate Verizon's efforts in providing an interim pricing proposal for us to consider, the Commission is not limited to Verizon's proposal.

2. Problems with Verizon's Switching Proposal

With regard to interim switching rates, we agree with Joint Commenters that Verizon has proposed a flawed trend analysis based on proposals in Florida using two different cost models. Essentially, the 1996 and 2001 Florida studies used to indicate a trend in switching prices do not provide an apples to apples comparison. Joint Commenters detail significant problems with the Florida trend analysis including:

- The trend analysis relies on two different cost models, with different methodologies and assumptions. The 1996 cost model was prepared in the same year and using the same TSLRIC methodology as the Verizon California 1996 study (which the Commission found flawed in D.96-08-021). (Murray Declaration, 8/20/02, para. 9.) The 1996 study estimates costs based on a small subset of wire centers (*Id.*, para. 16.), whereas the 2001 cost study is based on the TELRIC-based ICM, and it estimates switching costs for each wire center. (*Id.*)
- Verizon itself admits that the two Florida cost studies use different methodologies and cannot be relied on to produce a reliable trend for tandem switching rates. (*Id.*, para. 8-17.)
- Verizon omits switch features, which Joint Commenters consider an integral part of the switching UNE and the cost analysis on which Verizon relies for its cost trend. Joint Commenters contend that Verizon's failure to include features could bias the cost trend. Further, switch feature costs should decline in parallel to other switching costs. (*Id.*, paras. 35-36.)

We agree with Joint Commenters that Verizon's trend analysis, which is based on a comparison of Florida cost study proposals, is significantly different from the trend analysis used to set rates for Pacific Bell. In setting Pacific's interim rates, the Commission relied on the same model to compute costs at both end points of the trend analysis. This enabled the Commission to isolate the effect of changing only a few variables, namely loop and switching equipment costs and demand growth. In contrast, Verizon's trend analysis uses two different cost models, which Verizon admits contain methodology differences. (Collins Declaration, 7/30/02, para. 9.) This fact alone makes Verizon's proposed trend analysis quite different from the one we performed in calculating interim rates for Pacific.

Further, our own experience with Verizon's cost filings in California in 1996 and 1997 cast doubt over whether these models are truly comparable. Verizon admits that the 1996 model it uses for its trend analysis is similar to the model filed in 1996 in California. (*Id.*, para. 7.) This 1996 California model is the same one that the Commission found inadequate and modified in D.96-08-021 to approximate forward-looking costs. Verizon uses a 2001 version of its ICM model for the trend analysis, which appears to be a later version of the ICM model that Verizon filed in California in 1997 to replace the 1996 studies the Commission rejected. While we agree with Verizon that cost models may evolve over time to reflect technology and network design changes, we do not find it appropriate to use admittedly different cost studies to perform a trend analysis. Therefore, the Commission cannot be assured that the "trend" identified by the models represents changes in forward-looking economic costs rather than methodological changes in the model itself that are irrelevant to cost changes. Because we have other options available and proposed in detail on the record, we will not use Verizon's trend analysis.

Verizon asks us to take official notice that on October 14, 2002, the Florida PSC adopted UNE rates derived from Verizon's proposal in that state and these rates are higher than Verizon's proposal in California.
Joint Commenters do not object to this notice, but ask that the Commission disregard Verizon's claims concerning the implications of Florida's new UNE prices. We will grant Verizon's request for official notice, but as Joint

Commenters suggest, we will disregard Verizon's claims regarding these rates. Likewise, we will disregard Joint Commenters' counter claims regarding the import of the Florida rates.[25] At the same time, we note that Verizon does not explain the differential between its proposed UNE rates in Florida and the rates ultimately adopted by the Florida PSC. For example, the Florida PSC adopted end office switching rates per minute of use (MOU) and tandem switching per MOU that are 24 % and 16% lower than Verizon's initial Florida proposals, respectively. The Florida PSC adopted a basic port rate 29% lower than Verizon's proposal in that state. (Verizon Petition to Reopen Proceeding, 10/25/02, Attachment (Appendix A-1, p. 385.)) The fact that the Florida PSC adopted final UNE rates does not mean that Verizon's trend analysis using proposals it made in Florida is valid, particularly when the adopted rates are significantly lower than Verizon's proposed rates. Thus, we are still not persuaded to rely on Verizon's trend analysis.

Finally, Verizon's Florida proposals can be differentiated from SBC-Ameritech's proposals in Illinois, which were used to set interim rates for Pacific, because in that case the record revealed similarities between California and Illinois with regard to switching characteristics. Here, Verizon has only asserted similarities, but has provided no data showing these similarities actually exist. (Collins Declaration, 7/30/02, para. 7.)

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[25] We will also disregard Verizon's November 12, 2002 reply comments in support of its motion to reopen the proceeding because this reply responds to Joint Commenters' claims that we are disregarding. Joint Commenters' motion to strike Verizon's November 12, 2002 reply comments is therefore granted.

3. Problems with Verizon's Loop Proposal

Turning to interim loop rates, Verizon provides little explanation why it supports the 15.1% discount recently applied to Pacific. Although Verizon proposes a trend analysis using Florida cost studies for its interim switching proposal, it abandons this approach for loops. This inconsistency is largely unexplained. Verizon suggests it does not want to waste time litigating interim rates, but it does not explain why a trend analysis using Florida or another Verizon state would not be appropriate for loops.

We understand that Verizon is offering this approach as a way to expedite the proceeding and avoid prolonged litigation over interim rates. While we can appreciate that as a goal, this does not mean we should give greater weight to Verizon's proposal, or ignore inconsistencies in it, simply because it was voluntary. Verizon's loop proposal contains a reversal from its earlier positions without an adequate explanation. Verizon initially alleged that it would be inappropriate to apply Pacific's switching discount to Verizon because there are no similarities between Pacific's and Verizon's switching networks. Verizon also opposed use of Pacific's loop and switching interim rates because they resulted from sanctions on Pacific. Later, Verizon reversed positions in part and now supports using Pacific's loop discount. Verizon takes this new position with regard to interim loop rates, and in contrast to its position on switching, without showing any similarity between Verizon's and Pacific's loop networks to support using Pacific's discount. These contradictions lead us to find that Verizon has not sufficiently explained why it would be reasonable to use the percentage discount found in California for Pacific's loop costs, but not for switching. On the whole, we find Verizon's loop discount proposal unreasonable and contradictory because it proposes one methodology for its switching rates and an entirely different methodology for loop rates. Verizon's explanation that it is only trying to expedite this proceeding is not enough to support adoption of its proposal when other alternatives are available to the Commission. .

Verizon contends that although it agrees to a 15.1% decrease to its average loop rate, its loop rate should actually increase because the current rate is below cost. Verizon alleges that several loop cost drivers, such as labor, cable costs, and the cost of money, have increased since 1996. Verizon's argument for higher loop costs is not well-supported. We are not convinced that Verizon's current loop prices are below TELRIC and should be raised simply because proposals that Verizon made here in 1997, and later in Florida, are higher than current TSLRIC-based rates. The fact that Verizon has *proposed* higher rates does not prove that current rates are below cost, particularly when neither of Verizon's proposals in Florida or California has been adopted.[26] Moreover, Verizon has not provided any analysis indicating why Florida loop costs are indicative of California loop costs. Verizon also argues that several cost indices prove loop cost drivers have increased. Verizon's contentions are not supported by an analysis of the effects of any input increases on per unit loop rates. If Verizon intends to pursue this line of reasoning, it will need to provide further support for its analysis in the permanent phase of this proceeding.

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[26] We note that the rates recently adopted by the Florida PSC are significantly lower than Verizon's initial proposal in that state. Verizon initially proposed rates of $22.17 and $30.91 for zones 1 and 2 respectively, whereas the Florida PSC adopted rates for these zones of $12.00 and $16.18. (Verizon Petition to Reopen Proceeding, 10/25/02, Attachment (Appendix A-1, p. 383.))

Verizon argues we should accept its proposed interim rates because its own comparison of loop and switching rates across other states in which Verizon operates, even after adjustment using the Synthesis Model, shows that its proposal is reasonable.[27] Specifically, Verizon explains that its proposed average loop rate of $14.27 and its 35% to 52% switching rate discounts are well within the range of Synthesis Model adjusted rates in other Verizon states. (Verizon Response, 9/9/02, p. 8). We do not find this to be a meaningful or convincing argument. The fact that Verizon's proposed rates fall within the range of other states' UNE rates, many of which were adopted as long ago as 1996 and 1997, does not prove that Verizon's proposed rates are accurate. Verizon's multi-state comparison produces a very large range. One could just as easily argue from this analysis that rates for California should fall at an end-point for this range rather than somewhere in the middle. Moreover, Verizon's Synthesis Model analysis indicates that average California loop rates should be 7% higher than New Jersey loop rates, but Verizon proposes a loop rate of $14.27 that is 50% higher than New Jersey's current loop rate without explaining this differential. (Meny Declaration, 9/9/02, Attachment 1, p. 5.)

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[27] Verizon adjusted the default wire center results of the Synthesis Model for "various adjustments that the FCC has found appropriate in the section 271 benchmarking context." (Meny Declaration, 9/9/02, para. 5., referring to the FCC's review, under Section 271 of the Telecommunications Act of 1996, to applications by ILECs for authority to provide in-region interLATA services.) For each state, Verizon made these adjustments and calculated the percentage cost difference between California and that state, then used this percentage cost difference to adjust UNE rates in other Verizon states to account for cost differences between that state and California. (*Id.*) By providing this analysis, Verizon implicitly supports the approach of comparisons to UNE rates in other Verizon states, and the approach of using the Synthesis Model to compare relative costs in these states.

Indeed, Verizon's multi-state rate comparison presents further contradictions in Verizon's logic. On the one hand, Verizon contends it is inappropriate to use another Verizon state to set rates for California. At the same time, Verizon maintains that a comparison of Verizon's proposed rates to the range of UNE rates across all Verizon jurisdictions, adjusted to reflect California specific inputs using the Synthesis Model, shows the reasonableness of Verizon's own proposal. (Meny Declaration, 9/9/02, para. 2.)

In summary, we find Verizon's proposals use an inappropriate TSLRIC starting point for discounts to both loop and switching prices, and a flawed trend analysis for switching. Verizon provides little justification for using the 15.1% discount recently applied to Pacific's unbundled loop rates, particularly when it eschews this idea for switching. Verizon's Synthesis Model analysis is not convincing when it suggests that we should adopt Verizon's proposed interim rates merely because the rates fall within the large, and somewhat dated, range of rates from other Verizon states. Therefore, Verizon's interim rate proposals are not reasonable and we will not adopt them.

4. Joint Commenters' and TURN's New Jersey Proposal is Preferable to the Proposal to Use Pacific Bell Interim Rates

In contrast to Verizon's proposal to base interim UNE rates on its current TSLRIC rates, Joint Commenters propose to use Pacific Bell's interim UNE rates as a basis for interim UNE rates or, if the Commission prefers a proposal based on another Verizon jurisdiction, they propose, along with TURN, to use Verizon's New Jersey UNE rates.

We agree with Joint Commenters' and TURN's proposal to base Verizon's interim UNE rates on rates for Verizon New Jersey because these are among the most recent forward-looking, TELRIC-based UNE rates from another

Verizon state.[28] We agree with Joint Commenters and TURN that using the Synthesis Model to reflect loop and switching cost differences between California and New Jersey is reasonable for the purposes of interim pricing. Because the rates apply to a company within the same regional Bell operating company (RBOC), it is reasonable to use the Synthesis Model to adjust for regional and network differences between California and New Jersey. Further, because these rates are so recently adopted, they reflect conditions after GTEC's merger with Bell Atlantic in mid-2000 to form the company now known as Verizon. Moreover, we agree that using Verizon New Jersey rates is a better alternative than using Verizon New York rates because New York rates were the product of a settlement. Despite Verizon's objections, we find that deaveraging as proposed by Joint Commenters and TURN is reasonable because it is based on the differences shown by the Synthesis Model for the former GTEC and former Contel areas now served by Verizon.

We find that Joint Commenters' and TURN's proposal to use New Jersey rates is not that different from Verizon's own suggestions to use Florida rates for a trend analysis and to use other Verizon states as a reference point for California rates. For example, Verizon proposes to use Florida cost studies while providing little, if any, data on network similarities between

[28] We take official notice that the Florida PSC adopted rates for Verizon on October 14, 2002 (Docket No. 990649B-TP). Nevertheless, we will still rely on a comparison with New Jersey because none of the parties to this case proposed using actual rates from Florida, and we have no basis on which to find that Florida rates are more appropriate than New Jersey rates. Rates for New Jersey and Florida have been adopted within months of each other and are both equally valid as examples of recently adopted rates. If we were to continually revise our decision for each new state that adopts UNE rates, we might never issue a decision.

Florida and California. We find it superior to use the New Jersey rates adjusted for the Synthesis Model rather than Verizon's Florida-based trend analysis because the New Jersey rates are final adopted rates in contrast to trends elicited from proposed rates in Florida. We also find it preferable to use New Jersey rates as a starting point for interim rates rather than Verizon's current California rates, which are derived from a 1996 TSLRIC analysis as we have already discussed. Verizon itself has suggested the reasonableness of comparing UNE rates across other Verizon jurisdictions using the Synthesis Model. Thus, we find that it is appropriate to use New Jersey rates as an interim measure, especially after adjustments based on the Synthesis Model.

Joint Commenters and TURN have proposed adjusting either the New Jersey rates or Pacific's interim rates using the FCC's Synthesis Model. We agree with Verizon that it may not be appropriate to use the Synthesis Model for inter-RBOC comparisons, particularly when the FCC has only made comparisons when two states have a common RBOC. (Verizon Comments, 8/20/02, p. 12.) For this reason, we do not think it is appropriate to compare the costs of Verizon and Pacific and adjust them using the Synthesis Model. Instead, we will base interim rates on Verizon's New Jersey rates, adjusted using the Synthesis Model. Although Joint Commenters and TURN urge us to overlook the FCC's cautions in this circumstance, we are not compelled to do so because we have the option of relying on rates recently adopted in another Verizon jurisdiction. Therefore, we find Joint Commenters' and TURN's proposal to use New Jersey rates more reasonable than using Pacific Bell's interim rates. We prefer to base interim rates on a TELRIC analysis emanating from Verizon itself, as opposed to Pacific.[29]

5. Adjustments Using the Synthesis Model

We find that using the Synthesis Model to compare relative costs between California and New Jersey is reasonably consistent with how the FCC has used the Synthesis Model in Section 271 proceedings to determine whether UNE rates are acceptable.[30] We agree with Joint Commenters that the forward-looking economic cost criteria that the FCC applied in developing the Synthesis Model for universal service purposes are consistent with, and largely identical to, the forward-looking cost criteria that the FCC has adopted for UNEs.[31] Further, we agree with Joint Commenters that the Synthesis Model adjusts relative switching costs based on major cost drivers, including line

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[29] Verizon suggests that the Commission cannot use Pacific's interim rates as a basis for Verizon's interim rates because of due process problems. Verizon has had ample opportunity to respond to this proposal and make its case regarding this approach. Pacific's interim loop rates are not based on a discovery sanction against Pacific, but are based on a trend analysis measuring changes in equipment input costs and line growth. Pacific's interim switching rates are based on a discovery sanction in part, but are also supported based on a showing of geographic similarities in addition to the discovery sanction.

[30] *See Joint Application by SBC Communications, Inc., Southwestern Bell Tel. Co., and Southwestern Bell Communications Services Inc., d/b/a Southwestern Bell Long Distance for provision of In-Region, InterLATA Services in Kansas and Oklahoma,* Memorandum Opinion and Order, FCC 01-29, CC Docket No. 00-217, 16 FCC Rcd 6237, January 19, 2001, at para. 84. ("Our USF cost model provides a reasonable basis for comparing cost differences between states. We have previously noted that while the USF cost model should not be relied upon to set rates for UNEs, it accurately reflects the relative cost differences among states.")

[31] *See* Murray Declaration, 7/30/02, para. 10, citing, *In the Matter of Federal-State Joint Board on Universal Service,* Report and Order, FCC 97-157, CC Docket No. 96-45, 12 FCC Rcd 8776, May 7, 1997, at paras. 250 and 251.

density per switch and the number of host and remote switches.[32] For loops, the Synthesis Model takes into account population densities that drive equipment sizing, a major determinant of geographic variation in loop costs.[33]

When it comes to actually performing the Synthesis Model comparison of California and New Jersey rates, Joint Commenters and Verizon take different approaches. Joint Commenters used Synthesis Model results straight from the FCC's website to derive a differential between California and New Jersey UNE costs. For loops, Joint Commenters developed adjustment factors between California and New Jersey on a deaveraged basis by comparing Synthesis Model results for the former GTEC and former Contel areas now served by Verizon with the average rates for New Jersey.

Verizon claims that Joint Commenters' approach inappropriately allocates all of the fixed per-line common support expenses to loop costs instead of assigning a portion of these costs to other elements. (Collins/Meny Declaration, 8/20/02, para. 20.) Joint Commenters counter that there is no single

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[32] *See In the Matter of Verizon New England, Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Company and Verizon Global Networks Inc., For Authorization to Provide In-Region Inter LATA Services in Massachusetts*, Memorandum Opinion and Order, FCC 01-130, CC Docket No. 01-9, 16 FCC Rcd 8988, April 16, 2001, at para. 23.

[33] *See In the Matter of Federal-State Joint Broad on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, Tenth Report and Order, FCC 99-304, CC Docket No. 96-45 and 97-160, 14 FCC Rcd 20156, October 21, 1999, at para. 84 ("The model also uses structure cost tables that identify the per foot cost of loop structure by type (aerial, buried, or underground), loop segment (distribution or feeder), and terrain conditions (normal, soft rock, or hard rock) for each of the nine density zones.") and para.87 ("The Commission found that an efficient carrier will vary its plant mix according to the population density of an area and tentatively concluded that the assignment of plant mix defined by the model should reflect both terrain factors and line density zones").

agreed upon approach for allocating overheads in the Synthesis Model. They offer comparisons with varying overhead assumptions and claim that despite these varying assumptions, the results do not vary by that much. (Klick Declaration, 9/20/02, para. 16.)

In contrast to Joint Commenters approach, Verizon compares UNE rates across states after adjusting common support expenses and other items as described by the FCC in the Section 271 benchmarking process. (Meny Declaration, 9/9/02, para. 5.)[34] Verizon's Synthesis Model analysis does not compare loop costs on a deaveraged basis, but only compares Verizon's California statewide average loop rate to New Jersey's statewide average loop rate. Verizon's results indicate that California loop and switching costs are 7% higher than New Jersey costs. (*Id.*, Attachment 2, p. 5.)

Joint Commenters criticize Verizon's analysis because it does not use a consistent approach between loops and switching. Specifically, Joint Commenters allege that Verizon does not include any overhead expense allocation when it compares switching costs. (Murray Declaration, 9/20/02, para. 10, n. 11.) Further, Verizon distorts its analysis by focusing on end-office switching investment while disregarding other components of total switching investment. (Klick Declaration, 9/20/02, paras. 7-12.)

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[34] Specifically, Verizon started with the Synthesis Model's default wire center results, then it allocated fixed, per-line common support expenses across all UNEs, removed the allowance for retail uncollectible revenues in the model, and added allowances for wholesale uncollectible revenues and carrier-to-carrier customer service costs. (*See In the Matter of Application of Verizon Pennsylvania Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc. for Authorization to Provide In-Region InterLATA Services in Pennsylvania,* Memorandum

Footnote continued on next page

We have examined both methods used for Synthesis Model comparisons and we prefer to use an approach consistent with the method most recently used by the FCC. This is the same as the approach offered by Verizon, with one exception. We will compare the Synthesis Model results for deaveraged zones in California to the statewide average Synthesis Model results for New Jersey. In other words, we will compare the results for the former GTEC territories and the former Contel territories to New Jersey results because we want to set deaveraged loop rates for Verizon in California.

Commission staff has made the adjustments noted by Verizon in order to obtain Synthesis Model results for this comparison. We have been careful to avoid the mistakes alleged by Joint Commenters regarding Verizon's switching analysis, by treating overheads consistently for loops and switching and considering the results based on total switching investment. The results show that loop costs in the former GTEC areas and in the former Contel areas are 2.2% lower and 111.9% higher than New Jersey average loop costs, respectively. For switching, the Synthesis Model as run by Verizon indicates that end-office usage costs for Verizon are 10.7 % higher than New Jersey, port costs are 3.2% lower than New Jersey, and tandem switching costs are 38.9% higher than New Jersey. The analysis and results of this Synthesis Model comparison are set forth in Appendices B and C.

Based on these results, we will set rates for Verizon equivalent to New Jersey rates, and apply the percentages shown by our Synthesis Model analysis wherever the results show that California costs are higher than

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Opinion and Order, FCC 01-269, CC Docket No. 01-138, 16 FCC Rcd 17419, September 19, 2001, at para. 65, n. 249.)

New Jersey costs. In other words, we will not set interim rates any lower than New Jersey UNE rates, even where the Synthesis Model indicates that California costs may be lower than New Jersey. We prefer this approach in order to be conservative in setting interim rates. This means that, before adjusting for shared and common costs,[35] loop rates in the former GTEC areas will be set equal to the New Jersey loop rate of $9.52, and loop rates in the former Contel areas will be set 111.9% higher than the current New Jersey loop rate.[36] For Interim UNE switching, end-office usage rates will be set 10.7% higher than the current New Jersey rate, port and feature charges will be set equivalent to New Jersey rates, and tandem rates will be set 38.9% higher than New Jersey rates.[37]

Verizon opposes any adoption of another state's UNE rates for use in California, and it specifically objects to the proposal to use New Jersey rates. Verizon contends that this Commission should not abdicate its authority to review the numerous methodological and other issues, such as network requirements, geography, and demand levels, that factor into UNE rate decisions. Further, Verizon argues that New Jersey rates have nothing to do with the costs Verizon incurs to provide UNEs in California. As an example, Verizon contends that New Jersey UNE rates are based upon different depreciation lives than used by this Commission. (Verizon Reply Comments, 9/20/02, p. 21).

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[35] *See* Section V below for a discussion of adjustments for shared and common costs.

[36] The Synthesis Model does not derive a 4-wire loop rate, but we can use the model's results for 2-wire loops to adjust New Jersey's 4-wire loop rate by the same percentages.

[37] We agree with Joint Commenters that because of anomalies in the Synthesis Model for tandem switching in the former Contel areas, we will compare tandem switching prices between the former GTEC areas and Verizon New Jersey.

We agree with Verizon that the Commission should not abdicate its obligation to set UNE rates and it should examine the multitude of issues involved with cost modeling. We will indeed pore over the multitude of cost modeling issues in the permanent phase of the case. On the other hand, the circumstances surrounding the delays in setting TELRIC-based UNE rates for Verizon are unusual and have led to an extraordinarily lengthy delay in this case. We reluctantly turn to another state at this juncture, as we found it necessary to do for Pacific, because of the unique circumstances of this case. When we used Illinois rates for Pacific's interim switching rates, it was necessitated by discovery disputes. We turn to New Jersey to set interim rates for Verizon because we can no longer justify rates for Verizon based on a 1996-era TSLRIC cost study.

We have already explained why we do not find Verizon's own proposal reasonable because it is based on an inappropriate starting point and a flawed trend analysis. Given these findings, we find the proposal to use Verizon's New Jersey rates more reasonable than using Pacific's interim rates, despite the potential methodological differences between New Jersey's cost studies and this Commission's prior rulings. The interim rates we adopt today will be subject to adjustment once final rates are set. This fact, coupled with the Synthesis Model adjustment to account for cost differences between New Jersey and California, override our concern with any methodological differences such as differing depreciation assumptions.[38] For these reasons, coupled with our

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[38] Indeed, we are revisiting certain inputs such as fill factor and depreciation in our ongoing UNE Reexamination for Pacific (A.01-02-024 and consolidated proceedings). Thus, application of the findings of earlier Commission UNE costing decisions to Verizon is not a certainty.

view that Verizon's current rates are not a legitimate starting point for calculating interim rates, we find it reasonable to turn to the work of another state in this particular circumstance. We are also satisfied that this is a sound approach because in applying rates from Verizon New Jersey, we rely on the methodology used by the FCC to compare UNE rates in order to set what we consider TELRIC-based interim rates for Verizon.

6. Rate Structure and Switch Feature Issues

In adopting the proposal to use Verizon New Jersey rates, we must decide whether to accept Joint Commenter's proposal to convert the New Jersey switching rates into the Verizon California switching rate structure.

Joint Commenters point out that Verizon New Jersey has incorporated the costs of switch features into the port charge, although a few switch features are priced individually. With regard to switch features, Joint Commenters propose eliminating charges for features for which Verizon New Jersey does not charge, and basing charges for other features on New Jersey's current rates adjusted using the Synthesis Model. Verizon has proposed leaving switch feature charges at current levels rather than setting interim rates for them.

We will use the Joint Commenters' approach to switch features because otherwise, it would be difficult to use the New Jersey rates to set separate port and feature prices for Verizon California. For simplicity and because the rates will be subject to adjustment once final rates are adopted, we will accept the Joint Commenters' proposals and adopt rates for switch features equal to the rates New Jersey has established for switch features. This means that where Verizon New Jersey charges an individual feature rate, the same rate will be charged for Verizon California. Interim rates for all other features will be set at zero because Verizon New Jersey has incorporated these into its port charge, which we adopt for the interim in California. In a later phase, if we find that it is reasonable to adopt charges for all of Verizon's switch features, carriers will owe payment to Verizon for features they have purchased from the date of this order.

7. Port Issues

With regard to DS-1 port rates, we note that when we use New Jersey rates as interim rates for Verizon, the DS-1 port rate is above the level that Verizon currently charges for this UNE in California. We have no basis on which to increase any of Verizon's current UNE rates, and indeed Verizon itself proposed a sizeable 34.5 % reduction to the DS-1 port rate. Therefore, we will leave the DS-1 port rate at its current level, subject to adjustment from the date of this order, once we establish a final DS-1 port rate in the permanent phase of this proceeding.

Joint Commenters request that we extend any interim discounts to Verizon's 2-wire and Centrex port rates to other, "non-basic" ports. Joint Commenters fail to identify the other "non-basic" ports that they want discounted and we are unclear if there are corresponding port rates for Verizon New Jersey that we could use to derive other "non-basic" port rates. We are unwilling to make a guess on what additional ports Joint Commenters are talking about. Therefore, we will deny this request.

8. Interim Rates Will Be Subject to True Up

The interim rates that we adopt in this order shall be adjusted, either up or down, once final rates are set. This is the same as the approach the Commission took when setting interim UNE rates for Pacific in D.02-05-042. In that order, the Commission noted that a true-up provision protected against later claims that interim rates were not cost-based in compliance with Section 252(d) of the Federal Telecommunications Act. (D.02-05-042, *mimeo.*, p. 50.)

Therefore, we require Verizon to establish a balancing account to track the revenues received from the interim UNE rates adopted in this order. The balancing account should begin tracking revenues on the same date the interim rates become effective, which is the effective date of this order. Further, the balancing account should accrue interest at the three-month commercial paper rate, as is common practice for accounts of this type. When permanent UNE rates are adopted at the conclusion of this Verizon UNE phase, we will determine how to adjust the interim rates, either up or down, from the date the interim rates became effective through the date of adoption of a final rate.

9. Comments on the Draft Decision

a. Verizon.

After the mailing of the Draft Decision on November 14, 2002, Verizon filed comments recommending the Commission reject the Draft Decision and adopt Verizon's interim rate proposals instead. Verizon alleges that its proposals are the only ones supported by any evidence. According to Verizon, interim UNE rates must reflect the cost of providing UNEs in California and adoption of Verizon New Jersey rates results in interim UNE rates that are below TELRIC. Verizon states that the ALJ did not review New Jersey cost studies, did not make a finding that Verizon New Jersey rates reflect TELRIC costs in California, and did not account for the fact that New Jersey inputs differ from prior decisions of this Commission. Therefore, Verizon contends that the Draft Decision results in interim UNE rates below TELRIC and not supported by substantial evidence. Verizon faults the Draft Decision for dismissing the UNE rates recently adopted in Florida after submittal of the record in this matter, and suggests that these new Florida rates are more probative of UNE costs than New Jersey rates.

We disagree with Verizon's fundamental assumption that the interim rates in this order are below TELRIC and therefore not reasonable. This Commission has never established TELRIC-based rates for Verizon, as discussed at length in this order. It is difficult to understand how any interim rates set herein could be "below TELRIC" when the Commission has never actually completed a forward-looking (i.e. TELRIC) analysis of Verizon's costs.

Verizon suggests that a detailed review of New Jersey cost studies is required in order to set interim rates. We disagree because this would defeat the purpose of interim rate-setting, which is to arrive at a proxy rate quickly while a comprehensive review of cost studies continues on a reasonable schedule. In D.02-05-042, the Commission discussed in some detail its authority to set interim rates "as long as the rate is subject to refund and sufficient justification for the interim relief has been presented." (D.02-05-042, mimeo at 11, citing *TURN v. CPUC* (44 Cal. 3d 870,878 (1988)). Both of these criteria are met as discussed in this order. We can rely on the TELRIC analysis of the New Jersey Board of Public Utilities without an extensive review of New Jersey cost studies.[39]

Verizon suggests there is no credible rationale for applying New Jersey rates to California, and it presents several pages of entirely new argument on why New Jersey UNE rates should be ignored. Unfortunately, Verizon is providing new factual information in its comments after the close of the record

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[39] Indeed, Verizon's arguments that we cannot adopt New Jersey UNE rates without a detailed review of cost studies contradict its own requests for this Commission to rely on a Florida-based trend analysis without a detailed review of Florida cost studies.

and without an opportunity for other parties to comment adequately on the assertions therein. Rule 77.3 prohibits submittal of new factual information in comments on a draft order. Verizon had ample opportunity to present its arguments opposing the New Jersey rates and to suggest adoption of rates from a state other than New Jersey. We will not consider new information and arguments that Verizon presents in comments on the draft decision.

Furthermore, we find that the Draft Decision provides a credible rationale for adopting New Jersey rates, namely an analysis using the FCC's Synthesis Model and corresponding adjustments to New Jersey rates. This analysis was conducted using the information supplied by the parties before submittal of the case. Indeed, the decision adopts the methodology offered by Verizon for adjusting rates using the Synthesis Model. Verizon's contention that New Jersey rates are not TELRIC-based is inappropriate. We will not second-guess the work of another state commission and essentially "rehear" how New Jersey set UNE rates. The New Jersey Board of Public Utilities has found that the rates it adopted were based on the TELRIC standard.[40] Verizon can always seek remedy by appealing the order of the New Jersey Board if it believes that errors were made there.

Verizon suggests that the Draft Decision dismisses the Florida rates out of hand. Yet Verizon never proposed that actual Florida rates be used to set interim rates in California. It appears that Verizon considers the adoption of final rates in Florida as supportive of its trend analysis. Once again, Verizon presents new information regarding the newly adopted Florida rates after the

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[40] *See New Jersey UNE Order*, March 6, 2002, p. 266.

close of the record in this phase. This order takes official notice of the newly adopted Florida rates, but still dismisses the Verizon proposal to adopt rates based on a trend analysis. We see no connection between the adoption of rates in Florida and Verizon's trend analysis using proposals it made in Florida. The fact that the Florida Commission adopted final rates does not cure the flaw in Verizon's trend analysis, namely that it relies on two different cost models that estimate forward-looking costs using different methodologies.

b. Joint Commenters and Other Parties

Joint Commenters suggest that the Draft Decision errs in using Verizon's methodology to adjust UNE prices using the Synthesis Model. Specifically, Joint Commenters state that the Draft Decision improperly compares end-office usage costs per minute of use rather than per switched line. Covad Communications Company (Covad) echoes these comments. We will not revise the Draft Decision in this regard because we find that the appropriate cost driver for the switching UNE is usage and not line counts. Further, Joint Commenters contend that comparison of California and New Jersey switching sub-elements (i.e. ports and usage) creates interim rates that are systematically biased upward. Again, we disagree. The Synthesis Model provides the detail to compare at the sub-element basis and we find it appropriate to use this level of detail to set interim rates for Verizon California.

V. Shared and Common Cost Markup

We now turn to adopting a markup for shared and common costs[41] to apply to the nonrecurring costs we adopted for Verizon in D.98-12-079 and to apply to the interim UNE rates we adopt today.

Verizon states that the Commission adopted a 22% markup when it established Verizon's current UNE rates in D.97-01-022. (D.97-01-022, *mimeo.*, p. 7.) Verizon proposes that to simplify this interim proceeding, the Commission should use this same 22% markup, both with regard to interim loop and switching rates and non-recurring costs.

In contrast, Joint Commenters contend that a forward-looking shared and common cost markup should be substantially lower than the 22% embedded in Verizon's rates, because the 22% markup emerged from GTEC's 1996 TSLRIC cost study. They contend that a 22% TSLRIC markup bears no relation to a TELRIC-based shared and common cost markup. Joint Commenters explain that when the Commission converted Pacific's TSLRIC studies into TELRIC results, estimates of Pacific's shared and common costs were cut approximately 50% because a TELRIC study involves far fewer "shared" costs and eliminates retail only costs. (Joint Commenters, 8/20/02, p. 14.) They further note that when GTEC merged with Bell Atlantic to create Verizon, four years after GTEC's 1996

[41] Shared and common costs are defined in Appendix C of D.95-12-016. According to page 6 of Appendix C, shared costs are "costs that are attributable to a group of outputs but not specific to any one within the group, which are avoidable only if all outputs within the group are not provided." Common costs are defined as "costs that are common to all outputs offered by the firm." The FCC has defined "forward-looking common costs" as "economic costs efficiently incurred in providing a group of elements or services (which may include all elements or services provided by the incumbent [local exchange carrier]) that cannot be attributed directly to individual elements or services." (47 C.F.R. 51.505(c)(1).)

cost studies were filed in California, GTEC itself represented that the merger would lead to more than $2 billion in expense savings, including significant overhead cost savings. (Murray Declaration, 7/30/02, para. 29.)

Therefore, instead of the 22% markup proposed by Verizon, Joint Commenters recommend using a markup of 8% based on their own analysis of average RBOC overhead costs. When the Commission sets Verizon's interim rates, Joint Commenters recommend the Commission adjust the shared and common cost markup embedded in Pacific's rates from 19% to 8%, or the markup embedded in the Verizon New Jersey rates from 10% to 8%. Likewise, they recommend adding 8% to Verizon's nonrecurring costs adopted in D.98-12-079 in order to set nonrecurring prices for Verizon.

Joint Commenters derive their 8% markup proposal by aggregating ARMIS data reported to the FCC related to expenses and revenues for all RBOCs nationwide. Using this data, they calculate the ratio of total regulated corporate operations expenses to total costs (other than overheads) for all RBOCs in 2001. (Murray Declaration, 7/30/02, paras. 33-36.) Joint Commenters contend that the resulting 8% can be used as a conservative estimate of Verizon's shared and common costs because Verizon, as the nation's single largest RBOC, is well-positioned to achieve a lower level of overhead costs than the average RBOC.

In response, Verizon opposes Joint Commenters' request to lower the markup to 8%. First, Verizon maintains the calculation is flawed because it fails to include all shared and common costs, such as network support expenses and engineering expenses. Second, Verizon states the Commission has already rejected a similar proposal to base the markup calculation for Pacific on ARMIS data. (D.99-11-050, *mimeo.*, pps. 69-70.) Third, Verizon contends that when the Commission adopted GTEC's 22% markup, it made substantial adjustments to reduce GTEC's proposal from 46% to the 22% level. Finally, Verizon notes that the Commission recently rejected the identical suggestion by Joint Commenters to adjust Pacific's markup to 8% using ARMIS data and instead increased Pacific's markup to 21%. (D.02-09-049, *mimeo.*, pps. 12 and 17.)

Z-Tel supports use of the 8% markup factor recommended by Joint Commenters.

Discussion

We are not persuaded by Joint Commenters that we should abandon the 22% markup that we adopted for Verizon in D.97-01-022. We acknowledge that the 22% markup was set in the context of a TSLRIC proceeding and that once we conduct a TELRIC analysis for Verizon, the markup percentage may be reduced. However, we are not persuaded that the markup will be reduced by the large percentage suggested by Joint Commenters, particularly when Verizon's markup was already reduced from a proposed level of 46% to its current 22%. Moreover, we should not abandon the calculation of the markup that we made using Verizon specific information in D.97-01-022 for an overly simplistic methodology that is based on aggregate ARMIS data from all RBOCs. To arrive at their 8% markup, Joint Commenters' aggregate revenue and expense data for all RBOCs and fail to even consider the individual variations between RBOCs in overhead percentages. This is an overly simplistic methodology using nationwide, aggregated RBOC data rather than company-specific data, and for those reasons, we do not find it reasonable.

Although we deny Joint Commenters' 8% proposal, we could, of course, opt to use the 10% overhead rate embedded in the Verizon New Jersey rates. We decline to use this approach because we are not comfortable simply lifting an overhead rate from New Jersey and applying it to California. While we use New Jersey information to compare costs for loops and switching, the information is adjusted using the Synthesis Model for network differences between California and New Jersey. We do not think the same approach is valid for comparing overhead costs between differing states. To the best of our knowledge, the Synthesis Model was not intended for overhead comparisons. We have no basis to support applying the Verizon New Jersey markup of 10% to Verizon California's interim UNE rates and nonrecurring costs.

The only other approach offered was Verizon's proposal to retain the 22% markup adopted in D.97-01-022. We find it more reasonable to maintain the 22% markup in the interim rates we adopt today because it is based on a Verizon-specific analysis, even if it is somewhat dated. Pacific's current markup of 21%, as recently adopted in D.02-09-049, provides a useful guidepost. We cannot ignore the huge disparity between an 8% markup based on a methodology that averages ARMIS data for all RBOCs, and the 21% that is currently in place for Pacific based on a company-specific analysis. We acknowledge that Pacific's markup was calculated based on cost studies that were filed in the 1997 time frame, as was Verizon's. That is certainly a reason to review the markup for both companies in the context of UNE pricing proceedings, but it is not sufficient justification to abandon Verizon's company-specific markup for one that is based on nationwide averages.

In comments on the Draft Decision, Joint Commenters contend that the Commission inappropriately relies on Pacific's 21% markup because that number is outdated given recent mergers. Further, they argue that the draft order errs in not addressing the flaws in Verizon's 22% markup raised by Joint Commenters. They request that the Commission revise the order to adopt the 10% markup embedded in Verizon New Jersey UNE rates. Verizon responds that there is no evidence on the record to support adoption of the 10% New Jersey markup. Further, Verizon reiterates that the Commission already reduced Verizon's proposed 46% markup to the 22% level when the markup was adopted in D.97-01-022 and that no further adjustments are warranted.

There are no substantive changes to the Draft Decision based on these comments. The order does not rely on Pacific's 21% rate to set the markup for Verizon, but merely notes this is a useful benchmark for comparison. The order acknowledges that while the markup level is an area of UNE ratesetting that will be explored further for Verizon, the Commission should take a more conservative approach in maintaining a markup derived from a Verizon-specific analysis at this time.

VI. Price Floors

Verizon's Proposal

In D.99-12-018, the Commission granted interim pricing flexibility to GTEC for its Category II services, based on a methodology using GTEC's pending OANAD cost studies. At that time, the Commission found that the delays in adopting UNE rates for GTEC had also delayed GTEC's Category II pricing flexibility and its ability to respond competitively to the retail pricing of packaged local service offerings to business customers. (D.99-12-018, *mimeo.*, p. 11.)

Verizon explains that despite the Commission's decision to allow interim pricing flexibility, Verizon has been unsuccessful in exercising any pricing flexibility under this decision. Following D.99-12-018, Verizon filed Advice Letter 9354 requesting an interim price floor for its Zone Usage

Measurement Service (ZUM),[42] which was protested and never acted upon by the Commission. Verizon ultimately withdrew this advice letter in March 2002. In June 2002, Verizon submitted Advice Letter 10121, again requesting an interim price floor for ZUM based on the methodology adopted in D.99-12-018 and updated usage volumes and distributions. The Telecommunications Division suspended Advice Letter 10121 on July 18, noting Verizon's request for price floors in this proceeding and expressing concern that the advice letter might prejudge that request. As of this date, the advice letter has not gone into effect.

Verizon now requests that its Advice Letter 10121 should be allowed to go into effect and that the Commission should update the formula adopted in D.99-12-018 to set interim retail price floors for Verizon's other Category II services.[43] According to Verizon, the lack of price floors has prevented Verizon from meeting its competitors' ability to market bundled service offerings. Essentially, Verizon explains that in D.94-09-065 (the "IRD Decision"), the Commission required ILEC's to impute into their retail price floors the contribution based on the actual price paid by competitors for network elements that make up competing services. (IRD Decision, *mimeo.*, pps. 217-218; 56 CPUC

[42] Verizon's tariff for ZUM Service provides that calls within Zones 1 and 2, a 0 to 12 mile range, shall be charged at the local calling rate, and calls within Zone 3, a 12-16 mile range, shall be billed at a separate rate in lieu of, not in addition to, toll charges for Zone 3 calls. (*See* Verizon Tariff Schedule Cal. P.U.C. No. H-1, 1st Revised Sheet 2.1.)

[43] In D.99-12-018, the Commission adopted the same price floor formula used for Pacific and set forth in D.99-11-050. That formula is:

Retail Service Price Floor = Volume Sensitive TSLRIC (of the retail service at issue) + (MBB price – volume sensitive TSLRIC of the MBB)

MBB refers to "monopoly building blocks," which are loops, ports (*i.e.*, switching), and white page listings. (*See* D.99-12-018, *mimeo.*, p. 9.)

2d 117, 234.) If any other prices are used, price floors will be either too high or too low and distort pricing signals. Thus, Verizon asks that, in accordance with the imputation requirements set forth in D.94-09-065, any interim UNE rates adopted by the Commission should replace the monopoly building block prices in the price floor calculation. In addition, Verizon suggests it be allowed to reduce the volume sensitive TSLRIC figure in the price floor formula, which is derived from Verizon's 1997 cost study filing, by the same percentage that the current UNE prices are reduced. (Verizon Response, 9/20/02, p. 26.)

Joint Commenters' Response

Joint Commenters oppose Verizon's request to update the price floor methodology to reflect any interim UNE prices that are adopted in this phase. They contend it is better to wait and set price floors when final UNE prices are adopted rather than run the risk that price floors based on interim prices may be too low. If that were to occur, Joint Commenters contend that fairness dictates a provision for reopening contracts between Verizon and its retail customers if they are based on price floors that are later adjusted upward. They also suggest that there are practical difficulties in setting price floors based on newly adopted interim UNE rates combined with TSLRIC estimates from 1996 or earlier. Rather than tangle with all of these problems, Joint Commenters suggest that the Commission should not set price floors until the permanent phase of this case.

Discussion

It is undisputed that the Commission set a methodology for calculating interim price floors in D.99-12-018. We find that the same reasons enumerated in that order as rationale for allowing interim price floors remain today. Specifically, GTEC has not yet been granted pricing flexibility to respond competitively to competitors' bundled local service offerings. We do not believe that it will prejudge this case if the Telecommunications Division lifts its suspension of Verizon's ZUM Advice Letter, although the Telecommunications Division should ensure that the advice letter is compliant with the methodology set forth in D.99-12-018.

The other issue raised by Verizon regarding price floors is whether Verizon should substitute interim UNE rates adopted in this order when calculating interim price floors for the remainder of its Category II services, and whether to adjust TSLRICs used in the price floor formula to mirror any UNE rate adjustments. We agree with Verizon that interim price floors should reflect the actual price paid by competitors for network elements, or monopoly building blocks, that make up the competing service. This comports with the Commission's analysis on imputation in the IRD Decision, which discussed the value of accurate pricing of monopoly building block components in promoting economic efficiency and fairness. (IRD Decision, 56 CPUC 2d 117, 234.) If we did not use the most current UNE rates, Verizon would have to calculate price floors for its services using its 1997 cost studies, which contain UNE rates much higher than those adopted today. This would result in a large disparity between the actual UNE rates paid by competitors and the rates used in the price floor formula. As a result, Verizon would not be able to price its retail services as low as competitors, thus distorting pricing signals and impeding competition.

The same analysis applies to the volume sensitive TSLRICs used in the price floor formula. Because we are adopting interim UNE rates through this order that are significantly lower than the UNE costs and TSLRICs filed by GTEC in 1997, we should allow Verizon to adjust the price floor formula as it has proposed to acknowledge the cost declines that are adopted in this order and to avoid distortions in pricing signals in the competitive market.

In summary, when Verizon calculates interim price floors using the methodology set forth in D.99-12-018, it should substitute the UNE rates adopted in this order for the rates contained in its previously filed OANAD cost studies and it should reduce the volume sensitive TSLRIC figure in the price floor formula, which is derived from Verizon's 1997 cost study filing, by the same percentage that its current UNE rates are reduced.

Joint Commenters suggest that some sort of true-up mechanism is necessary if these interim price floors are too low. In D.99-12-018, the Commission did not establish a true-up mechanism for interim price floors. Clearly, in the final phase of this case when the Commission sets final UNE rates for Verizon, new price floors will be adopted. At that time, any interim price floors will be replaced with new ones, but we will not institute any kind of true-up mechanism. We will, however, require Verizon to make clear in any contracts that it enters into with customers based on these interim Category II price floors that the prices in the contract are subject to change upon adoption of final price floors by the Commission in the later phase of this case.

In comments on the Draft Decision, Joint Commenters and Covad suggest that the Draft Decision errs in allowing Verizon to update its price floor methodology based on the adoption of interim UNE rates when Pacific's price floors were not adjusted. Verizon responds by noting that Pacific already has price floors in place based on Commission-approved cost studies, so adjustments to interim price floors are unnecessary. We agree with Verizon that the circumstances differ between Pacific and Verizon. Pacific's price floors are based on adopted TELRIC and TSLRIC cost studies, whereas the Commission has yet to establish price floors for Verizon using adopted cost studies. Therefore, it is appropriate to revise the methodology to calculate Verizon's interim price floors until such time as permanent cost studies are adopted for Verizon. There are no changes to the Draft Decision with regard to the price floor issue.

VII. Non-recurring Prices

Parties' Positions

In D.98-12-079, the Commission adopted forward-looking "nonrecurring costs" for Pacific and GTEC, which means the Commission determined the costs for initial fees that CLCs pay Pacific and Verizon to order and provision the use of network facilities. Later, in D.99-11-050, the Commission used these costs to establish nonrecurring prices for Pacific, but the Commission has not yet adopted nonrecurring prices for Verizon.

The parties agree that the nonrecurring costs adopted for GTEC in D.98-12-079 should now be converted into nonrecurring prices. To do this, Verizon proposes that the Commission add a 22% markup to its nonrecurring costs. Next, Verizon explains that nonrecurring costs were established using Pacific's nonrecurring products and services. Therefore, Verizon has "mapped" the adopted nonrecurring costs to the corresponding Verizon products and services using Verizon's existing rate structure. Verizon claims it would be unreasonable to require Verizon to change its numerous operations support systems (OSS) and billing systems to accommodate different rate structures, particularly when CLCs rarely order many of the nonrecurring rate elements for which costs were set in D.98-12-079. Verizon also opposes any changes to its operating and billing systems for interim rates. Verizon claims that changes to its rate structure would require significant amounts of time and money, and could take up to one year to implement. Verizon claims the Commission cannot force it to implement a different rate structure until after a full and fair permanent proceeding.

Finally, Verizon states that in its nonrecurring pricing proposal, it calculated service order costs by weighting semi-mechanized and fully mechanized charges[44] by Verizon's current flow-through percents based on its recent experience in processing UNE orders. (Collins Declaration, 7/30/02, para. 17.)

Joint Commenters oppose Verizon's proposals with regard to nonrecurring pricing, and claim Verizon's proposals suffer from two fatal flaws. First, Joint Commenters oppose the 22% markup Verizon requests as excessive. Second, Joint Commenters claim that Verizon's proposed nonrecurring prices exceed TELRIC-based prices because Verizon has improperly reconfigured the Commission-adopted nonrecurring costs into a rate structure that reflects Verizon's embedded levels of manual order processing. This may force competitors to compensate Verizon for costs that Verizon may never incur. While Joint Commenters agree that Verizon may not have precisely the same name for its UNE products as Pacific, the basic UNEs are the same between companies and Verizon should be required to set nonrecurring prices that reflect the costs adopted by the Commission. Joint Commenters contend that Verizon's proposals undermine the cost basis of the nonrecurring costs adopted in D.98-12-079.

Specifically, Joint Commenters allege that Verizon has combined dissimilar nonrecurring costs for different UNE options and types of orders into

[44] "Semi-mechanized" service order charges recover the costs for orders that flow-through the process mechanically, orders that "fall-out" due to a problem, and orders that were never designed to flow-through. The semi-mechanized charge is weighted by the proportion of time that Verizon experiences fall-out during the ordering process. The mechanized charge is weighted by the proportion of time that UNE service orders flow through without any manual intervention. (Collins Declaration, 7/30/02, para. 17.)

nonrecurring prices that are as much as 300% higher than the nonrecurring prices approved for Pacific. Verizon's proposal would force competitors to pay for functions that they do not require and orders that they do not submit. For example, Verizon's proposal eliminates the distinction that the Commission adopted between the cost of mechanized and semi-mechanized orders by forcing competitors to pay the higher semi-mechanized order costs. Joint Commenters maintain that Verizon's proposal contradicts Commission precedent that required the nonrecurring charge to be governed by the type of system the competitor uses to place its order, rather than by the type of system of the ILEC.
(Joint Commenters, 8/20/02, p. 15, citing D.99-11-050, *mimeo*, pps. 158-159.)

Joint Commenters maintain that Verizon local exchange companies in other states have rate structures that closely parallel the rate structure of Pacific and there is no valid reason for Verizon's proposal in California to depart so substantially from this Commission's adopted rate structure for Pacific, and the structure Verizon uses in other jurisdictions. (*Id.*, p. 15.) Joint Commenters note that the effect of Verizon's "mapping" of nonrecurring costs into the nonrecurring prices it proposes is that competitors would be forced to pay Verizon *four times* as much as they would pay Pacific for the same nonrecurring service.[45]
Joint Commenters contend that this is contrary to the Commission's use of the same model in D.98-12-079 to adopt nearly identical nonrecurring costs for Pacific and GTEC. (Turner Declaration, 8/20/02, para. 10.)

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[45] Joint Commenters claim that a mechanized order for a UNE loop and cross-connection would cost $18.88 if ordered from Pacific, and $75.26 if ordered from Verizon. Similarly, a mechanized UNE-P order from Pacific would cost $26.86, and the same order from Verizon would cost $112.94. (*Id.*, p. 16.)

Joint Commenters claim that Verizon has been on notice since December 1998 that it would need to adapt its billing systems to accommodate separate costs for mechanized, semi-mechanized, and manual service orders, as well as separate costs for initial versus additional orders. Joint Commenters ask that the Commission require Verizon to implement nonrecurring prices that mirror the structure of the costs that have been in place since 1998. If Verizon can prove this is not feasible at this time, it should be required to credit competitors for the difference between Verizon's current proposed rates and final rates that reflect the proper, Commission-adopted cost structure.

In response, Verizon disagrees that D.98-12-079 "implied" a rate structure that "Verizon has refused to implement." Verizon states the Commission clearly left the issue of how nonrecurring costs should be recovered to the subsequent pricing phase.

Discussion

First, we adopt a 22% markup to nonrecurring costs as already discussed in Section V. We want to make clear that in applying this markup to Verizon's nonrecurring costs, and making the other modifications to Verizon's proposal described below, this establishes nonrecurring prices for Verizon. In contrast to the interim recurring UNE rates for certain loops, switch elements, and ports set in the remainder of this order, these *nonrecurring* prices are *not* interim and *not* subject to true-up. If, in the permanent phase of this case to follow, we adopt a different shared and common cost markup, we will adjust Verizon's nonrecurring prices at that time on a going-forward basis. It is not the Commission's intent to revisit Verizon's nonrecurring costs and prices in the permanent phase of this case.

Second, we must resolve the discrete disputes over various aspects of Verizon's "mapping" of its nonrecurring costs into prices. We will address each disputed item separately below. With regard to these disputed items, Verizon generally argues that it should not be required to make costly and time-consuming changes to its order processing system for "interim rates." We have already explained that the nonrecurring prices we adopt today are not interim. When the Commission adopted nonrecurring costs for GTEC in D.98-12-079, it gave no indication that it intended to revisit these costs when reviewing new cost studies for Verizon's recurring UNE costs.

1. Blending of Mechanized and Semi-Mechanized Costs

In D.98-12-079, the Commission identified three categories of costs for ordering UNEs – namely manual, semi-mechanized, and mechanized. (D.98-12-079, *mimeo.*, p. 27.) In setting costs for each of these categories, the Commission assumed a certain percentage of orders would "fall-out" due to processing errors and need to be manually examined. For example, the Commission assumed that 4% of mechanized orders would "fall-out." Thus, the cost of processing 4% of mechanized orders manually was built into the adopted mechanized order costs. The Commission also found that mechanized service order charges should apply when the CLC submits its order through a mechanized interface. (D.99-11-050 at 158-159.)

Verizon admits that it developed its nonrecurring service order prices by weighting the semi-mechanized and fully mechanized charges using current fall-out percentages shown by Verizon's recent, or "embedded," order processing experience. (Collins Declaration, 7/30/02, para. 17.) Joint Commenters oppose this method because it ignores the fall-out percentages adopted by the Commission in D.98-12-079. In that order, the Commission rejected Verizon's embedded fall-out rates and adopted forward-looking fall-out rates instead. According to Joint Commenters, Verizon's method of weighting semi-mechanized and fully mechanized charges using fall-out rates from its current experience violates the intent of the forward-looking fall-out rates adopted in D.98-12-079. They also maintain that Verizon's approach double-counts the costs of those orders that fall-out because those costs are already reflected in the rates.

Verizon defends its approach as reasonable because it says it cannot determine at the time a CLC order is received whether the order will require manual processing. According to Verizon, it uses a single order-processing interface which cannot distinguish between mechanized and semi-mechanized service orders when they are received.

We agree with Joint Commenters that Verizon's combination of mechanized and semi-mechanized costs into one initial order charge defeats the Commission's intent in identifying separate costs and forward-looking fall-out rates for the three order types found in D.98-12-079. Verizon wants to charge all CLCs the same rate whether the CLCs order is mechanized or semi-mechanized which means that CLCs placing a mechanized order will pay the higher semi-mechanized cost. This is unreasonable, as is Verizon's attempt to charge embedded rather than forward-looking fall-out rates adopted in D.98-12-079. Verizon needs to configure its order processing system to identify the three categories—mechanized, semi-mechanized, and manual— so that it can charge CLCs based on the order type they use. We are not persuaded by Verizon's objections as to the cost and time involved to change its order processing system because Verizon has been on notice since December 1998 when the three order types were adopted, or, at the latest since November 1999 when the Commission adopted prices for Pacific mirroring these three categories, that it would likely need to charge CLCs based on order type.

2. Initial and Additional Order Charges

Verizon's nonrecurring charge proposal combines the costs for initial orders and additional orders[46] based on a weighted average of the cost to process the average order size. Verizon does not establish separate charges for initial orders and additional orders.

Joint Commenters recommend separate charges for initial and additional orders. They argue that combining these charges as Verizon proposes harms CLCs that target residential customers with only one line or switch port because they will pay for additional orders with every initial order even though they are not likely to place additional orders. Verizon counters that separate charges are not required and any harm is minimal because Verizon assumes only 23% to 28% of loop orders will include an additional order.

We find that Verizon should separate its charges for initial orders and additional orders. Verizon's proposal to combine these charges means that CLCs that rarely or never send in additional orders are forced to pay the costs of additional orders as if they are actually made 23% to 28% of the time. For CLCs that often send in additional orders, *i.e.*, more frequently than 23% to 28% of the time, they benefit and do not have to pay the full costs of their additional orders. This does not comport with cost causation principles. Further, we prefer to keep nonrecurring charges for Pacific and Verizon somewhat similar to avoid large

[46] An "additional order" is an order for an additional line that is transmitted to Verizon through the same local service request used to order the first line. (Verizon Reply Comments, 9/20/02, p. 19.)

disparities in the conditions facing competitors in the markets of these two ILECs. We established separate initial and additional order charges for Pacific in D.99-11-050, so we will require Verizon to do the same. Therefore, we will require Verizon to establish separate initial and additional order charges.

3. Connect and Disconnect Charges

In D.98-12-079, the Commission adopted four main categories of costs, which are Connect, Disconnect, Change, and Record. Verizon claims it does not have these four categories in its billing system. Therefore, it proposes to combine Connect, Disconnect, and Record costs into a single nonrecurring charge. Joint Commenters contend this is inappropriate. First, the Commission explicitly set distinct connect and disconnect charges for Pacific, and stated there is no justification for assuming that every connect order should be combined with a disconnect order. Second, if CLCs are required to pay disconnect charges up front, this is an interest free loan to Verizon and leads to CLCs paying costs that exceed the costs borne by Verizon.

Verizon responds that it is reasonable and customary to recover disconnection costs at the time of the initial service order because it does this in both Massachusetts and Colorado. Further, Verizon contends that combining these charges is the only way to ensure that disconnect costs will be recovered, particularly with so many CLCs going out of business.

As we stated above, we prefer to keep nonrecurring charges for Pacific and Verizon somewhat similar. We established separate connect and disconnect charges for Pacific in D.99-11-050, so we will require Verizon to do the same. We agree with Joint Commenters that allowing Verizon to collect disconnect charges in advance amounts to an interest free loan and places an extra burden on CLCs that Verizon does not bear itself.

4. Record Costs

Verizon proposes to include the costs for a Record Order[47] in its Initial Order Charge. Joint Commenters object to Verizon's proposal to sum Connect, Disconnect and Record nonrecurring costs together because that assumes every order for a UNE will require a record change. Rather, Joint Commenters allege that Record Orders do not occur in a one-to-one relationship to every Connect order that is placed. They contend Verizon's proposal is inconsistent with the cost structure ordered by this Commission and they note that Verizon offers separate record charges in other states such as New York.

Verizon claims that it is reasonable to recover the costs of making changes to existing customer records through the initial order charge because this is common practice in other states. Verizon contends that a separate charge will dissuade CLCs from keeping their records accurate. Verizon acknowledges the criticism that it assumes each order will involve a Record Order and proposes to modify its proposal to reflect that only 10% of initial orders will require a record change at some future point.

Consistent with our findings regarding separate charges for initial and additional orders, we find that Verizon should charge separately for any Record Orders because this better comports with cost causation principles. Only those CLCs that actually make record changes should pay for them. We do not agree with the proposal that every CLC will pay a charge as if it makes a record change 10% of the time because this penalizes those CLCs that make fewer

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[47] A "Record Order" occurs when a CLC requests to make a change to its existing customers' records. (Verizon Reply Comments, 9/20/02, p. 18.)

changes, and benefits those CLCs that make more. We are not worried that a separate charge will dissuade CLCs from keeping their records accurate because we believe it is in the CLCs own best interest as a business to have accurate records. Verizon should not concern itself with designing a rate structure to ensure CLCs have accurate records.

5. Change Order and Subsequent Order Charges

Verizon proposes to “map” Pacific’s Change Order to Verizon’s Subsequent Order. Joint Commenters do not agree that these two order types are analogous. Verizon contends that its Subsequent Order covers the same activities as those covered by Pacific’s Change Order, namely circuit design changes, line feature changes, switch feature changes, and central office connection changes.

Joint Commenters objections do not have merit because they are unable to identify a specific problem with Verizon’s proposal. Therefore, we find that Verizon’s proposal in this regard is appropriate.

6. Summary of Nonrecurring Charges

Verizon shall make the following changes to the nonrecurring charge proposal it filed on July 30:

- Verizon should configure its order processing system in order to charge separate rates depending on whether the CLC employs a mechanized, semi-mechanized, or manual system to place its order.
- Verizon should separate its charges for initial and additional orders so that CLCs only pay for additional orders when they make them.
- Verizon should not collect disconnect charges in advance, as it proposes, because this is a requirement placed on CLCs that Verizon does not bear itself.

- Verizon should charge separately for Record Orders so that only those CLCs that actually make record changes pay the charge.
- Verizon should add a markup of 22% to its nonrecurring charges, once the changes above are made.

Before we can adopt final nonrecurring charges, we need to review Verizon's compliance with the changes ordered above. Therefore, within 20 days from the effective date of this order, Verizon shall file and serve a compliance filing containing a revised list of its nonrecurring charges and parties will have 14 days to comment on this filing. Verizon's compliance filing with revised nonrecurring charges shall go into effect 75 days after the effective date of this decision, unless the assigned ALJ issues a ruling suspending the effective date of these nonrecurring charges because of issues raised by Verizon's compliance filing. If Verizon's proposed nonrecurring charges are suspended, the existing nonrecurring charges shall remain in effect, subject to refund from the 75th day after the effective date of today's order, until any issues with nonrecurring charges are resolved through further Commission action.

In comments on the Draft Decision, Verizon requests that the Commission reject the Draft Decision's proposals regarding nonrecurring charges and not require Verizon to modify the rate structure for its nonrecurring charges at this time because it will take Verizon nine to twelve months to complete the recommended changes. Verizon contends that it cannot create separate rate elements for mechanized and semi-mechanized service orders, as required in the Draft Decision, because it cannot distinguish between these service order types. Essentially, Verizon states that nonrecurring charges should be reviewed again in the permanent phase.

Joint Commenters oppose these requests, noting that unless the Draft Decision is adopted, Verizon will succeed in delaying adoption of nonrecurring prices. Telscape Communications Inc (Telscape) comments that the Draft Decision should be revised to make nonrecurring charges effective as of the date of the decision. Unless this change is made, Telscape believes that Verizon will unreasonably delay compliance with the decision.

We are not persuaded by Verizon to make any changes to this section of the order. Verizon merely reargues its previous positions and does not establish any factual or legal errors in the order. As already noted, Verizon has had ample time to configure its order processing to comport with the three categories of costs adopted in D.98-12-079. Nevertheless, Verizon has proceeded with a different order processing system that does not identify these separate categories. It would be unfortunate to delay establishing charges for each type of order simply because Verizon has not yet implemented a system to match the costs this Commission adopted in 1998. Instead, we will direct Verizon to reconfigure its order processing to accommodate the three categories of order charges—mechanized, semi-mechanized, and manual.

We agree with Telscape that it would be ideal to have Verizon's nonrecurring charges effective with this decision. This approach is problematic, however, because it requires the Commission to adopt rates before knowing the effects of the changes ordered herein. Rather than the approach proposed by Telscape, we have modified the order to provide that Verizon's compliance filing with revised nonrecurring charges shall go into effect 75 days after the effective date of this decision, unless the assigned ALJ issues suspends this effective date.

VIII. Comments on Draft Decision

The Commission mailed the draft decision of the ALJ in this matter to the parties in accordance with Section 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed by Verizon, Joint Commenters, and Telscape. Reply comments were filed by Verizon, Joint Commenters, Covad, ORA, and TURN.

In general, Verizon urges adoption of its own interim pricing proposals rather than interim UNE rates based on Verizon New Jersey rates. Joint Commenters and Covad support the Draft Decision, but urge corrections to make interim UNE rates more closely mirror those of Verizon New Jersey. Covad, a digital subscriber line (DSL) provider, stresses that Verizon's loop rates must be priced according to TELRIC or Verizon will likely dominate the DSL market. ORA and TURN support the Draft Decision as written. Telscape, a CLC, urges changes regarding the effective date of nonrecurring charges. These specific comments have been addressed throughout the text of the order where appropriate.

IX. Assignment of Proceeding

Henry M. Duque was the Assigned Commissioner in this proceeding until the case was reassigned to Commissioner Michael R. Peevey in January 2003. Dorothy Duda is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. In D.96-08-021, the Commission found that GTEC's cost studies did not conform with the TSLRIC principles previously adopted by the Commission and it ordered GTEC to modify its cost studies using certain aspects of Pacific's studies as proxies.

2. The UNE rates currently in effect for Verizon were adopted in D.97-01-022 based on the modifications to GTEC's TSLRIC cost studies ordered in D.96-08-021.

3. Since the time that GTEC performed its TSLRIC analysis leading to its current UNE rates, the Commission and the FCC have moved to a TELRIC approach to UNE ratesetting.

4. In D.02-05-042, the Commission found that loop and switching equipment costs had declined in recent years since the time the Commission originally set UNE costs for Pacific in 1998.

5. In a May 31, 2002 ruling, the Assigned Commissioner and ALJ concluded the Commission should set interim UNE rates for Verizon.

6. The interim phase of this proceeding involved four rounds of submittals from the parties, including interim pricing proposals and comments on those proposals.

7. Verizon proposes discounts to its current UNE switching rates based on a trend analysis of proposals filed in Florida in 1996 and 2001.

8. The 1996 cost study used in Verizon's trend analysis was prepared in the same year and used the same methodology as GTEC's 1996 California cost study rejected in D.96-08-021.

9. The 2001 cost study used in Verizon's trend analysis is an updated version of the ICM filed in 1997 by GTEC in California.

10. The UNE rates adopted by the Florida PSC in October 2002 are significantly lower than the proposals made by Verizon in that state.

11. Verizon has not provided any data showing similarities between Florida and California with regard to switching networks.

12. Verizon opposes interim switching rates based on the discount adopted for Pacific's switching rates in D.02-05-042, but it proposes interim loop rates based on the loop discount adopted for Pacific in that order.

13. The FCC has used the relative costs reported by the Synthesis Model to compare the relative costs of unbundled loops and switching between ILECs in different states that operate under the same RBOC.

14. The Synthesis Model adjusts relative switching costs based on major cost drivers, including line density per switch and the number of host and remote switches.

15. The Synthesis Model adjusts relative loop costs based on population densities.

16. UNE rates for Verizon New Jersey, which were adopted in March 2002 and updated in July 2002, are among the most recent TELRIC-based UNE rates from another Verizon state.

17. Verizon New Jersey has incorporated the costs of several switch features into the port charge and charges for a few switch features on a separate basis.

18. In D.97-01-022, the Commission adopted a 22% markup for Verizon's UNEs.

19. Joint Commenters propose an 8% markup for UNE rates and nonrecurring charges based on an analysis of aggregate expense and revenue data for all RBOCs nationwide.

20. In D.99-12-018, the Commission granted interim pricing flexibility to GTEC for its Category II services.

21. Although Verizon has made two requests for interim price floors, its requests have not been granted as of the date of this order.

22. In D.94-09-065, the Commission required ILECs to impute into the retail price floor the contribution based on the actual price paid by competitors for network elements that make up the competing service.

23. In D.99-12-018, the Commission authorized interim price floors for GTEC whereby GTEC could use the UNE rates and TSLRICs contained in its 1997 cost studies to price down to the volume-sensitive portion of the TSLRIC for the service at issue, plus the contribution for MBBs (namely the loop, ports, and white page listings). The contribution for MBBs is the difference between the TELRIC-based price for each UNE found to be a MBB and the volume-sensitive portion of the TSLRIC for each of the three UNEs.

24. The Commission adopted nonrecurring costs for the ordering and provisioning of Verizon's network facilities in D.98-12-079.

25. Verizon proposes to "map" its nonrecurring costs to its corresponding products and services using Verizon's existing rate structure.

26. Verizon calculated service order charges by weighting semi-mechanized and mechanized costs based on its recent experience with the percent of orders that currently flow-through the order process without a problem.

27. In D.99-11-050, the Commission required the ILEC's nonrecurring charge to be governed by the type of system the CLC uses to place its order, rather than by the type of system used by the ILEC.

Conclusions of Law

1. The Commission should set interim UNE rates for Verizon because its current rates are the product of a TSLRIC cost study filed in 1995 and 1996 and rejected by the Commission as not reflecting forward-looking cost principles.

2. The Commission should set interim UNE rates for Verizon that reflect the TELRIC methodology and the most recent forward-looking cost information available for Verizon.

3. It is reasonable to assume that equipment costs declines that were found to impact Pacific's forward-looking UNE costs in D.02-05-042 also impact Verizon's forward-looking UNE costs in the same manner.

4. In this interim ratesetting phase, parties have been given sufficient opportunity to explain their interim pricing proposals.

5. Verizon's interim rate proposal is unreasonable because it discounts from current rates that do not reasonably reflect forward-looking economic principles.

6. There is no assurance that Verizon's trend analysis reveals changes in forward-looking costs rather than methodological changes in the underlying cost studies.

7. Verizon's trend analysis of 1996 and 2001 Florida cost proposals should not be relied on because it uses two different cost models which contain methodology differences and because the rates recently adopted in Florida are lower than Verizon's proposal.

8. The Commission should take official notice of UNE rates adopted in Florida on October 14, 2002.

9. Verizon has not sufficiently explained why it would be reasonable to apply Pacific's interim loop discount but not its interim switching discount.

10. It is not reasonable to assume that Verizon's loop costs have increased simply because Verizon has proposed loop rates higher than its current rates.

11. The forward-looking cost criteria in the Synthesis Model are consistent with and largely identical to the forward-looking cost criteria that the FCC has adopted for UNEs.

12. It is reasonable to use the Synthesis Model to reflect loop and switching cost differences between California and New Jersey for the purposes of interim pricing because this is reasonably consistent with how the FCC has used the Synthesis Model when comparing UNE rates across states.

13. It is reasonable to rely on UNE rates adopted for Verizon New Jersey, adjusted using the Synthesis Model, because these are among the most recent TELRIC-based rates for Verizon and they reflect conditions after GTEC's merger with Bell Atlantic to form Verizon.

14. It is reasonable to use the Synthesis Model to set deaveraged rates for Verizon, as proposed by Joint Commenters.

15. It is not reasonable to rely on a trend analysis of proposed rates in Florida when the adopted rates in Florida differ from the proposed rates.

16. When using the Synthesis Model to compare relative UNE costs, the Commission should use an approach consistent with the methods described by the FCC in its recent Section 271 orders.

17. The Synthesis Model indicates that loops costs in the former GTEC areas and in the former Contel areas are 2.2% lower and 111.9% higher, respectively, than Verizon New Jersey average loop costs rates.

18. The Synthesis Model indicates that for unbundled switching, end office usage costs are 10.7% higher than Verizon New Jersey, port costs are 3.2% lower than New Jersey, and tandem-switching costs are 38.9% higher than New Jersey.

19. In setting interim UNE rates, we should adjust Verizon New Jersey rates upwards wherever the Synthesis Model indicates that California costs are higher than New Jersey, but not vice versa.

20. The Commission should set switch feature prices at zero, except for those features priced individually by Verizon New Jersey, because Verizon New Jersey includes switch feature costs in its port charge.

21. Verizon's DS-1 port rate should remain at its current level, subject to adjustment from the date of this order, because there is no basis on which to increase it.

22. Verizon is not harmed by the interim rates adopted today if rates are subject to adjustment once final rates are determined.

23. Once final rates are adopted, the interim monthly recurring UNE rates adopted in this order should be adjusted, either up or down, from the effective date of this order.

24. Joint Commenters' markup proposal is unreasonable because it fails to consider the individual variations in overhead percentages between RBOCs.

25. It is not reasonable to use the 10% markup included in Verizon New Jersey UNE rates because the Synthesis Model does not account for variations in overhead costs between states.

26. The Commission should retain the 22% markup adopted for Verizon in D.97-01-022 and use it to set interim UNE rates and nonrecurring prices.

27. To be consistent with D.94-09-065, Verizon's interim price floors should reflect the actual price paid by competitors for network elements, or monopoly building blocks, that make up the competing service.

28. If Verizon were to calculate price floors using the UNE rates and TSLRICs from its 1997 cost studies, as set forth in D.99-12-018, this would result in a large disparity between the actual UNE rates paid by competitors and the rates used in the price floor formula. This would prevent Verizon from pricing retail services to match its competitors.

29. When Verizon calculates interim price floors using the methodology set forth in D.99-12-018, it should substitute the UNE rates adopted in this order for the rates contained in its previously filed OANAD cost studies and it should reduce the volume sensitive TSLRIC figure in the price floor formula, which is derived from Verizon's 1997 cost study filing, by the same percentage that its current UNE rates are reduced.

30. When entering contracts based on price floors calculated as set forth in this order, Verizon should notify customers that the prices in the contract are subject to change upon adoption of final price floors by the Commission.

31. Verizon's proposal to combine mechanized and semi-mechanized costs into one initial order charge is not reasonable because it ignores the fall-out rates adopted in D.98-12-079.

32. Verizon should configure its order processing system in order to charge separate rates depending on whether the CLC employs a mechanized, semi-mechanized, or manual system to place its order.

33. Verizon should separate its charges for initial and additional orders so that CLCs only pay for additional orders when they make them.

34. Verizon should not collect disconnect charges in advance, as it proposes, because this is a requirement placed on CLCs that Verizon does not bear itself.

35. Verizon should charge separately for Record Orders so that only those CLCs that actually make record changes pay the charge.

36. Verizon's proposal to map Pacific's Change Order charge to the Verizon Subsequent Order charge is reasonable.

ORDER

IT IS ORDERED that:

1. The monthly recurring prices for unbundled network elements (UNEs) offered by Verizon California, Inc. (Verizon) that are set forth in Appendix A to this decision satisfy the requirements of Sections 251(c)(2), 251(c)(3), and 252(d)(1) of the Telecommunications Act of 1996 and are hereby adopted on an interim basis and made subject to adjustment, either up or down, from today's date until final prices are adopted.

2. Verizon shall prepare amendments to all interconnection agreements between itself and other carriers substituting the interim monthly recurring prices for UNEs set forth in Appendix A of this order for the UNE prices set forth in such interconnection agreements. Such amendments shall be filed with the Commission's Telecommunications Division, pursuant to the advice letter process set forth in Rules 6.2 and 6.2 of Resolution ALJ-181, within 30 days after the effective date of this order. The amendments do not require a signature of the carriers involved as long as the amendments are limited to substituting the UNE rates adopted in today's order. Unless protested, such amendments will become effective 30 days after filing.

3. The interim UNE prices set forth in Appendix A of this order shall be effective on the date this order is effective. Verizon shall make all billing adjustments necessary to ensure that this effective date is accurately reflected in bills applicable to these UNEs.

4. Verizon shall have 60 days from the effective date of this order to complete the billing program changes necessary to reflect in bills the interim monthly recurring prices for UNEs adopted in this order. Upon completion of said billing

program changes, Verizon shall notify the Director of the Telecommunications Division in writing that all of the necessary billing program changes have been completed.

5. Within 10 days of the effective date of this order, Verizon shall file an advice letter to establish a balancing account to track the revenues received from the interim monthly UNE rates adopted herein, beginning on the same date the interim rates become effective. The balancing account should accrue interest at the three-month commercial paper rate. Unless protested, the advice letter shall become effective five days after filing.

6. Verizon shall make the following changes to its nonrecurring charge proposal:

- Verizon should configure its order processing system in order to charge separate rates depending on whether the CLC employs a mechanized, semi-mechanized, or manual system to place its order.
- Verizon should separate its charges for initial and additional orders so that CLCs only pay for additional orders when they make them.
- Verizon should not collect disconnect charges in advance, as it proposes, because this is a requirement placed on CLCs that Verizon does not bear itself.
- Verizon should charge separately for Record Orders so that only those CLCs that actually make record changes pay the charge.
- Verizon should add a markup of 22% to its nonrecurring charges, once the changes above are made.

7. Verizon's nonrecurring charge proposal is adopted, with the modifications set forth in this order. Within 20 days from the effective date of this order,

Verizon shall file and serve a revised list of its nonrecurring charges complying with the changes set forth in this order. Interested parties shall have 14 days to comment on that filing, unless the assigned Administrative Law Judge (ALJ) adopts a different schedule for responses. Verizon's nonrecurring charges shall go into effect 75 days after the effective date of this decision, unless the assigned ALJ issues a ruling suspending this effective date pending further Commission action. If Verizon's revised nonrecurring charges are suspended, the existing nonrecurring charges shall remain in effect, subject to refund from the 75th day after the effective date of this order, until all outstanding issues with nonrecurring charges are resolved.

8. When submitting an advice letter to the Commission regarding interim Category II price floors, Verizon shall calculate interim price floors according to the formula described in this order.

9. When entering contracts based on price floors calculated as set forth in this order, Verizon shall notify customers that the prices in the contract are subject to change upon adoption of final price floors by the Commission.

10. Verizon's petition to take official notice of UNE rates adopted for Verizon in Florida on October 14, 2002 is granted.

11. Joint Commenters' November 22, 2002 motion to strike Verizon's November 12, 2002 reply comments is granted.

12. The May 31, 2002 ruling of the Assigned Commission and Administrative Law Judge is affirmed.

13. This proceeding shall remain open so that the Commission can determine final monthly recurring charges and price floors for Verizon's UNEs.

This order is effective today.

Dated March 13, 2003, at San Francisco, California.

I dissent.

/s/ MICHAEL R. PEEVEY
President

CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

Appendix A

Verizon Interim UNE rates

UNE	Verizon's Current Rate	Percentage Adjustment	Adopted Interim Rate
Loops			
2-Wire Loop (State-wide Average)	$16.81		
Zone 1 (former GTEC area)		(37.2%)	$10.56
Zone 2 (former Contel CA area)		33.1%	$22.37
4-Wire Loop (State-wide Average)	$31.85		
Zone 1 (former GTEC area)		(31.8%)	$21.73
Zone 2 (former Contel CA area)		44.5%	$46.03
Switching			
Ports			
Basic Port	$4.58	(53.7%)	$2.12
Centrex Port	$4.58	(53.7%)	$2.12
DS-1 Port	$54.67	0.0%	$54.67
Switch Usage			
Tandem Switching (per mou)	$0.001500	(30.8%)	$0.001038
End Office Switching (per mou)	$0.003629	(59.8%)	$0.001457
Switch Features			
Three Way Calling	$0.65	(100.0%)	$0.0000
Call Forwarding	$0.12	(100.0%)	$0.0000
Customer Changeable Speed Calling 1-Digit	$0.10	(100.0%)	$0.0000
Customer Changeable Speed Calling 2-Digit	$0.16	(100.0%)	$0.0000
Call Waiting	$0.02	(100.0%)	$0.0000
Cancel Call Waiting	$0.01	(100.0%)	$0.0000
Automatic Callback	$0.04	(100.0%)	$0.0000
Automatic Busy Redial	$0.13	(100.0%)	$0.0000
Calling Number Delivery	$0.04	(100.0%)	$0.0000
Calling Number Delivery Blocking	$0.07	(100.0%)	$0.0000
Smart Ring	$0.01	(100.0%)	$0.0000
Customer Originated Trace	$0.04	(100.0%)	$0.0000
Selective Call Forwarding	$0.16	(100.0%)	$0.0000
Selective Call Acceptance	$0.12	(100.0%)	$0.0000
Remote Call Forward	$2.73	(100.0%)	$0.0000
Distinctive Alerting / Call Waiting Indicator (VIP)	$0.12	(100.0%)	$0.0000
Call Block	$0.17	(100.0%)	$0.0000
Last Number Redial	$0.04	(100.0%)	$0.0000
Selective Calling Waiting	$0.12	(100.0%)	$0.0000
Billed Features *			
Multi-Line Hunting			$0.000001
Intercom & Features			$0.011343

Continuation:

UNE	Verizon's Current Rate	Percentage Adjustment	Adopted Interim Rate
Hunting			$0.000263
UCD			$0.000154
Queuing			$0.000645
Attendant			$0.004869
Attendant Console			$0.024557
Centralized Attendant Services			$0.022771
Attendant Access Code Dialing			$0.004043
ARS Per MOU			$0.004086
ETS Per MOU			$0.006720
UNE-P			
Zone 1 (Former GTEC Areas)			
@ 1400 Local Voice & 300 Toll Minutes	$29.02	(44.6%)	$16.08
@ 2000 Local Voice Minutes	$28.96	(45.1%)	$15.90
Zone 2 (Former Contel Areas)			
@ 1400 Local Voice & 300 Toll Minutes	$29.02	(3.9%)	$27.89
@ 2000 Local Voice Minutes	$28.96	(4.3%)	$27.71

* Verizon offers the features below at retail. Interim rates are adopted for these features in the event carriers request these features at wholesale.

Appendix B

Synthesis Model Adjustments to Verizon New Jersey UNE Rates

UNE	New Jersey Current Rate	Synthesis Model Adjustment [1]	Adjusted New Jersey rate (w/ 10% mark-up)	Adopted Interim Rate (w/ 22% mark-up)
Loops				
2-Wire Loop (State-wide Average)	$9.52			
former GTEC area		(2.2%)	$9.52	$10.56
former Contel CA area		111.9%	$20.17	$22.37
4-Wire Loop (State-wide Average)	$19.59			
former GTEC area		(2.2%)	$19.59	$21.73
former Contel CA area		111.9%	$41.50	$46.03
Switching				
Ports				
Basic Port	$1.91	(3.2%)	$1.91	$2.12
Centrex Port	$1.91	(3.2%)	$1.91	$2.12
DS-1 Port	$55.65	n / a	$55.65	$54.67 [2]
Switch Usage				
Tandem Switching (per mou)	$0.000674	38.9%	$0.000936	$0.001038
End Office Switching (per mou)	$0.001187	10.7%	$ 0.001314	$0.001457
Switch Features				
Three Way Calling	$0.0000		no adjustment	$0.0000
Call Forwarding	$0.0000		no adjustment	$0.0000
Customer Changeable Speed Calling 1-Digit	$0.0000		no adjustment	$0.0000
Customer Changeable Speed Calling 2-Digit	$0.0000		no adjustment	$0.0000
Call Waiting	$0.0000		no adjustment	$0.0000
Cancel Call Waiting	$0.0000		no adjustment	$0.0000
Automatic Callback	$0.0000		no adjustment	$0.0000
Automatic Busy Redial	$0.0000		no adjustment	$0.0000
Calling Number Delivery	$0.0000		no adjustment	$0.0000
Calling Number Delivery Blocking	$0.0000		no adjustment	$0.0000
Smart Ring	$0.0000		no adjustment	$0.0000
Customer Originated Trace	$0.0000		no adjustment	$0.0000
Selective Call Forwarding	$0.0000		no adjustment	$0.0000
Selective Call Acceptance	$0.0000		no adjustment	$0.0000
Remote Call Forward	$0.0000		no adjustment	$0.0000
Distinctive Alerting / Call Waiting Indicator (VIP)	$0.0000		no adjustment	$0.0000
Call Block	$0.0000		no adjustment	$0.0000

Last Number Redial	$0.0000		no adjustment	$0.0000

Continuation:

UNE	New Jersey Current Rate	Synthesis Model Adjustment [1]	Adjusted New Jersey rate (w/ 10% mark-up)	Adopted Interim Rate (w/ 22% mark-up)
Selective Calling Waiting	$0.0000		no adjustment	$0.0000
Billed Features				
Multi-Line Hunting	$0.000001		$0.000001	$ 0.000001
Intercom & Features	$0.010227		$0.010227	$0.011343
Hunting	$0.000237		$0.000237	$0.000263
UCD	$0.000139		$0.000139	$0.000154
Queuing	$0.000582		$0.000582	$0.000645
Attendant	$0.004390		$0.004390	$0.004869
Attendant Console	$0.022142		$0.022142	$0.024557
Centralized Attendant Services	$0.020531		$0.020531	$ 0.022771
Attendant Access Code Dialing	$0.003645		$0.003645	$0.004043
ARS Per MOU	$0.003684		$0.003684	$0.004086
ETS Per MOU	$0.006059		$0.006059	$0.006720

1 Where percentages are negative, New Jersey rates were retained at current levels.
2 Retained at current level, subject to true-up.

Appendix C

Synthesis Model Comparison Results

	Synthesis Model Results				Comparison Factor				CA Interim Rates					
	1	2	3	4	5	6	7	8	9	10	11	12	13	14
	Verizon CA	GTEC CA	Contel CA	Verizon New Jersey	GTEC CA & Verizon NJ (1)	Contel CA & Verizon NJ (2)	Verizon CA & Verizon NJ (3)	Commission Approved New Jersey UNE Rates	Former GTEC area w/ 10% mark-up (4)	Former Contel area w/ 10% mark-up (5)	Verizon CA w/ 10% mark-up (6)	Former GTEC area w/ 22% mark-up (7)	Former Contel area w/ 22% mark-up (8)	Verizon CA w/ 22% mark-up (9)
Loop		$11.73	$25.40	$11.99	-2.2.%	111.9%		$9.52	$9.52	$20.17		$10.56	$22.37	
EO Usage	$0.001902			$0.001718			10.7%	$0.001187			$0.001314			$0.001457
Port	$0.96			$0.99			-3.2%	$1.91			$1.91			$2.12
Tandem		$ 0.0005536		$0.000399			38.9%	$0.000674			$0.000936			$0.001038

Notes:

(1) Column 5 = (GTEC CA rate - Verizon NJ rate)/(Verizon NJ rate), or (Column 2 - Column 4)/Column 4

(2) Column 6 = (Contel CA rate - Verizon NJ rate)/(Verizon NJ rate), or (Column 3 - Column 4)/Column 4

(3) Column 7 = (Verizon CA rate - Verizon NJ rate)/(Verizon NJ rate), or (Column 1 - Column 4)/Column 4 [except for Tandem switching, where GTEC CA and Verizon NJ were compared]

(4) Column 9: No adjustment to NJ rate because comparison factor from Column 5 is negative.

(5) Column 10 = (Column 8) + (Column 8 x Column 6)

(6) Column 11 = (Column 8) + (Column 8 x Column 7) [except no change for port because comparison factor is negative]

(7) Column 12 = (Column 9 / 1.1)(1.22)

(8) Column 13 = (Column 10 / 1.1)(1.22)

(9) Column 14 = (Column 11 / 1.1)(1.22)