ICC Docket No. 00-0812
Verizon Exhibit No. _____

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Verizon North Inc. (f/k/a/ GTE North Incorporated) and Verizon South Inc. (formerly known as GTE South Incorporated)	))))	Docket No. 00-0812
Petition seeking approval of cost studies for unbundled network elements, avoided costs and intrastate switched access services.	)))	

Rebuttal Testimony of

TERRY R. DYE

On Behalf of

Verizon North Inc. and
Verizon South Inc.
(Formerly GTE North Incorporated and GTE South Incorporated)

January 4, 2002

I. INTRODUCTION AND PURPOSE

Q. Please state your name, position, and business address.

A. My name is Terry R. Dye, and I am currently employed as Manager – Pricing Policy at Verizon Services Group. My business address is 600 Hidden Ridge Drive, Irving, Texas.

Q. Are you the same Terry R. Dye who previously filed direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the direct testimonies of AT&T witness Cate Hegstrom and Staff witness James Zolnierek. In my rebuttal testimony I respond to both AT&T's and Staff's arguments that Verizon's cost estimates in this case are unreasonable based on a comparison with Verizon's current inter- and intra-state switched access rates (*See* Mr. Zolnierek's testimony at page 5 and Hegstrom generally). With respect to Mr. Zolnierek's testimony, my rebuttal testimony addresses the *pro forma* revenue analysis presented in the first five attachments to his direct testimony. I also briefly address Mr. Zolnierek's criticism relating to ICM's use of two modeled networks. My rebuttal testimony supports the conclusion that Verizon's ultimate cost estimates are reasonable and should be adopted by the Commission.

II. CURRENT RATES SHOULD NOT ESTABLISH THE COST CEILING

A. Intrastate Switched Access Rates

Q. On page 16 of his testimony, Mr. Zolnierek alleges that Verizon seeks to renege upon its commitment to reduce rates by $10.03 million. Would you please comment?

A. Mr. Zolnierek is incorrect. Verizon met its commitment on the revenue reductions contained in the ICC Order in Docket No. 98-0866 ("Merger Order"), released on October 29, 1999. The specific switched access reductions were covered in compliance with the Illinois Commerce Commission ("Commission" or "ICC") Order issued in March 2000 in Docket Nos. 97-0601/0602 ("Access Charge Order") directing the elimination of non-cost based rates. The elimination of these non-cost based rate elements resulted in annual intrastate access revenue reductions of approximately $13M. Tariff filings were made in May and June of 2000 to reflect the elimination of these rates, to break the mirroring of interstate access rates, and implement new cost-based rates reflecting LRSIC plus 28.86 percent for recovery of shared and common costs. In addition, Verizon filed tariffs on 7/13/2000 with an effective date of 7/14/2000, implementing annual rate reductions of $10.05 million. Hence, Verizon has met its revenue and rate reduction commitments.

Q. Did the Commission Staff agree with the actions Verizon took to comply with the Merger Order and the Access Charge Order?

A. Yes. As noted previously, Verizon filed tariffs in May and June 2000, effective with 1-day notice. The Commission allowed these tariffs to go into effect without suspension.

Q. Is Verizon currently under any obligation to cap switched access rates in future proceedings?

A. No. While the Commission's Merger Order included a condition to mirror interstate access rates pending a general rate case (condition #4), the Commission in its Access Charge Order broke this mirror in order to establish rates based on cost. The Access Charge Order did not include any mandate, which precludes Verizon from seeking to increase its intrastate access rates in future proceedings.

Q. Would a requirement to cap rates at current levels be consistent with a policy of cost-based rates?

A. No. The main objective in Phase I of this proceeding is to test Verizon's Integrated Cost Model ("ICM") and develop a set of costs that can be relied on to establish cost-based rates. Since the current rates are based on outdated cost estimates, and a proxy shared and common cost factor, it would be inconsistent and unreasonable to use the current rates as a ceiling. Rates should at least cover the identified costs, both from an economic and policy perspective. Therefore, establishing an artificial cost ceiling at the current rates would create a conflict with a cost-based pricing policy.

Q. On page 15 of his direct testimony, Mr. Zolnierek discusses the results of his attachment JZ-1.5. Further, he states that he is not aware of any reason why the costs presented in this case should be higher than our current rates. Could you address this attachment and his concerns?

A. Yes. Mr. Zolnierek's analysis is flawed because it fails to recognize differences in the costing methodology underlying the currently effective intrastate rates and the methodology used to develop the LRSIC plus Common cost calculations sponsored in my direct testimony. As Mr. Tucek explains in his rebuttal testimony, the cost methodology underlying the currently effective rates treats certain costs differently than does ICM. For example, the previous method excluded costs from the unit costs that ICM includes. These are the costs ICM labels as shared.

To correct Mr. Zolnierek's analysis, I have prepared Dye Rebuttal Attachment TD-1. Attachment TD-1 compares the LRSICs presented in this case, with the shared costs excluded,[1] to the currently effective rates adjusted to remove the 28.86% shared and

[1] Verizon provided these costs in response to information request MAH 1.04.

common cost mark-up.[2] Since the 28.86% cap on Verizon's shared and common costs was based on Ameritech cost information, and not based on any evidence related to Verizon's costs, it is necessary to exclude these costs from both the current rates and proposed costs to arrive at a reasonable cost comparison. This corrected analysis provides a reasonable means of judging the change in underlying costs from the costs previously used to establish the current rates.

Q. What conclusions do you draw from this analysis?

A. This Attachment shows that overall, the costs filed in this case are actually slightly lower than the comparable costs upon which our current rates are based. The switching costs have declined by about four percent, while those in the transport category have increased by three percent. Consequently, Mr. Zolnierek's own analysis, when properly developed, shows that the costs produced by ICM are reasonably comparable to the costs previously relied upon. Further, the overall LRSIC plus Common cost estimates presented by Verizon in this case are higher than the overall current rates only because the current rates were established shared and common cost contribution factor which was not based on Verizon's costs.[3]

Q. Have there been any recent UNE cases for Verizon where other the state Commissions have approved cost based switching rates similar to those filed in this case?

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[2] This is the mark-up allowed by the Commission in docket 97-0601,97-0602 & 97-0516 Consol. and the mark-up used in establishing Verizon's current switched access rates. This mark-up was ordered for both Ameritech and Verizon and was not based on Verizon specific costs.

[3] The Commission adopted the shared and common cost percentages for switched access rate elements contained in AT&T Gebhardt Cross Ex. 1A, page 3, which was based on Ameritech's costs.

A. Yes. Since Mr. Zolnierek and Ms. Hegstrom have both focused on the end office switching component, I offer the following comparison of cost-based switching rates recently approved by the North Carolina and Hawaii Commissions:

North Carolina – Final Order in P-100 S133d (3/01/00)	$0.0067488
Hawaii – Final Order in Docket 7702 (12/19/00)	$0.0076074
Verizon – Filed UNE switching costs ICC Docket No. 00-0812	$0.0056000
Verizon – Filed Switched Access EOS rates ICC Docket No. 00-0812	$0.0060342

As can be seen, the switching rates for both Hawaii and North Carolina are greater than either Verizon's current interstate or intrastate rate in Illinois

B. Interstate switched access rates

Q. Both Mr. Zolnierek and Ms. Hegstrom point to Verizon's interstate rates as evidence that Verizon's LRSIC plus Common cost estimates in this Docket are unreasonable. Could you shed some light on this issue?

A. Mr. Zolnierek's and Ms. Hegstrom's arguments rely on incorrect assumptions that Verizon's interstate rates are cost-based, and that these rates are representative of the forward-looking switching costs of Verizon's Illinois service territory. Since neither of these assumptions are valid, the Commission should disregard their testimonies on this topic.

Q. How is their assumption that Verizon's interstate rates are cost-based invalid?

A. The current interstate rates are not cost-based, but were established as the result of the FCC's CALLS Order. This Order was an integrated, negotiated agreement among various groups within the industry, consumer groups, and the FCC. It involved many tradeoffs that were specific to the context of CALLS. Verizon agreed to target price cap reductions to the Average Traffic Sensitive category, and to push those rates toward the target, as part of a broader agreement which also set higher Subscriber Line Charges ("SLCs"), established a new universal service fund, and implemented several other items.

Ms. Hegstrom and Zolnierek cannot isolate any one piece of CALLS out of context, export it to the state level, and claim that it is the right cost-based number for the given service.

Further, because CALLS was a national agreement, and in some cases a national target rate was set, it does not reflect different circumstances among individual states. Even if the CALLS rates could be construed as being representative of Verizon's costs on a national basis, there is no reason to believe that those costs are appropriate for Verizon's Illinois network.

Q. Ms. Hegstrom suggests that since Verizon has volunteered to reduce its per minute-of-use interstate switched access rate to $0.0055 by year 2004, that this provides the absolute maximum level of cost-based rates for Illinois (Hegstrom Dir., p. 14). Please respond to this assumption.

A. Ms. Hegstrom's suggestion should be rejected because the $0.0055 rate was not based on any empirical cost standard. Again, even if it could be argued that the $0.0055 rate reflects Verizon's national average costs, to suggest this rate would impose an absolute maximum level of cost-based rates for each and every state across the nation would be both wrong and illogical.

Q. Mr. Zolnierek claims that because the FCC has observed that the target interstate rates are not predatory, Verizon's LRSIC plus Common cost estimates are unreasonable. Please comment.

A. Mr. Zolnierek relies on paragraph 170 of the CALLS Order, where the FCC stated "To engage in predatory practices, a price cap LEC would have to charge rates below its incremental costs to drive out its competitors, and then raise prices to monopoly levels after the competitors have left the market." The FCC reached the conclusion that the rates were not predatory, in part, because it reasoned that, given the overall regulatory scheme, "[p]rice cap LECs will not be able to increase these prices to monopoly prices…." Since the current regulatory scheme would not permit predation, even if the CALLS rates were below costs, they would not harm efficient competition. Therefore, the FCC's statement does not support the conclusion that Verizon's LRSIC plus Common cost estimates filed in this case are unreasonable.

Q. Could you provide some context to Mr. Zolnierek's argument?

A. Yes. Mr. Zolnierek concludes that Verizon's filed end-office switched access costs in this case exceed the FCC's national target average traffic sensitive rate by $0.00055342, or by approximately ten percent, arguing that it provides evidence that Verizon's LRSIC plus Common cost estimates are, on their face, unreasonable. This conclusion is simply wrong because it assumes that the interstate target rate is equal to the forward-looking costs of switching. It is not. As I explained above, the interstate target rate is a national average target that was not cost based.

Q. Should the Commission accept Mr. Zolnierek's argument on pages 9 and 10 of his direct testimony that Verizon's interstate rates are above costs based on interstate rates of return published by the FCC?

A. No. As Mr. Zolnierek points out, the FCC's rate of return data includes revenue from services other than switched access. Additionally, the rates of return relied on by Mr. Zolnierek are based on embedded costs. The fact that Mr. Zolnierek acknowledges this on page 10 of his direct testimony does not excuse or validate his use of an embedded cost benchmark to draw conclusions about forward-looking costs. His attempt to do so is inconsistent with the spirit, if not the letter, of the Commission's Administrative Rules for costs studies.

III. THE USE OF TWO MODELED NETWORKS IS REASONABLE

Q. Mr. Zolnierek claims on page 25 of his direct testimony that ICM uses two modeled networks, is he correct?

A. Yes, he is, but it is reasonable to model two networks. As Mr. Tucek explains in detail, in order to estimate the costs of an unbundled loop, ICM makes the assumption that all loops served by a Digital Loop Carrier ("DLC") are terminated on a Central Office Terminal ("COT"). The requirements for providing a single unbundled loop to a CLEC mean that it must be handed off to the CLEC collocation arrangement at a voice-grade level. Loops served by a DLC are connected to the central office via fiber feeder at a DS-1 level, which can carry up to 24 voice transmissions on a single channel. In order to provide the CLEC with a single unbundled loop, ICM models the use of the COT to terminate the loops so that each loop can be handed off to the CLECs at a voice-grade level. Alternatively, for the switched access filing, ICM assumes that the fiber-fed DS-1's are terminated on the trunk side of the switch, because this is the network configuration that most closely resembles the real world situation under which switched access is provided. Even though the switched access filing corresponds to the "Retail" network, the modeled expenses under both runs exclude avoided retail costs. The common cost allocator is based on the "Retail" configuration.

Q. Is Mr. Zolnierek's criticism of this approach valid?

A. No. It is true that the wholesale network results in a somewhat greater level of modeled investment than does the retail configuration. However, as Mr. Tucek explains in his rebuttal testimony, the increase is appropriate and the difference is not significant.

IV. SWITCHED ACCESS NON-RECURRING RATES

Q. On page 7 of his direct testimony, Mr. Hanson recommends that Verizon present an exhibit containing all of its proposed non-recurring rates as part of its rebuttal testimony. Could you please clear up the confusion on Verizon's proposed non-recurring rates for switched access?

A. Yes. As discussed in my direct testimony, Verizon filed switched access costs in order to comply with the Access Charge Order. Since Verizon was also filing cost studies for UNEs in this case to comply with the Merger Order, we requested and received approval from the ICC to comply with the Commission's Access Charge Order by also including switched access costs in this case. While Verizon has filed a switched access price list, Verizon has not filed tariff sheets requesting a change in the current switched access rates.

Attachment TD-3 to my direct testimony provided the current[4] switched access non-recurring rates for illustrative purposes. Mr. Hanson however recommends[5] that Verizon present an exhibit containing all of its proposed non-recurring rates. Even though Verizon is not proposing new non-recurring rates at this time, I have prepared an Attachment (Dye Rebuttal Attachment TD-2) which contains the non-recurring (as well as recurring) switched access costs and rates.

Further, on page three of his prefiled testimony, Mr. Hanson mentions eight switched access non-recurring rates that are not listed in Verizon's cost study. The rates he is

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[4] See Ill. C.C. No. 10, Sect. 4 Twelfth Revised Sheet No. 102.

[5] See page 7 lines 157 and 158.

referring to are those he mentions at page four of his direct testimony.[6] All of these rates are unchanged from current levels and are not cost based. Additionally, the revenue from these rate elements is accounted for in the development of the recurring rate elements, in that the revenues provide an offset to decrease the monthly rates.

Q. Specifically, how was the revenue from these non-recurring rate elements accounted for?

A. The revenue impact of the non-recurring charges ("NRCs") is developed through the use of an annuity as an offset to the monthly costs to reflect the up-front non-recurring payment. The annuity from a present amount was developed using the same annual cost of money underlying the recurring costs. Also, the recovery period used was the plant life of the investments. To illustrate the impact, a $200 NRC, using a 10.2% annual cost of money and an 18-year plant life as the recovery period, produces a monthly annuity of $2.03. This monthly annuity is used as a credit to offset or reduce the monthly recurring costs. It should be noted that this occurred only with services for which a flat-rate monthly charge applies, such as Entrance Facilities and Multiplexing. Inasmuch as offsetting credits affect only the monthly recurring charges, usage-based rate elements were not affected by NRC adjustments.

Q. Does this conclude your rebuttal testimony?

A. Yes.

[6] Specifically these rates are for the 2 and 4 wire entrance facilities at $200, High Capacity Digital DS1-Initial and Additional Systems at $450, High Capacity Digital DS-3, Electrical Interface at $1,000, High Capacity Digital DS-3, Optical Interface at $750, Multiplexing DS1 to Voice at $800, and Multiplexing DS3 to DS1 at $450.