STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

November 5, 2004 **Agenda ID #4039**

TO: PARTIES OF RECORD IN RULEMAKING 93-04-003 AND INVESTIGATION 93-04-002

Enclosed is the draft decision of Administrative Law Judge Duda. The decision will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ Angela K. Minkin
Angela K. Minkin, Chief
Administrative Law Judge

ANG: avs

Decision **DRAFT DECISION OF ALJ DUDA** **(Mailed 11/5/2004)**

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**)

OPINION MODIFYING DECISION 03-03-033 TO ADJUST INTERIM UNBUNDLED NETWORK ELEMENTS RATES

I. Summary

In Decision (D.) 03-03-033, the Commission adopted interim rates for a subset of unbundled network elements (UNEs) Verizon California Inc. (Verizon) sells to competitive local exchange carriers. In adopting interim UNE rates, the Commission relied on UNE rates recently adopted for Verizon in New Jersey, and then adjusted these rates based on the Federal Communication Commission's (FCC's) Synthesis Model to compare relative costs between Verizon's operations in California and New Jersey. (D.03-03-033, p. 33.) This decision grants a petition for modification of D.03-03-033 and adjusts the interim rates to reflect recent increases in Verizon New Jersey UNE rates. The new interim rates are set forth in Appendix A, and the changes include an 8.4% increase in Verizon's interim 2-wire loop rates to $11.45 and $24.26 in

Zones 1 and 2, respectively. Verizon's interim 4-wire loop rates increase 8.8% to $23.63 and $50.09 in Zones 1 and 2, respectively. Verizon's interim port rate is increased 42.3% to $3.02.

II. Verizon's Petition for Modification

On May 21, 2004, Verizon filed a petition requesting modification of D.03-03-033 because the New Jersey Board of Public Utilities (the "Board") had recently modified its UNE rates.[1] Verizon states in its petition that given the Commission's reliance on New Jersey rates, the Commission must now increase the interim rates to reflect adjustments made by the New Jersey Board.

In D.03-03-033, the Commission found it was reasonable to rely on UNE rates from New Jersey rates because "these are among the most recent forward-looking, TELRIC-based UNE rates" for Verizon. In its petition, Verizon alleges that because the New Jersey Board has modified its UNE rates, interim rates in California are based on outdated New Jersey UNE rates, which are no longer reasonable and must be adjusted.

Specifically, the New Jersey Board made upward adjustments to its UNE rates after finding the cost of capital it had previously adopted required modification to consider future competition and the risk of operating in a competitive market. The Board increased the cost of capital used as an input in its cost studies from 8.82% to 9.88% and it modified switching port and usage

[1] *See In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc.*, Decision and Order, Docket No. TO00060356, (N.J.B.P.U., May 7, 2004)("New Jersey Order"), which is included in Verizon's Petition, 5/21/04, Exhibit A to the Declaration of Michele Meny.

rates to correct cost modeling and allocation errors.[2] The Board's decision adopting new UNE rates for Verizon New Jersey went into effect on May 14, 2004. Verizon contends these New Jersey UNE rate adjustments are a material change in circumstances that warrant modification of D.03-03-033. Therefore, the Commission must revise its interim UNE rates upwards by the same margin adopted in New Jersey.

Verizon includes in its petition a recalculation of its interim UNE rates based on the newly adopted New Jersey rates. In D.03-03-033, the Commission adjusted New Jersey UNE rates to reflect a Synthesis Model comparison of UNE costs in California and New Jersey. Verizon contends it uses the same methodology applied in D.03-03-033 with the newly adopted New Jersey rates. As a result, Verizon requests the Commission increase the 2-wire interim loop rate by $0.89 in Zone 1 and $1.89 in Zone 2; the 4-wire interim loop rate by $1.90 in Zone 1 and $4.06 in Zone 2; the interim port rate by $0.90; the interim end office switching usage rate by $0.000239; and the interim tandem switching rate by $0.000151.

Commission Rule 47(d) specifies that petitions for modification shall be filed within one year of the underlying order. Verizon contends that although its petition is filed more than one year following adoption of D.03-03-033 on March 13, 2003, its current petition is justified because the New Jersey Board did not issue its decision with updated UNE prices until May 7, 2004. Therefore, Verizon could not have filed this petition prior to the release of the Board's order.

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[2] Verizon Petition, 5/21/04, pp. 3-4; *see also* New Jersey Order, p. 21 and 35.

III. Comments on Petition

Comments on Verizon's petition were filed jointly by AT&T Communications of California, Inc. (AT&T) and MCI Corp. (MCI), and jointly by a group of small competitive local exchange carriers (CLCs), namely Anew Telecommunications Corp d/b/a Call America, DMR Communications, Navigator Telecommunications LLC; and Tri-M Communications d/b/a TMC Communications (collectively the "small CLCs").

AT&T/MCI contend that Verizon's petition should be denied for several reasons. First, the petition fails to establish new material facts requiring modification of D.03-03-033 because the Commission did not rely on New Jersey rates to the extent alleged by Verizon. Rather, AT&T/MCI explain that the Commission compared Synthesis Model results for California and New Jersey and modified the New Jersey rates upwards wherever modeling results indicated higher costs in California. Therefore, they argue that although New Jersey has changed a few modeling inputs, this does not mean the Commission is required to modify its interim rates.

Second, AT&T/MCI maintain it is not necessary for the Commission to stop its efforts to set permanent UNE rates for Verizon by opening a proceeding to modify interim rates when Verizon's interim rates are subject to true-up and it is not harmed by the current level of interim rates.

Third, AT&T/MCI argue the Commission cannot accept Verizon's unverified calculations that convert New Jersey rates into new interim rates for Verizon California. According to AT&T/MCI, recent New Jersey UNE rate changes are interim and still under review for accuracy. Finally, they suggest that if there is any fine-tuning of interim UNE rates, it should involve lowering

the 22% shared and common cost markup factor incorporated into the interim rates to the 8% level adopted in New Jersey.

The small CLCs oppose Verizon's petition for many of the same reasons, emphasizing Verizon's petition will unnecessarily delay the permanent UNE rate proceeding and disagreeing with Verizon's assertions that interim rates based on initial New Jersey rates are no longer valid. In addition, the small CLCs disagree with Verizon's claims that it is harmed by the current interim rates, particularly given Verizon's statements in other forums that it will maintain UNE rates at current levels. Specifically, the small CLCs cite statements by Verizon to the Commission that it would not immediately raise rates on UNEs as a result of the FCC's TRO and that it would maintain current UNE rates for mass market UNE-Platform customers for five months. (Small CLC response, 6/21/04, p. 7.)

IV. Discussion

We find Verizon's petition for modification of D.03-03-033 reasonable and we will grant it. The interim rates adopted in D.03-03-033 used the Verizon New Jersey UNE rates as a starting point for an analysis involving the FCC's Synthesis Model. Now that the New Jersey Board has found it reasonable to adjust these rates, both to modify the cost of capital and to correct a cost allocation error involving switching, it is logical that interim rates in California based on the original New Jersey rates should be adjusted as well, as long as the adjustment is not unduly burdensome to calculate or implement.

The protests of AT&T/MCI and the small CLCs are not persuasive. First, AT&T/MCI claim the Commission did not rely on New Jersey UNE rates to the extent suggested by Verizon. While it is true the Commission performed its own analysis and did not simply apply New Jersey rates to California, the New Jersey UNE rates were the starting point for the Synthesis Model analysis used in

D.03-03-033 to set interim rates. Now that the starting point has been corrected and modified, and given that it is not an onerous process to translate the updated New Jersey rates into our own interim rates, we find it reasonable to make the adjustments suggested by Verizon.

Second, the protesting parties argue that adjusting interim rates will take valuable time and resources away from the efforts to set permanent rates for Verizon. We do not agree with this assertion. Verizon has provided the calculations to adjust its interim rates based on the newly adopted New Jersey rates. The staff of our Telecommunications Division verified these calculations and the rate adjustments are not complex. There is no need for a protracted proceeding to debate how to make interim rate adjustments. The adjusted interim UNE rates are found in Appendices A, B and C to this order, which replace the appendices in D.03-03-033.

Third, AT&T / MCI claim the New Jersey rates are still interim. While it is true that the May 21, 2004 order by the New Jersey Board required a compliance filing, that has now occurred and the rates are final.[3] The adjusted New Jersey rates are now in effect and this Commission can rely on them to the same extent it relied on the earlier New Jersey rates.

Fourth, the protesting parties claim there is no need to adjust interim rates since they are already subject to adjustment, or "true-up," once final rates are

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[3] On September 28, 2004, Verizon filed a motion requesting official notice of the September 22, 2004 decision of the New Jersey Board rejecting petitions for reconsideration of its May 7, 2004 UNE rate decision. (*See In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc.*, Decision and Order on Motions for Reconsideration and Request for Limited Reopening and Motions to Strike, Docket No. TO00060356 (N.J.B.P.U., Sept. 22, 2004).) Verizon's motion is unopposed and we will grant it.

adopted. Along the same lines, the protesting parties claim a change in interim rates will create unnecessary complexity in the true-up process. We agree with Verizon that the mere existence of a true-up mechanism at a later date should not prevent adjustment of interim rates based on the best information available, and modifying interim rates will send appropriate market signals because the new rates are based on the most current Verizon New Jersey rates. Finally, we disagree that the true-up will be complicated by this adjustment. When permanent rates are set, the true-up will reflect (1) the difference between the original interim rates and permanent rates for the period the original interim rates were in effect, and (2) the difference between the revised interim rates and permanent rates for the period that revised interim rates are in effect. Verizon's explanation is straightforward and we agree this is how the true-up should be calculated once final rates are set.

V. Comments on Draft Decision

The draft decision of the Administrative Law Judge (ALJ) in this matter was mailed 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 _____ and reply comments were filed by_____.

VI. Assignment of Proceeding

Commissioner Michael R. Peevey is the Assigned Commissioner and Dorothy J. Duda is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. In D.03-03-033, the Commission set interim rates for a subset of Verizon's UNEs, using UNE rates recently adopted for Verizon's operations in New Jersey as a starting point and adjusting these rates based on the FCC's Synthesis Model.

2. On May 7, 2004, the New Jersey Board adjusted UNE rates for Verizon New Jersey to modify the cost of capital and to correct a cost allocation error involving switching.

3. Verizon's petition was filed more than one year following D.03-03-033 because the New Jersey Board adjusted Verizon New Jersey UNE rates in May 2004.

Conclusions of Law

1. It is reasonable to adjust Verizon's interim UNE rates based on adjustments to New Jersey rates because the changes are not unduly burdensome to calculate or implement.

2. Verizon's petition for modification of D.03-03-033 should be granted.

3. The rates set forth in Appendices A, B, and C of this order should replace the rates in Appendices A, B, and C. of D.03-03-033.

O R D E R

IT IS ORDERED that:

1. The May 21, 2004 petition of Verizon California Inc. (Verizon) to modify Decision (D.) 03-03-033 is granted.

2. Appendices A, B, and C of this order should replace Appendices A, B, and C in D.03-03-033.

This order is effective today.

Dated _____, at San Francisco, California.

ATTACH A B C TO DOT R9304003 I9304002