COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts	)	D.T.E. 01-20

VERIZON MASSACHUSETTS'
MOTION TO REOPEN THE RECORD

Verizon Massachusetts Inc. ("Verizon MA") moves the Massachusetts Department of Telecommunications and Energy ("Department") to reopen this proceeding to permit Verizon MA to provide evidence demonstrating that the rates set by the Department for unbundled network elements ("UNEs") fail to provide Verizon MA with just compensation, as required by the Fifth and Fourteenth Amendments to the United States Constitution and the Declaration of Rights of the Massachusetts Constitution. Good cause to reopen the record exists because the evidence Verizon MA seeks to offer could not have been developed and presented prior to the Department's adoption of final rates. The Department accordingly should reopen the record to accept and consider such evidence now.

No party would be prejudiced by consideration of Verizon MA's proffered evidence because the rates are already in effect. By contrast, failure to consider this evidence would prevent Verizon MA from demonstrating that it has been denied constitutionally adequate compensation for its provision of UNEs to CLECs. Inclusion of this additional evidence would permit the Department to make an informed judgment concerning whether and how to modify

the final rates, or to take other remedial action to address the unconstitutional taking that Verizon MA will demonstrate.

DISCUSSION

On July 16, 2003, the Department approved final UNE rates in the above-captioned proceeding. Pursuant to the Department's orders in this case, the statewide average UNE loop rate in Massachusetts is $13.93, and the average UNE-P rate is $18.69. These rates suffer from an even more critical flaw than their failure to comply with TELRIC – they will not come close to allowing Verizon MA to recover its prudent historical investments and the associated real-world operating costs of providing UNEs to CLECs. Indeed, if Verizon MA were compelled to continue providing UNEs to CLECs at the rates set by the Department, it would be unable to earn a constitutionally sufficient rate of return, and its financial integrity would be substantially compromised. The rates thus are inadequate as a matter of both federal and state constitutional law.

The Department permits parties to "present additional evidence after having rested . . . upon motion and showing of good cause."[1/] Department precedent defines "[g]ood cause for purposes of reopening . . . as a showing that the proponent has previously unknown or undisclosed information regarding a material issue that would be likely to have a significant impact on the decision."[2/] Such "good cause" clearly exists here, in view of the evidence Verizon MA proffers to show that the rates set by the Department effect an unconstitutional

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1/ 220 CMR § 1.11(8).

2/ Opinion, *Petition of Bay State Gas Co., pursuant to G.L c. 164, §§ 94 and 220 C.M.R. § 6.00 et seq., for Authority to Establish a Gas Cost Incentive Mechanism*, Docket No. D.T.E. 01-81, at 20-21 (Mass Dep't of Telecomms. And Energy Dec. 5, 2002) (*citing Machise v. New England Telephone and Telegraph Company*, D.P.U. 87-AD-12-B at 4-7 (1990); Boston Gas Company, D.P.U. 88-67 (Phase II) at 7 (1989); *Tennessee Gas Pipeline Company*, D.P.U. 85-207-A at 11-12 (1986)).

taking; as a practical matter, until final rates were adopted, Verizon MA could not calculate the shortfall with specificity and could not present that calculation to the Department for its consideration. Verizon MA has now been able to make that calculation, and it should be given an opportunity to submit the evidence and make its "taking" claim.

Under both Massachusetts law and Supreme Court precedent, it is clear that a regulatory takings claim may and should be considered when there is "a final and authoritative determination from which a court can determine whether a regulation has gone 'too far.'"[3/] The Supreme Court has made clear that once the state has determined specific UNE rates, those rates are subject to challenge on the basis that they fail to provide adequate compensation.[4/] Indeed, Commissioner Connelly observed precisely this in suggesting that the Department's order may give rise to a claim of confiscation.[5/] Thus, now that the final rates have been calculated and gone into effect, Verizon MA should be afforded the opportunity to show that the rates adopted by the Department will in fact give rise to a taking of constitutional dimensions, and the record should be reopened to permit submission of supporting evidence.

No other outcome makes sense. As the Supreme Judicial Court of Massachusetts has noted, new evidence should be considered where a party claims that rates are confiscatory because such data "should not be excluded from consideration, especially where violation of the

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3/ *Grasso v. New Bedford*, 774 N.E.2d 1186 n.10, 2002 WL 31039718 (Mass. App. Ct. 2002) (citation omitted); *see also Daddario v. Cape Cod Comm'n,* 681 N.E.2d 833, 836 (Mass. 1997), *quoting Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 186 (1986) ("The ripeness doctrine provides that 'a claim that the application of government regulations effects a taking of a property interest is not ripe until the government entity charged with implementing the regulations has reached a final decision regarding the application of the regulations to the property at issue.'").

4/ *Verizon Communications Inc. v. FCC.*, 535 U.S. 467, 524 (2002) (The Court found "want of any rate to be reviewed" to be significant "given that this Court has never considered a taking challenge on a ratesetting methodology without being presented with specific rate orders alleged to be confiscatory.").

5/ *See* January 14, 2003 Order at 164.

Constitution is at stake."[6/] Now that the Department's rates are in effect so that no party will be prejudiced if the record is reopened, there is no valid countervailing interest to consider in weighing Verizon MA's motion. In contrast, delay will cause Verizon MA to continue to bear the cost of the confiscatory shortfall.

While a claim of confiscation "would be accorded particular scrutiny" on appeal,[7/] Verizon MA should not be required to resort to judicial review to have its claim heard. When a regulated entity presents serious allegations that rates may result in a taking, it is beyond dispute that the agency *must* consider those allegations and look at the relevant evidence, and failure to do so constitutes reversible error.[8/] Parties have a constitutional right to have adequate compensation awarded *at the time of the taking*, and cannot lawfully be forced to await appeal, or some later action, in order to present a takings claim.[9/]

Finally, there is no question that the evidence Verizon MA seeks to submit presents compelling proof of an unconstitutional taking. As the attached testimony of Verizon MA witnesses Harold E. West, III and Marsha S. Prosini demonstrates, Verizon MA has performed two different studies that both show the vast gap between the rates set by the Department and the costs Verizon MA has incurred for the historical investment required to provide UNEs to CLECs and the costs it will incur in the future. *See* Testimony of Harold E. West, III and Marsha S.

6/ *Boston Gas Co. v. Department of Pub. Utils.,* 269 N.E.2d 248, 253 n.8 (Mass. 1971)(*quoting Opinion of the Justices*, 106 N.E.2d 259, 264 (Mass. 1952)).

7/ *See Opinion of the Justices*, 106 N.E.2d 259, 263-64 (Mass. 1952).

8/ *See Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1176-1179 (D.C. Cir. 1987) (where regulated entity presents serious allegations that rates result in a taking, the agency may not refuse to consider those allegations and review the relevant evidence).

9/ *See Preseault v. ICC*, 494 U.S. 1, 11 (1990) (Constitution requires "'reasonable, certain, and adequate provision for obtaining compensation' at the time of the taking") (quoting *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 124-125 (1974)).

Prosini (Aug. 13, 2003) ("West/Prosini"). These studies demonstrate that Verizon MA's cost of providing a loop is over $25, and its cost of providing a UNE-P is over $40. *Id*. at 3, 10-11, 20. By contrast, the statewide average loop rate set by the Department is $13.93, and the UNE-P rate is $18.69. *Id*. at 3, 21. As a result, the UNE rates set by the Department will permit Verizon MA to recover less than 60% of the cost of providing a loop and not even half of the cost of providing a UNE-P.

Moreover, the Department's rates would threaten Verizon MA's financial integrity. The rate reductions ordered by the Department retroactive to August 2002 will reduce Verizon MA's return on investment to below *3.3%* for 2002. *Id*. at 4, 22. By contrast, the Department determined in this proceeding that the appropriate cost of capital to be used in setting UNE rates is 11.45%.[10/] The effect of the Department's rates on Verizon MA's rate of return on investment will only be magnified in the future, since the 2002 return reflects only the five months affected by retroactive application of the Department's below-cost rates. (West/Prosini at 22.)

If the historical growth trends in the volume of loop and UNE-P orders in Massachusetts are projected forward, by 2005 the annual shortfall based on the Department's rates would be more than $113 million. *Id.* at 4, 22-23. Moreover, at the Department's rates, Verizon MA's net income would reach *zero* if only about 12% more of Verizon MA's lines were leased as UNE-Ps – a percentage that already has been exceeded in New York. *Id.* at 4, 23. And, if Verizon MA had been compelled to sell all of its lines in 2002 at the UNE-P rates set by the Department, it would have recovered less than 75% of its approximate wholesale-related costs, leaving a shortfall of approximately *$320 million*. *Id*. at 4, 23-24. To require Verizon MA to reduce its UNE rates under these circumstances would be confiscatory.

In sum, the UNE rates set by the Department in this proceeding would force Verizon MA to provide UNEs to CLECs at an ongoing loss, and the result would be a substantial and unlawful confiscation of Verizon MA's property. While the 1996 Act compels an incumbent to turn over parts of its network for its competitors' exclusive use, the Act also requires that competitors pay a "just and reasonable" rate for this use, a rate that is based on cost.[11/] The rates set by the Department not only fail to satisfy this test under the TELRIC standard, but are manifestly insufficient as a matter of state and federal constitutional law.[12/] It is axiomatic that, under the federal Constitution, in compensating a utility for use of its property serving the public, an agency may not set rates "so 'unjust' as to be confiscatory."[13/] Similarly, Massachusetts law provides that agencies must set rates that provide the utility "an opportunity to earn a fair and reasonable return [on its investment]."[14/] Indeed, as the Massachusetts courts have concluded, "[i]t is a long-standing principle that a public utility is entitled to charge rates that allow it to meet its cost of service, including a fair and reasonable return on honestly and prudently invested capital."[15/] And to be fair and reasonable, a return should "cover[] utility operating expenses, debt service, and dividends, . . . compensate[] investors for the risks of investment, and [be]

10/ *See* July 11, 2002 Order at 18.

11/ 47 U.S.C. §§ 251(c)(3), 252(d)(1).

12/ "Confiscatory rates violate articles 1, 10, and 12 of the Declaration of Rights of the Massachusetts Constitution, and the Fourteenth Amendment to the United States Constitution." *Re New England Telephone and Telegraph Company,* D.P.U. 94-50 (1995), *quoting Fitchburg Gas & Elec. Light Co. v. Department of Pub. Utils*., 371 Mass. 881, 884 (1977).

13/ *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307 (1989) (quoting *Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U.S. 578, 597 (1896)).

14/ *Town of Hingham v. Department of Telecomms. & Energy*, 740 N.E.2d 984, 989 (Mass. 2001).

15/ *Id.* at 990.

sufficient to attract capital and assure confidence in the enterprise's financial integrity."[16/] Rates that fail to compensate the incumbent for its unrecovered prudent historical investment and actual out-of-pocket operating expenses to provide UNEs to CLECs do not satisfy this standard. Although historical investment "need not be taken into account as such in ratemaking formulas, it may need to be taken into account in assessing the constitutionality of the particular consequences produced by those formula."[17/] As Verizon MA's evidence shows, the Department's rates do not come close to covering Verizon MA's historical investment and operating costs of providing UNEs and are therefore constitutionally insufficient.

The shortfall in the recovery of real costs that Verizon MA will suffer if it is compelled to continue to provide UNEs at the recently set rates will inevitably impact Verizon's overall financial integrity and its ability to attract capital: no company can continue to do business and attract investors while experiencing such ongoing and growing losses. Indeed, as Verizon MA's evidence shows, retroactive application of the Department's rates will cause Verizon MA's return on investment for 2002 to drop below *3.3*% *Id*. at 4, 22. Such an outcome clearly does not fulfill the Department's obligation to permit Verizon MA "to attract capital, and to compensate its investors for the risks assumed."[18/] Indeed, looking at Verizon MA's overall rate of return is itself extremely conservative. Under a regulatory regime where *all* of an incumbent's business is open to competition, a state commission cannot justify the unconstitutional taking

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16/ *Fitchburg Gas & Elec. Light Co. v. Department of Pub. Utils.,* 359 N.E.2d 1294, 1297 (Mass. 1977).

17/ *See, e.g., Duquesne*, 488 U.S. at 317 (Scalia, J., White, J., O'Connor, J. concurring); *see also Verizon*, 535 U.S. at 527 n.37 (quoting *Duquesne*, 488 U.S. at 317).

18/ *FPC v. Hope Natural Gas Co*., 320 U.S. 591, 605 (1944); *see also Leopoldstadt, Inc. v. Comm'r of the Div'n of Health Care Finance and Policy*, 762 N.E.2d. 824, 832 (Mass. 2002) ("A return is fair and reasonable if it covers utility operating expenses, debt service, and dividends, if it compensates investors for the risks of investment, and if it is sufficient to attract capital and assure confidence in the enterprise's financial integrity.") (internal citations omitted).

caused by confiscatory UNE rates by factoring in those other revenues that are subject to competition or revenues under another sovereign's jurisdiction.[19/]

The Department cannot turn a blind eye to the evidence of confiscation that Verizon MA presents today. Doing so would allow the perpetuation of a manifest injustice that will have a severe impact on Verizon MA's financial integrity and on the health of the telecommunications industry in Massachusetts generally. Consideration of the evidence will harm no party, as the new rates are in effect and presumably will remain so during the interim. The Department accordingly must grant Verizon MA's motion to reopen the record and consider Verizon MA's proffered evidence. Failure to do so would be reversible error, as Verizon MA's evidence clearly demonstrates that the rates set by the Department in this proceeding fail to compensate Verizon MA for its costs, and are thus confiscatory.

[19/] *See Brooks-Scanlon Co. v. Railroad Comm'n*, 251 U.S. 396, 399 (1920); *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930); *Michigan Bell Tel. Co. v. Engler*, 257 F.3d 587, 593 (6th Cir. 2001).

CONCLUSION

For the reasons set forth above, the Department must reopen the record for the limited purpose of accepting Verizon MA's evidence and considering Verizon MA's claim of confiscation.

Respectfully submitted,
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