D.P.U. 94-185

Investigation by the Department on its own motion into IntraLATA and Local Exchange Competition in Massachusetts.

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I. INTRODUCTION

On January 6, 1995, on its own motion, the Department opened a generic adjudication on intraLATA and local exchange competition in Massachusetts. See Local Competition, D.P.U. 94-185, Order Opening Investigation (January 6, 1995). The matter was docketed as D.P.U. 94-185. "The purpose of the investigation was to determine and put in place the structural components necessary to ensure the development of open markets, relying on competitive forces wherever possible, in order that the benefits associated with competition will be realized by all telecommunications customers in the Commonwealth." Id. at 3. The Department stated that the investigation would "include, but not be limited to, an examination of the following issues: (1) interconnection of networks, including local and interoffice signalling, and associated databases; (2) provisioning of number resources; (3) telephone number portability; (4) cooperative engineering, operations, and maintenance practices and procedures; (5) billing arrangements; (6) compensation arrangements; (7) directory and directory assistance provisioning; (8) provisioning of access to emergency services; (9) universal service funding; (10) intraLATA toll presubscription; (11) resale of [New England Telephone and Telegraph Company d/b/a NYNEX's ("NYNEX")] unlimited services; and (12) unbundling and pricing of NYNEX network elements." Id. at 3-4. By Hearing Officers Ruling dated March 24, 1995, the Department added the following six issues to the scope of the proceeding: (1) entry or franchise restrictions; (2) regulatory safeguards; (3) access to conduits, poles, rights of way and other pathways; (4) dispute resolution; (5) schedule for the implementation of market structure issues; and (6) cost studies.

On October 23, 1995, the Hearing Officers moved the issue of determination of price floors for NYNEX's services from D.P.U. 95-83 (the Department's investigation of NYNEX's first annual price cap filing) into this proceeding, because the price floors issue closely related to the issues of the pricing and cost methodology for interconnection arrangements.

By Hearing Officers Ruling dated April 23, 1996,[1] the Department significantly reduced the scope of the proceeding by removing from further consideration 15 issues primarily concerning interconnection,[2] as a result of passage of the Telecommunications Act of 1996 ("Act"), after finding that "[f]inal disposition of the interconnection issues in the case is provided for substantively and procedurally in the Act." April 23, 1996 Hearing Officers Ruling. The Hearing Officers concluded that it was not "useful or appropriate at this point for the Department to provide guidance on interconnection issues outside of the framework of the Act" through a traditional Department order or some other means but rather to "let the § 252 resolution process of the Act run its course." Id. at 2-3. With respect to universal service funding, the April 23, 1996 Hearing Officers Ruling noted that "§ 254 of the Act includes substantive guidance and

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1 All hearing officer rulings referenced in this Order were issued in D.P.U. 94-185.

2 The issues removed were: (1) interconnection of networks, including local and interoffice signalling and associated databases; (2) provisioning of number resources; (3) telephone number portability; (4) cooperative engineering, operations, and maintenance practices and procedures; (5) billing arrangements; (6) compensation arrangements; (7) directory and directory assistance provisioning; (8) provisioning of access to emergency services; (9) intraLATA toll presubscription; (10) resale of NYNEX's network elements; (11) unbundling and pricing of NYNEX's network elements; (12) entry or franchise restrictions; (13) access to conduits, poles, rights of way, and other pathways; (14) schedule for implementation of market structure issues; and (15) universal service funding. April 23, 1996 Hearing Officers Ruling.

procedures for resolving" this issue and that "the Department will open a separate universal service funding proceeding, incorporating the [applicable portions of the] record in D.P.U. 94-185 . . . in order to implement the intrastate requirements of § 254 of the Act." Id. at 4. The April 23, 1996 Hearing Officers Ruling concluded that because the Act does not address the issues of (1) regulatory safeguards, (2) dispute resolution (as defined by the Hearing Officers in the March 24, 1995 Hearing Officers Ruling at 8-9), (3) cost studies, and (4) price floors, those issues would remain in the case and would be addressed in this final Order. Id. at 5.

Pursuant to notice duly issued, a procedural conference was held at the Department's offices on January 30, 1995. No public hearings were held. Twenty-one days of evidentiary hearings were held at the Department's offices between July 6 and December 22, 1995. Pursuant to G.L. c. 12, § 11E, the Attorney General of the Commonwealth ("Attorney General") filed a notice of intervention in the proceeding. In addition, NYNEX; AT&T Communications of New England, Inc. ("AT&T"); MCI Telecommunications Corp. ("MCI"); Sprint Communications Company L.P. ("Sprint"); MFS Communications Company, Inc. ("MFS"); Cablevision Lightpath, Inc. ("CLI"); Teleport Communications Group, Inc. ("TCG"); the New England Cable Television Association, Inc. ("NECTA"); Southwestern Bell Mobile Systems, Inc. d/b/a Cellular One ("Cellular One"); Frontier Communications of New England ("Frontier"); the New England Public Communications Council ("NEPCC"); the Department of Defense and All Other Federal Executive Agencies ("DOD"); Brooks Fiber Communications of Massachusetts ("Brooks Fiber"); UrbanNet of Massachusetts, Inc. ("UrbanNet"); ACC National Telecom Corporation ("ACC"); LDDS Communications, Inc. d/b/a LDDS Metromedia ("LDDS"); Nextel Communications, Inc.

("Nextel"); Taconic Telephone Corporation; Richmond Telephone Company; and the Telecommunications Resellers Association ("TRA") were granted intervenor status in the proceeding. Representative Jim Marzilli and the Business Telecommunications Users Group ("BTUG") were granted limited participant status.

NYNEX sponsored the testimony of Dr. William E. Taylor, senior vice president, National Economic Research Associates, Inc.; Dr. Alfred E. Kahn, special consultant with National Economic Research Associates, Inc.; Paul J. Calabro, managing director for state regulatory planning; and Paula L. Brown, managing director of pricing for Massachusetts. AT&T sponsored the testimony of Dr. John W. Mayo, an economist; Brenda J. Kahn, manager of access management, network services; Donna J. Nanney, docket manager for government affairs for the eastern region; Michael J. Morrissey, vice president for government affairs; William D. Salvatore, district manager for regulatory affairs; Kevin Curran, division manager in the consumer communications services business unit; and Roger L. Riggert, a consultant with RLR Resources. MCI sponsored the testimony of Dr. Nina W. Cornell, an economist; Joseph Dunbar, senior regulatory analyst; Charles B. Goldfarb, executive staff member for regulatory and public policy analysis; and Don Laub, senior manager for state regulatory and governmental affairs. Sprint sponsored the testimony of Mark Sievers, director of regulatory policy and coordination; and Michael J. Nelson, staff director for regulatory affairs policy. MFS sponsored the testimony of William Montgomery, an economic consultant; Timothy T. Devine, director of regulatory affairs for the northeast region; and Gary J. Ball, director of regulatory affairs for the eastern region. Teleport sponsored the testimony of Dr. Gerald W. Brock, an economist; Ken Morin, manager of

switching systems for TC-Boston; and Paul Kouroupas, director of regulatory affairs for the eastern region. NECTA sponsored the testimony of Lee L. Selwyn, president of Economics and Technology, Inc. CLI sponsored the testimony of Leo D. Maese, director of regulatory planning. Cellular One sponsored the testimony of Dr. Jerry A. Hausman, professor of economics at the Massachusetts Institute of Technology; and Paul J. Saur, vice president of network operations. LDDS sponsored the testimony of Joseph Gillan, an economic consultant. DOD sponsored the testimony of Harry Gildea, a consultant with Snavely, King & Associates; and Mark Langsam, chief of the economics branch (local telecommunications procurement division) of the information resources and management service of the General Services Administration.

The evidentiary record consists of 1001 exhibits. NYNEX entered 147 exhibits, the Attorney General entered 410 exhibits, AT&T entered 143 exhibits, MCI entered 52 exhibits, Sprint entered 2 exhibits, MFS entered 42 exhibits, Teleport entered 4 exhibits, NECTA entered 130 exhibits, CLI entered 16 exhibits, Cellular One entered 19 exhibits, LDDS entered 2 exhibits, DOD entered 5 exhibits, and the Department entered 29 exhibits. The record also includes 82 responses by various parties to record requests.[3]

Initial briefs were filed by January 26, 1996 by NYNEX, the Attorney General, AT&T, MCI, Sprint, UrbanNet, NECTA, MFS, Teleport, CLI, DOD, Cellular One, LDDS and TRA.

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[3] The majority of the exhibits and record requests contained in the record relate to issues no longer under consideration. In making its determination on the four remaining issues in the case, the Commission relied only on that portion of the record that relates to those issues.

Reply briefs were filed by May 17, 1996 by NYNEX, the Attorney General, AT&T, MCI, Sprint, MFS, Teleport, NECTA and DOD.

II. ISSUES

A. Introduction

As noted above, the Department removed interconnection and other related issues from further consideration in this docket, since the Act provided for their resolution procedurally and substantively. However, several issues that are integral to the development of local and intraLATA competition in Massachusetts still remain for Department determination. They are: cost studies, price floors, dispute resolution, and regulatory safeguards. These issues are either specific to Massachusetts (e.g., the price floors issue) (see NYNEX, D.P.U. 94-50, at 205-207 (1995)) or were not resolved by the Act.

B. Cost Studies

1. Introduction

In IntraLATA Competition, D.P.U. 1731, at 38 (1985), the Department found that properly defined incremental (marginal) costs "represent the most efficient costs to be considered for pricing services as competition enters a marketplace." In addition, the Act requires an economically-efficient, cost-based rate structure for interconnection and unbundled network elements (i.e., monopoly/essential services). See Act, § 252(d). Moreover, the universal service provisions of the Act require that universal service support be eliminated from rate structure and replaced with an explicit funding mechanism. Id., § 254(e). Thus, the Department in this docket must determine the proper cost study methodology to be used as a basis for (1) pricing of

unbundled network elements, (2) price floor computations, and (3) measurement of subsidies. Consistent with the Department's goal of economic efficiency in pricing, the Department must decide between the use of the long-run incremental cost ("LRIC") methodology or the total service long-run incremental cost methodology ("TSLRIC").

2. Positions of the Parties

a. NYNEX

NYNEX argues that LRIC, and not TSLRIC, should be the basis for computing the rates for interconnection and for determining price floors (NYNEX Initial Brief at 65). NYNEX claims that a switch from NYNEX's existing marginal cost methodology to the TSLRIC methodology would require the Department to abandon the existing rate structure and engage in a new round of cost studies, litigation and rate rebalancing proceedings (id.). NYNEX argues that the marginal cost methodology adopted by the Department in D.P.U. 86-33-G for developing prices is based on a LRIC study (id. at 67).

NYNEX indicates that, although TSLRIC may be appropriate to determine whether a service is subsidized, LRIC is more appropriate for setting economically-efficient prices (id. at 66). NYNEX argues that LRIC measures only the value of the additional volume-sensitive resources that society expends to supply additional units whereas TSLRIC includes not only volume-sensitive costs, but all forward-looking service-specific fixed costs (id.). NYNEX also claims that while TSLRIC measures changes in costs averaged over the entire range of output, LRIC measures changes in costs associated with an additional increment of output (id.).

To illustrate the pricing strategies under the two regimes, NYNEX provides an example of a toll service using LRIC and TSLRIC pricing of $0.03 and $0.06 per minute, respectively (id.). NYNEX indicates that, while competitive forces dictate that rates for toll services be set at $0.03 (i.e., the cost for an additional minute), the average price for toll service would need to be at least $0.06 per minute so that toll service as a whole would not be subsidized (id. at 67). NYNEX, which offers several toll calling plans with varying per-minute usage rates, could achieve the average price, for example, by setting the first 100 minutes of use per month at $0.10 per minute and subsequent minutes at $0.04 per minute (id.). According to NYNEX, while such pricing would promote economic efficiency and avoid potential cross-subsidization, it may not comply with a TSLRIC methodology, which would require setting rates at $0.06 (id.). Therefore, NYNEX claims TSLRIC pricing would require NYNEX to recover its service-specific fixed costs equally for all units of service, instead of recovering it where markets permit, as competitors do (id. at 68).

NYNEX argues that the contention by some parties that its marginal costs are stale is unfounded because, as it claims, it has conducted and submitted new marginal cost studies in each of its transitional rate filings (id.). NYNEX also asserts that there is no justification for the Department to depart from its long-standing cost and pricing principles by adopting TSLRIC (id.). Moreover, NYNEX states that the chance of cross-subsidization is substantially mitigated because of NYNEX's price cap and the fact that NYNEX's usage rates are generally far above their costs using either LRIC or TSLRIC (id. at 68-69).

In its Reply Brief, NYNEX addressed the issue of cost studies as it relates to price floors and cost allocation only because, according to NYNEX, the Department has decided to "terminate its investigation into interconnection, mutual compensation, resale, and Universal Service issues" (NYNEX Reply Brief at 3). NYNEX argues that the primary effect of a change to TSLRIC from LRIC, as proposed by the intervenors, would be to severely limit NYNEX's ability to recover its costs by altering the cost and pricing rules on which all its services are based (id. at 30). NYNEX contends that TSLRIC is not only an inappropriate means for setting prices or price floors, but that it would be disruptive and also would potentially require the reconsideration of restrictions placed on NYNEX in D.P.U. 94-50 (NYNEX Initial Brief at 70 and Reply Brief at 30). Accordingly, NYNEX requests that the Department maintain NYNEX's marginal cost study as the appropriate cost methodology for ensuring economically efficient prices (NYNEX Initial Brief at 70).

b. Attorney General

The Attorney General recommends that the Department order NYNEX to perform TSLRIC studies with a markup/contribution for shared and common costs on all essential inputs sold to competitors (Attorney General Initial Brief at 13). He contends that his proposal "establishes a realistic goal of setting NYNEX's prices for essential inputs at levels which would most closely resemble a truly competitive marketplace where prices would be set at their most economically efficient levels based on competitive forces ..." (id. at 14).

c. AT&T

AT&T claims that NYNEX should perform a cost study that calculates the incremental cost for each service, so that the Department can determine whether the prices of monopoly inputs should be marked up to provide contribution towards alleged joint and common costs (AT&T Initial Brief at 19). AT&T argues that, because telecommunications regulation and technology have changed significantly since the Department's cost study decision in 1989, and because the Act requires cost-based pricing of interconnection and network element charges, NYNEX's current marginal cost study is too old to provide proper pricing signals today (AT&T Reply Brief at 5-6). Despite NYNEX's attempt to dismiss complaints of the staleness of its marginal cost data, AT&T argues that the current cost study is based on demand profiles and service configurations that are ten years old and cannot be expected to provide accurate pricing signals (id. at 6-7). Moreover, AT&T argues that NYNEX's marginal cost study is not a true long-run incremental cost study because it is based on a medium-term time horizon and, therefore, cannot include significant changes in demand and technology (id. at 6). AT&T contends that, even if NYNEX's marginal cost study were based on a LRIC approach, pricing based on a TSLRIC cost study is better because, unlike LRIC, it captures all the costs particular to a service, minimizes the problem of joint and common costs, and, therefore, eliminates the anti-competitive effects of adding large amounts of contribution to the prices of monopoly bottleneck services (id. at 7-8). AT&T claims that, unless TSLRIC cost studies are conducted, there will be no proper basis to determine whether NYNEX is engaged in cross-subsidizing its services (id. at 9).

d. MCI

MCI argues that, in order to test and prevent subsidy in the future, NYNEX must perform TSLRIC cost studies (MCI Initial Brief at 42).

e. MFS

MFS indicates that, because NYNEX's cost studies are (1) too old to reflect telecommunications services costs of today, and (2) use a cost methodology different than TSLRIC, a methodology that assigns common costs properly, the Department should require NYNEX to perform comprehensive cost studies that will correct these deficiencies (MFS Initial Brief at 126).

f. NECTA

NECTA claims that new marginal cost studies are necessary due to major changes in NYNEX's deployment of technology, increases in its non-regulated services, and gains in its operating efficiencies and productivity (NECTA Initial Brief at 38). NECTA argues that, because of NYNEX's venture into new competitive and non-regulated services, such as video technology, cost methodologies previously approved by the Department for "phased rate rebalancing "of monopoly services are inadequate to detect when cross-subsidy occurs (id. at 39). Accordingly, NECTA recommends that the Department require NYNEX to submit a comprehensive cost study, supported with documentation, sensitivity analysis, and identification of all costs assigned to interstate and intrastate video operations, that identifies (1) costs and revenues assigned to intrastate telephone operations; and (2) intrastate operational savings (id. at 39-40). Moreover, NECTA argues that NYNEX should be directed to provide the Department with a copy of any interstate video dial tone tariff filing with the Federal Communications Commission ("FCC") and

to provide a cost study supporting the removal of costs from telephone operations when NYNEX offers intrastate cable services (id. at 40). NECTA also maintains that new cost studies are needed to determine universal service funding and the reasonableness of charges for services provided by NYNEX (id.). Furthermore, NECTA contends that the Act, specifically the pricing of network elements under §§ 251 and 252 and determining universal funding under § 254, has increased the need for new cost studies (NECTA Reply Brief at 1-2).

g. CLI

CLI argues that, if competition is to develop, NYNEX's charge to Competitive Local Exchange Carriers ("CLECs") for monopoly services, such as interconnection, unbundled loops, directory listings, directory assistance, and interim number portability, should be based on properly conducted TSLRIC cost studies (CLI Initial Brief at 120). CLI claims that a properly designed TSLRIC study also would help determine whether a universal service subsidy is required (id.). According to CLI, NYNEX's present cost studies are too old and do not use a TSLRIC methodology, which properly assigns common costs based on cost causation principles (id. at 121).

h. DOD

DOD argues that, in the emerging competitive environment, it is important that NYNEX conduct new cost studies (DOD Initial Brief at 19). DOD contends that the Act requires that state regulatory authorities have detailed cost data from incumbent LECs in order to determine just and reasonable rates for interconnection, network elements, and wholesale services (DOD Reply Brief at 4). DOD also argues that it is essential to have price ceilings on monopoly services

in order to prevent NYNEX from overcharging competitors and price floors on competitive services in order to prevent cross-subsidies (id. at 4). According to DOD, price floors should be based on TSLRIC as described by MCI in this proceeding (id. at 5).

3. Analysis and Findings

It is undisputed by the parties in this case that TSLRIC is the proper methodology to use to determine whether a service is subsidized.[4] The question then is whether LRIC or TSLRIC is the appropriate cost measure to use as the basis for price floor computations and the pricing of monopoly/essential services.

TSLRIC is determined by taking the long-run incremental cost of an entire service and dividing it by the expected output. As a result, TSLRIC is referred to as the average incremental cost of the entire service. It includes all forward-looking costs that are variable with the offering of a service as well as forward-looking, service-specific fixed costs, which are recovered equally from each unit sold.

In contrast, LRIC represents the volume-sensitive costs that a firm incurs in producing an additional increment of output. LRIC does not include forward-looking service-specific fixed

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[4] In its Reply Brief, NYNEX addressed only the issue of cost studies as it relates to price floors and cost allocation (and not also the pricing of monopoly services and measurement of subsidies) because of what it calls the "Department's decision to terminate its investigation into interconnection, mutual compensation, resale, and Universal Service issues" (see NYNEX Reply Brief at 3-4, citing April 23, 1996 Hearing Officers Ruling). While the Department did remove those issues from consideration in this docket, the April 23, 1996 Hearing Officers Ruling did not state that by taking that action, the Department was discontinuing its investigation of cost studies within the context of the measurement of subsidies and the pricing of monopoly services.

costs (i.e., costs that do not change as output changes but nevertheless are incurred to produce the service).

Thus, TSLRIC is more consistent than LRIC with the principles of common carriage in G.L. c. 159, § 19, which require that monopoly services and essential elements be priced on a nondiscriminatory basis for similarly-situated customers. See G.L. c. 159, § 19. The statute states that "[n]o common carrier shall ... refund, or remit directly or indirectly, any rate ... except such as are ... regularly and uniformly extended to all persons and corporations under like circumstances for the like, or substantially similar, service." Id. Because TSLRIC is the average incremental cost of the entire service, it also is more consistent with the Act, which requires that customers in rural and high cost areas have access to telecommunications services at rates that are "reasonably comparable to rates charged for similar services in urban areas." See Act, § 254(b)(3).

Accordingly, because the TSLRIC methodology ensures that all similarly-situated customers pay an equal portion of service-specific fixed costs and because it is the best methodology for determining whether a service is subsidized, we find that it is appropriate to use TSLRIC as the basis for determining the prices of NYNEX's monopoly/essential services, for computing price floors for monopoly services, and for measuring subsidies.[5]

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[5] We note that the FCC in its August 8, 1996 Final Rules in its Local Competition Rulemaking adopted a TSLRIC cost methodology (which it termed Total Element Long-run Incremental Cost or "TELRIC") for the pricing of unbundled network elements. In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, FCC 96-325, pp. 355-356 (rel. Aug. 8, 1996) ("Local Competition Rules"). In comments submitted to the FCC

(continued...)

On the other hand, for competitive services, companies have the ability to recover service-specific costs disproportionately from customers based on their usage level. For example, the Department has approved various customer-specific pricing plans filed by carriers. Customer-specific pricing plans allow carriers pricing flexibility to respond to competitive bidding situations. Service prices differ from customer to customer depending on the usage level committed by the customer. Therefore, because the use of LRIC allows flexibility in recovering service-specific costs, we find that it is appropriate to use LRIC as the basis for determining the prices and price floors for NYNEX's competitive services.[6]

The final issue for determination is whether NYNEX's Marginal Cost Study VI ("MCS VI") is appropriate as a LRIC study. Some parties argue that MCS VI, adopted by the

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(...continued)

in that docket, the Department argued that interconnection and unbundled network elements should be priced at TSLRIC, after the establishment of explicit universal service funding mechanisms. The Department stated that "[a]fter implicit universal service subsidies are removed from retail and wholesale rates and replaced with an . explicit universal service mechanism, rates for interconnection, network elements, and reciprocal compensation should be set equal to the incumbent [Local Exchange Carrier] LEC's total-service, long-run incremental cost (TSLRIC) of providing the service, plus a portion of fixed and common costs distributed on the basis of Ramsey pricing principles.... In addition, if it is demonstrated by the incumbent LEC that it has fixed and common costs which would not be recovered with TSLRIC pricing, a portion of such costs should be recovered in interconnection, network element, and reciprocal compensation rates based on Ramsey pricing principles." Massachusetts Department of Public Utilities' Initial Comments, CC Docket No. 96-98, at 10-11 (May 15, 1996).

6 We believe that the two-part price floor approach, in conjunction with TSLRIC essential input pricing, that we adopt in this Order and the basic residential rate freeze ordered in D.P.U. 94-50 will not allow NYNEX to recover disproportionate amounts of contribution from monopoly customers. We would expect any attempt to price services too far above TSLRIC would be met by a response from competitors.

Department in D.P.U. 86-33-G, is not appropriate because (1) it is not a LRIC study, and (2) even if the Department finds that it is a LRIC study, the data contained in MCS VI are too stale to provide proper pricing signals. NYNEX, on the other hand, argues that MCS VI is a LRIC study and that its data are not stale because it has submitted updated marginal cost studies in each of its transitional rate filings. We find that NYNEX's MCS VI is a LRIC study and can serve as an appropriate basis for determining the prices and price floors for NYNEX's competitive services (see Tr. 7, at 174). In addition, we find that parties' claims that the data contained in MCS VI are stale are unfounded. As stated in D.P.U. 94-50, for each transitional filing, NYNEX was required to conduct and submit new marginal cost studies, which, "though not approved by the Department in those proceedings, were utilized by the Department in making its decisions in the transitional rate filing cases." D.P.U. 94-50, at 501.

Therefore, in compliance with the findings in this Order and consistent with the FCC's Local Competition rules, the Department directs NYNEX to develop and file a comprehensive description of the method it proposes to use to complete its TSLRIC cost study within 60 days of the date of this Order. Within 60 days of the approval by the Department of that method, NYNEX shall submit a geographic-based TSLRIC study, complete with supporting documentation, for all monopoly services and essential network elements, performed in accordance with the approved TSLRIC method.[7]

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[7] In Docket 96-325, at 387, the FCC ordered that states create a minimum of three cost-related rate zones to implement deaveraged rates for interconnection and unbundled elements.

C. Price Floors

1. Introduction

In D.P.U. 94-50, at 205, the Department determined that explicit price floors for NYNEX's services, both monopoly and competitive, are necessary to prevent cross-subsidization and anti-competitive pricing. In that Order, the Department concluded that the appropriate price floor for a NYNEX rate element depends on whether NYNEX controls an essential input for a competitor's offering of a competing service, and found:

> For those services where NYNEX controls an essential input for a competitor's offering of a competing service, in order to prevent anti-competitive pricing, the proper price floor for NYNEX's own rate element shall consist of the relevant wholesale rate that at least one competitor pays to NYNEX in order to offer the service, and NYNEX's marginal cost of related overhead. For all other services, in order to prevent cross-subsidization, the proper price floor shall be the marginal cost, as reported in [NYNEX's] most recent marginal cost study, MCS VI.

Id. at 205-206.

At issue in this docket is the interpretation of the Department's directives above, specifically (1) the definition of the term "service" in setting price floors, (2) the determination of "essential inputs," and (3) the appropriate calculation of price floors for NYNEX's services.

2. Positions of the Parties

a. NYNEX

NYNEX argues that it offers a reasonable and practical approach to the computation of price floors, which takes into account the emerging competition at the local level and the way services are purchased by customers in competitive and non-competitive markets (NYNEX Initial

Brief at 120). NYNEX also maintains that, using its recommended approach, its retail prices comport with the price floors established, except for Coin Service rates (id. at 120).[8]

NYNEX offers two definitions of "service" for purposes of establishing price floors. NYNEX defines the Rate Element Approach as the method in which "each rate element or tariffed charge constitutes a separate service" (id. at 122). The other approach is to define a service by "[taking] into account the configurations through which customers actually subscribe to offerings," which NYNEX calls the Purchase Approach (id.). NYNEX indicates that the Purchase Approach analysis is based on average customer characteristics (NYNEX Reply Brief at 24, citing Exh. NYNEX-143, Attachment 2, Tab (A)(1)).

NYNEX argues that the Purchase Approach is the only viable method for establishing price floors. NYNEX contends that the Rate Element Approach assumes it would be possible for customers to purchase each tariffed item on a separate basis, and maintains that this assumption is both factually incorrect and does not reflect the way customers purchase services (NYNEX Initial Brief at 123). In arguing that use of the Rate Element Approach would lead to untenable results, NYNEX cites an example from the testimony of NYNEX witness Paula Brown:

> For example, [if the Rate Element approach were used] a service like business local usage would show a deviation in one rate element but exceed the price floor in another rate element. In reality, the average per minute charge that a customer pays exceeds the price floors of the elements when combined (id. at 123, citing Exh. NYNEX-142, at 8).

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[8] NYNEX indicated that it would make a proposal to address the coin price floors in the 1996 price cap annual filing (NYNEX Initial Brief at 120, citing Exh. NYNEX-142, at 15).

NYNEX maintains that this result would occur if the Rate Element approach is used and would necessitate a redesign of NYNEX's rate structure (id. at 123).

The Purchase Approach, on the other hand, is both viable and practical according to NYNEX, because it "reflects the way in which service is actually purchased and used by customers" (id. at 123). NYNEX argues that since many rate elements must be purchased together, individual price floors are irrelevant (id. at 123-124). Rather, NYNEX contends that a total price floor for the service offering is the proper measure for identifying anti-competitive prices, since it is the entire service which a competitor would consider in any marketing strategy (id. at 124).

Regarding AT&T's argument that NYNEX should adopt a definition of service similar to the definition submitted by NYNEX's witness, Thomas Caldwell, in D.P.U. 94-50, NYNEX contends that AT&T has taken the testimony out of context (id. at 124).[9] NYNEX argues that Mr. Caldwell's testimony was made "in the context of establishing rules for applying the price cap formula," and not for establishing price floors (id.; NYNEX Reply Brief at 22). NYNEX maintains that Mr. Caldwell's use of the term "service" includes configurations of multiple offerings and features, which it contends is what the Purchase Approach is designed to achieve (NYNEX Reply Brief at 22).

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[9] In responding to an information request in D.P.U. 94-50, NYNEX's Caldwell provided the classification of NYNEX services by category (basic monopoly, auxiliary monopoly, basic competitive, and auxiliary competitive) that resulted from the Department's Order in D.P.U. 92-100 (Exh. AT&T-6).

NYNEX argues that marginal costs, as approved by the Department in D.P.U. 93-125, are the relevant price floors for all services in which NYNEX does not control an essential input (NYNEX Initial Brief at 125). NYNEX indicates that the Department's directives in 94-50 are explicit in this respect (id. at 120). However, for local, toll and 800 usage, NYNEX considers switched access to be an essential input, requiring an analysis of the wholesale price and the marginal cost of related overhead of each service in order to determine the price floor (id. at 125).

In calculating price floors for these services, which contain essential inputs, NYNEX considers two scenarios: (1) an Existing Tariff scenario, and (2) a CLEC Competition scenario (NYNEX Reply Brief at 34). In the Existing Tariff scenario, NYNEX considers both originating and terminating access as essential inputs for toll and 800 usage, while in the CLEC Competition scenario only terminating access is considered essential, since NYNEX assumes that CLECs will be able to offer alternative originating access (NYNEX Initial Brief at 125; NYNEX Reply Brief at 34). NYNEX also argues that since the link is not an essential element, it should not be included in either scenario for purposes of establishing price floors (NYNEX Initial Brief at 125). NYNEX maintains that in light of the emergence of local competition, the CLEC Competition view of inputs should be used in the price floor analysis (NYNEX Reply Brief at 35). Regarding the Attorney General's argument that NYNEX's price floors are below the proposed link rates, NYNEX maintains that the Attorney General's beliefs are based upon a review of an incorrect summary, that was originally filed and later corrected, in the testimony of NYNEX's witness, Paula Brown (id. at 37-38).

NYNEX contends that the marginal-related overhead cost used in calculating price floors is the aggregate of two elements: (1) the difference between retail and wholesale related overheads, and (2) any network cost differentials in providing retail versus wholesale service (NYNEX Initial Brief at 126, citing Exh. NYNEX-143, at 11-17). For the first element, NYNEX uses expense ratios to calculate the retail and wholesale related overheads. NYNEX reviews each of its expense accounts and assigns expenses to either a retail or wholesale category, and then assigns all expenses in the retail category to either a Residence, Business, or Coin category, with similar wholesale categories determined by mirroring the percentage of expenses in each retail category (Exh. NYNEX-143, at 12-13).[10] NYNEX then examines revenue by Residence, Business, and Coin categories, and calculates expense-to-revenue ratios for each category (id. at 13). NYNEX determines an overhead rate for each category by first multiplying the expense ratio by the appropriate retail or wholesale price, and then subtracting the resulting wholesale rate from the retail rate, resulting in the marginal overhead expense component of the price floor for that category (id.). NYNEX states that the network marginal cost differentials, the other component of price floors, are calculated using MCS VI (NYNEX Initial Brief at 126).

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[10] NYNEX states that expenses are based on the accounting reports for the twelve months ending December, 1994, for the following accounts: Account 6611 - Product Management; Account 6612 - Sales; Account 6613 - Product Advertising; Account 6623.1 - Customer Account; Account 6623.2 - Service Ordering Processing; Account 6623.3 - Coin Collections and Public Commissions; Account 6623.4 - Customer Instruction; and Account 6623.7 - Commission, Non-Public (NYNEX Initial Brief at 126, citing Exh. NYNEX-143, at 12-16).

NYNEX argues that its approach to marginal overhead calculations is simple and reasonable, while AT&T's embedded cost allocation method is "complicated, fatally flawed and untested" (id. at 126).

b. Attorney General

The Attorney General argues that NYNEX's price floor filing contains insufficient and unreliable information which should not be used to establish price floors (Attorney General Initial Brief at 113). Instead, he recommends that the Department conduct a limited, further investigation into appropriate price floors, since NYNEX's proposal sets price floors at too low a level, and no other party has offered a complete set of alternatives (id. at 113). The Attorney General suggests that NYNEX should be required to: (1) present alternative price floor calculations based on overhead rates 5, 10, and 15 percent higher than any rate it assumes, (2) present price floors for each tariffed service offered, (3) present calculations assuming that the link is an essential input in the near term, and (4) file price floors based on TSLRIC (id. at 122, citing Exhs. MCI-52, at 4; AT&T-143, at 12). He also notes that although he finds NYNEX's price floors flawed, he finds the status quo acceptable at least for a brief period prior to the next compliance filing (id. at 122).

The Attorney General expresses concern that NYNEX consciously chose not to develop price floors that track existing, tariffed services (id. at 118, citing Tr. 20, at 94-98; Exh. AT&T-143, at 23). The Attorney General notes that NYNEX's use of the term service to mean bundled configurations based upon how customers subscribe to offerings contradicts NYNEX's own witness in D.P.U. 94-50, Thomas Caldwell, whose service definition tracks actual tariffs (id. at

119, citing Exh. AT&T-143, at 23-24). The Attorney General further argues that NYNEX's approach is fundamentally flawed because it assumes that CLECs will offer near-identical arrays of services to NYNEX's, and assumes that customers will subscribe to these services in the same ratios as current NYNEX customers (id. at 120, citing Exh. NYNEX-142, at 6).

The Attorney General contends that NYNEX's proposed price floor calculations contain a number of flaws including: (1) the absence of the link as an essential input, and (2) an understatement of NYNEX's true overhead costs (id. at 115-118). The Attorney General argues that "[w]hile NYNEX asserts that the link is not an essential input, the link should be considered essential for competition to develop" (id. at 115, citing Exhs. AT&T-143, at 26-27; MCI-52, at 17). The Attorney General notes that in some cases NYNEX's price floors for particular services are less than NYNEX will charge its competitors for the link, an essential input (id. at 115). The Attorney General also advises the Department to be skeptical of NYNEX's calculation of retail costs, explaining that although the 35 percent differential between wholesale and retail rates in the interexchange market may not directly indicate the magnitude of retail overhead expenses in the local exchange market, it "strongly suggests that NYNEX has understated its true overhead costs" (id. at 117). The Attorney General agrees with AT&T's criticism of NYNEX's failure to include certain common costs in retail overhead expenses that "vary proportionately with aggregate direct costs" (id. at 118, citing Exh. AT&T-143, at 4, 15).

c. AT&T

AT&T argues that NYNEX's price floor filing should be rejected and that the Department should order NYNEX to perform proper TSLRIC studies for each of its tariffed services (AT&T Initial Brief at 29).

AT&T contends that neither the Rate Element Approach nor the Purchase Approach, as defined by NYNEX, adequately provide service-specific price floors (id. at 35-37). Regarding the Rate Element Approach, AT&T agrees with NYNEX's own criticism; however, regarding the Purchase Approach, AT&T maintains that it "renders meaningless the resulting price floors because it precludes any determination of whether individual service prices are anti-competitively low or reflect cross-subsidies between services" (id. at 36). AT&T argues that NYNEX should instead use the definition of service as provided by NYNEX's witness, Thomas Caldwell, in an information request response in D.P.U. 94-50 (id. at 39).[11] Mr. Caldwell's definition classifies services under four categories: basic monopoly services, auxiliary monopoly services, basic competitive services, and auxiliary competitive services (Exh. AT&T-6).

AT&T argues that the proper measure of incremental costs for the purpose of establishing price floors is TSLRIC (id. at 29). AT&T contends that establishing prices based on TSLRIC "mimics the efficiency results that are produced by a competitive market," and is therefore the only cost measure that insures against cross-subsidization by another service (id. at 30, citing Tr. 2, at 61-63). Regarding NYNEX's claim that it be allowed to price any particular unit of a service at LRIC as long as the service recovers its TSLRIC on an aggregate basis, AT&T responds that

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[11] The document submitted by Mr. Caldwell in D.P.U. 94-50 is taken from an attachment to testimony submitted by NYNEX's Paula Brown in D.P.U. 93-125.

since LRIC excludes service-specific fixed costs, pricing at LRIC would be anti-competitive and would allow NYNEX the opportunity to recover its service-specific fixed costs from less competitive, high-cost regions or markets (id. at 31).

AT&T argues that since NYNEX's price floor calculations are based on MCS VI, which is not a TSLRIC methodology or even a long-run view of cost causation, the Department should order NYNEX to perform proper TSLRIC studies for each of its tariffed services (id. at 32).

AT&T argues that NYNEX's price floor filing is deficient in three other areas: (1) the calculation of the retail overhead expense factor is too low, (2) the wholesale overhead expense factor is overstated, and (3) an inadequate identification of "essential inputs" is used (id. at 39, 43).

The first deficiency, according to AT&T, is that NYNEX has incorrectly calculated its retail costs, which NYNEX claims are 13 percent of its retail revenues (id. at 40). Instead, AT&T offers the testimony of its witness, Brenda Kahn, who calculates retail overhead expenses at 31.6 percent for local services, and 26.8 percent for toll services (id. at 41).[12]

AT&T maintains that the second deficiency (that NYNEX has materially overstated its wholesale overhead expenses) is a result of (1) NYNEX's failure to distinguish between switched and special access expenses, and (2) the use of an incorrect factor in determining the amount of wholesale switched access that is switched through tandem switches (id. at 42). As a result of this

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[12] AT&T claims that calculating expense factors based on local versus toll services is more appropriate than NYNEX's method of calculating them based on customer classes because NYNEX's current services are broken down between local and toll service offerings (AT&T Initial Brief at 41-42).

overstatement, and given the insignificant difference between directly assignable overhead expenses for wholesale and retail services, AT&T also argues that the network cost differential should be eliminated from the price floor filing (id. at 42-43).

The third deficiency, AT&T claims, is that neither NYNEX's Existing Tariff nor its CLEC Competition scenario realistically reflects the current situation of emerging local competition (id. at 44). AT&T maintains that competition will develop through combinations of facilities-based and resold services, so there will be no CLEC that can offer ubiquitous facilities-based competition, as NYNEX has assumed for its "CLEC Competition" scenario in its price floor filing (id. at 44). Rather, AT&T maintains, CLECs will need both originating and terminating access to provide competitive toll and 800 services, making them essential facilities (id.). Also, AT&T argues that NYNEX's price floor filing should include the price of a link, and of originating local switched access, since competitors will be required to purchase either a link or bundled or unbundled wholesale exchange services from NYNEX in order to compete (id. at 44).

Given the deficiencies asserted in its Initial Brief, AT&T requests that the Department require NYNEX to resubmit its price floor filing within 30 days of a final order issued in this case (id. at 45).

d. Department of Defense

The Department of Defense argues that LRIC is the appropriate basis for calculating price floors (DOD Initial Brief at 19). Since a service that is priced above LRIC is making a contribution to the firm's common costs, DOD maintains that a service priced below its LRIC is being subsidized, which would suggest possible cross-subsidization by monopoly services (id. at

19). The DOD argues that there are three fundamental characteristics that make TSLRIC the appropriate type of long-run incremental cost measure: (1) the planning horizon is long enough to contemplate the replacement of capital investment, (2) a single cost study is performed for the entire service based on the total quantity of that service required by all users, and (3) the costs reflect the least-cost forward looking technology that would be employed if the firm were starting anew to provide the service (DOD Reply Brief at 5-6).

e. MCI

MCI argues that the price floor rules established by the Department in D.P.U. 94-50 do not go far enough to prevent NYNEX from being able to put its dependent competitors in a price squeeze (MCI Initial Brief at 46). Instead, MCI suggests that the Department should require that the price for any NYNEX service equal or exceed the sum of the following:

a) the tariffed rate for each monopoly building block used to provide the service (times the quantity of the building block used);

b) the TSLRIC of providing the other functions that are used to provide the service, but which are not separately tariffed; plus

c) any other service-specific costs of providing the service

(MCI Initial Brief at 47).

In its Reply Brief, MCI expresses concern that the price floor issue may be rendered moot by the Act (MCI Reply Brief at 3). MCI maintains that until it is clear whether different pricing standards will apply to the pricing of an incumbent local exchange carrier's ("ILEC's") toll access versus its exchange access than those applied to the pricing of its local exchange service versus

unbundled local loops, the Department will be unable to determine if the price floor issue has been rendered moot (id. at 3).

f. Sprint

Sprint argues that essential services should be priced above economic costs (Sprint Initial Brief at 12). Alternatively, Sprint maintains that price floors for competitive services should impute in the aggregate the same charges for essential network services as competitors pay the incumbent for the same services, plus the costs of other services actually used by the incumbent telephone company (id. at 12-13, citing Exh. Sprint-1, at 38).

3. Analysis and Findings

a. Definition of "Service"

Although NYNEX has offered two possible definitions of the term "service" in the context of price floors, AT&T and the Attorney General have correctly noted that neither of these definitions identifies the disaggregated services which NYNEX offers its customers. The Rate Element Approach is too specific, and ignores the reality that certain rate elements can only be purchased collectively, while the Purchase Approach is too broad, ignoring the reality that competition may exist for parts of the aggregate service. Competition should be given the opportunity to develop for all services which a consumer can purchase on an individual basis, including the underlying exchange service and any premium toll services.[13] Furthermore, NYNEX has based the Purchase Approach on average usage, which is an inappropriate measure for

[13] It would be unproductive to promote competition in the local market without providing consumers with as many choices as possible for as many services as possible.

considering price signals of flat-rated and measured services.[14] Accordingly, the Department finds that neither the Rate Element nor the Purchase Approach correctly identifies the services for which price floors are needed to prevent cross-subsidization and anti-competitive pricing.[15]

Thus, the Department concludes that the term "service" should be used to identify services which (1) are available for purchase by consumers or carriers, and (2) have a specific tariffed rate filed with the Department. Each price floor should be judged against an existing tariffed rate or a sum of existing tariffed rates.[16] Using this definition of "service," the Department directs NYNEX to file within 90 days of the date of this Order, a proposed list of services for which price floors subsequently will be calculated.

b. Determination of "Essential Inputs"

Currently, low-volume customers have no alternative to NYNEX for reaching their toll service providers, given NYNEX's position as an incumbent local exchange carrier. Therefore, a

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[14] For example, high-use customers of flat-rated premium toll services may pay an effective per-minute toll rate that is lower than the incremental cost for toll service, even if NYNEX's average revenue of the service covers the incremental cost of the service. However, the Department recognizes that the problems associated with average usage may be mitigated by the Act's requirement that NYNEX file wholesale versions of all of its retail services. D.P.U. 94-50, at 206.

[15] Regarding AT&T's recommendation that the Department adopt the definition of service used by NYNEX's Caldwell in D.P.U. 94-50 that groups NYNEX's services into four broad categories, the Department agrees with NYNEX that many services in that classification include multiple configurations, making it very similar to the Purchase Approach.

[16] To the extent that rate elements can only be purchased collectively, such as the per-message and per-minute charges incurred in the first minute of a local measured call, the proper price floor should include all charges for rate elements incurred as a result of using that particular service.

switched access competitive marketplace does not exist with respect to these customers. However, since dedicated access becomes more cost-effective than switched access at higher volumes of traffic, and dedicated access is currently available from companies other than NYNEX, high-volume customers do have an alternative to switched access for reaching their toll service providers. Because competitive provisioning of originating and terminating access is limited to these high-volume customers, the Department finds that both originating and terminating access should be considered essential elements for generally-tariffed services. Similarly, absent facilities-based competition, the link is an essential facility for basic local exchange service, and should therefore be included in all price floor calculations for services that include the dial-tone line rate.

c. Appropriate Calculation of Price Floor

As noted above, the price floor for NYNEX's services which contain inputs essential to the offering by a competitor of a competing service is the "relevant wholesale rate that at least one competitor pays to NYNEX in order to offer the service, and NYNEX's marginal cost of related overhead." D.P.U. 94-50, at 205-206. The record in this case demonstrates the need to provide additional guidance on how NYNEX should calculate the marginal cost of related overhead.

Correctly calculated, the marginal cost of related overhead of a service should reflect the LRIC incurred in providing the service at retail. NYNEX proposes to include network cost differentials in its calculation of non-network incremental retail costs. Network cost differentials, which may exist between providing service at wholesale and at retail, are not currently subject to competitive pressures. Until a fully developed facilities-based market exists, and downward

pressures exist on wholesale prices, incentives are minimal for NYNEX to improve its efficiency of providing services at wholesale. Therefore, the Department finds that network cost differentials should not be included in the calculation of price floors.

NYNEX also proposes to calculate these non-network incremental retail costs using Residence, Business, and Coin categories. AT&T proposes calculating them using local and toll categories. The Department finds that local and toll are more appropriate categories for distributing overhead retail costs since product costs are more likely to vary by function than by customer class. We disagree, however, with AT&T's proposed allocated costing methodology which may include unavoidable common costs in its calculations. Since wholesale rates should recover the common costs which are unavoidable, whether providing the service at retail or wholesale, it would be inappropriate to include them again in the calculation of non-network incremental retail costs.

d. Conclusion

As noted above, NYNEX is required to file within 90 days of the date of this Order, a list of services for which price floors will subsequently be calculated. Within 60 days of the Department's approval of that list of services, NYNEX is required to file price floors for all of its services in compliance with the directives in this Order. Rates for all of NYNEX's regulated services must meet or exceed the price floor by NYNEX's third annual price cap filing.

D. Dispute Resolution

1. Introduction

Given the Department's authority over common carriers, a dispute resolution process may be required to address the inter-carrier disputes which will likely arise in a competitive local exchange market.

2. Positions of the Parties

a. NYNEX

NYNEX argues that the Department's existing Rules of Practice provide suitable mechanisms for inter-carrier disputes to be heard (NYNEX Initial Brief at 139, citing Exh. NYNEX-16, at 82-83). In addition to the existing procedures, NYNEX suggests a separate process, modeled after the FCC's Open Network Architecture plan, for handling requests for unbundled network components (id. at 139-140). The FCC's plan includes specific standards for considering unbundled requests, time frames for a carrier to respond to requests, and regulatory review, if necessary (id. at 140). Regarding additional proposals suggested by other carriers, NYNEX claims that it would welcome Department staff participation at the early stage of a dispute, but any other type of proposal would not meaningfully improve upon existing Department procedures (id.).

NYNEX also argues that regardless of the positions taken by other parties in the case, the Act sets forth a process that should satisfy all parties, making further action by the Department unnecessary (NYNEX Reply Brief at 55). NYNEX claims that the Act places an obligation on

the ILEC to negotiate in good faith, and if an agreement cannot be reached, the Act provides a process for state agency arbitration, including specific time frames for all actions taken (id. at 56).

b. Attorney General

The Attorney General argues that an accelerated dispute resolution process should be implemented for all irreconcilable local exchange competition issues because the Department's current complaint process, with its half-year resolution deadline, will be too slow in a rapidly changing competitive marketplace (Attorney General Initial Brief at 102). The Attorney General's recommended dispute resolution mechanism is the following:

1) After two CLECs conclude that they cannot reach an agreement on a local competition issue, either CLEC can request resolution from the Department. The request should be served on both the Department and the requestee-CLEC. Upon a request, the Department should appoint a Hearing Officer and a Department staff person to oversee the matter. If the issues are sufficiently broad, the Hearing Officer may convene an industry task force within 30 days of the receipt of the request, to be chaired by the Hearing Officer. The request will be in the following format:

   a) The request will be in writing to the requestee and the Department.

   b) The request will specifically identify the underlying facts, the specific issues to be resolved and the requester's proposed solution to the issues.

   c) Additional information, deemed necessary to support the response, may be included as appendices.

2) Within 30 days of the filing of the request, the requestee will respond to the Requester-CLEC and the Department, unless the 30 days has been extended by mutual agreement. The response will be in the following format:

   a) The response will be in writing to the requester and the Department.

   b) The response will specifically identify the decision made and the underlying facts on which the decision was based.

c) Additional information, deemed necessary to support the response, may be included as appendices.

3) If the Requestee-CLEC indicates that it will comply with the request, the matter will be considered settled, unless the Department deems otherwise. The requestee-CLEC then has 30 days to comply with the request, unless the 30 days is extended by mutual agreement.

4) If the Requestee-CLEC fails to respond within 30 days, or within the time frame mutually agreed upon, or refuses to grant the request, the Hearing Officer will then recommend a resolution of the dispute to the Commission for approval within 30 days after the deadline for the Requestee-CLEC's response.

(Attorney General Initial Brief at 103-104).

c. AT&T

AT&T argues that its suggestions for revised dispute resolution procedures are necessary to facilitate the efficient development of local and intraLATA toll competition, and are designed to make the process quicker and more efficient for all parties concerned, including the Department (AT&T Initial Brief at 99,101).

AT&T recommends a two-stage dispute resolution process with the first stage being a mandatory negotiation phase (id. at 100). AT&T's suggested two-stage process is as follows:

Phase I

1) A negotiation phase should start with a written request to the carrier from which action is required. The Department should be copied, and the notice should be as specific as possible, describing both the issue and a solution.

2) A written response should be required within 30 days of the request unless the time is extended by agreement. The response should be required to be specific, explaining the decision and any action that will be taken.

3) Promised action should be required to be implemented within 30 days of the response, unless the parties agree to a longer period.

Phase II

1) If a negotiated solution cannot be achieved, the aggrieved party should be free to petition the Department.

2) The Department should establish two optional procedures for dealing with such petitions, both with time limitations. They should be:

a) the Department can choose to convene an industry task force[17], or

b) the Department can open an expedited docket

(id. at 101).

AT&T argues that this proposal is the most efficient to adopt because it is most like the federal resolution procedures mandated by the Act (AT&T Reply Brief at 3).

AT&T claims that the flaw in NYNEX's resolution proposal is that it does not require NYNEX to negotiate with new entrants, which can delay effective competition (id. at 3). AT&T contends that its own proposal is designed to encourage negotiation and to reduce the burden on the Department, thus encouraging the rapid development of local competition (id.).

d. DOD

DOD argues that the Department should not delegate its authority to resolve disputes to an outside arbitrator since it has a long history of success in this role, and is uniquely equipped to deal with the complex and important issues that will arise in the emerging competitive environment in the future (DOD Initial Brief at 18). Procedurally, DOD suggests a resolution

[17] AT&T asserts that 30 days should be sufficient for an industry task force to be convened and the Department to issue a recommendation (AT&T Initial Brief at 101).

process similar to that suggested by AT&T (DOD Reply Brief at 3-4, citing Exh. AT&T-4, at 15-16).[18]

e. CLI and MFS

CLI and MFS argue that a dispute resolution process is necessary to prevent the incumbent carrier from delaying competition, and in support, favors the resolution processes that were established in Connecticut and New York (MFS Initial Brief at 122-123; CLI Initial Brief at 117). CLI and MFS claim that in Connecticut, the incumbent is required to respond to all unbundling requests within 40 days; if the CLEC is dissatisfied with the response, it may file a request with the Connecticut Department of Public Utility Control to open a docket, and to set a hearing 30 days from the date of filing (MFS Initial Brief at 123, citing Connecticut Interconnection Order, Attachment A; CLI Initial Brief at 117-118). CLI and MFS similarly claim that the State of New York adopted a resolution process in 1989 that used a task force, chaired by Commission staff, which has enabled all but two or three disputes to be resolved with formal procedures (MFS Initial Brief at 123-124; CLI Initial Brief at 118). Additionally, MFS recommends the use of an "ombudsman" selected from the Department's staff to resolve disputes in the first instance (MFS Initial Brief at 124, citing Exh. MFS-1, at 94-95).

f. Cellular One

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[18] The only change in AT&T's proposal that DOD suggests is that, once the Department receives a petition for consideration, Department staff may recommend a resolution to the Commission for its approval within 30 days, or the Commission can open a docket (DOD Reply Brief at 3-4).

Cellular One maintains that CLECs should be free to negotiate among themselves, but if mutual agreement is not possible, carriers should be able to petition the Department for an investigation (Cellular One Initial Brief at 19). Cellular One suggests that the Department may want to require a period of good faith negotiation before commencing an investigation (id. at 20).

g. NECTA

NECTA recommends an abbreviated dispute resolution process that allows parties to resolve disputes without Department involvement, and one that takes into account the exigencies of competition and promotes economic resolution (NECTA Initial Brief at 28). NECTA argues that although it has outlined a resolution policy that the Department could adopt, it supports proposals of other parties which accomplish the same objective (NECTA Initial Brief at 28, citing Exhs. NECTA-1, at 79; CLI-1, at 39-41; and AT&T-4, at 14-17). In its reply brief, NECTA maintains that the passage of the Act does not eliminate the Department's need for a dispute resolution process (NECTA Reply Brief at 3).

h. MCI

MCI argues that since most disputes will arise after the approval of inter-carrier agreements, there is no urgent need for the Department to establish any particular dispute resolution procedures before the FCC releases its own rules (MCI Reply Brief at 2).

3. Analysis and Findings

While most parties agree that a formal process for dispute resolution will be necessary to resolve inter-carrier disputes in the local market, they disagree on whether the current federal and state resolution processes are suitable. The Act provides a process for resolving interconnection

negotiation disputes and for resolving certain technical disputes between parties to interconnection agreements.[19] However, neither the Act nor the Department's own existing dispute resolution process offers a means for prompt resolution of the many other potential disputes which may arise between carriers during implementation of interconnection agreements. Accordingly, we find that the following deadline-oriented dispute resolution process is an appropriate mechanism for a nascent competitive marketplace. Unnecessary delays will only benefit the incumbent local exchange carrier and may in some circumstances even constitute barriers to entry for CLECs.

a. Negotiation

The resolution of inter-carrier complaints will best be achieved through negotiation between the affected parties. Therefore, we direct carriers to attempt to resolve disputes among themselves during a negotiation period of at least 30 days before seeking assistance from the Department.

b. Mediation

The aggrieved party may petition the Department for mediation. The mediation petition should include all information the aggrieved party believes is necessary for the Department to conduct the mediation. The Department will assign a staff person or a professional mediator,

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[19] See Act, § 252(a)(2) and (b) (concerning state mediation and arbitration, respectively, of disputes arising during interconnection negotiations); see also § 273(d)(5) (concerning requirement that the FCC prescribe a default dispute resolution process when technical disputes arise between non-accredited standards development organizations and any parties who fund the standards-setting activities of these organizations; the FCC implemented the Act's requirement in FCC 96-205).

funded by the petitioning party, to conduct the mediation. The mediation period shall last a minimum of 60 days.

c. Department Investigation

If an agreement cannot be reached through mediation, the aggrieved party may petition the Department to open an expedited investigation into the dispute. The petition should include a comprehensive explanation of the dispute (e.g., unresolved issues, areas of agreement, stipulations of fact), as well as all relevant correspondence exchanged during negotiations and/or mediation. The aggrieved party shall provide a copy of the petition to all parties to the dispute on the same day that it is filed with the Department. The Department will open an expedited investigation within 10 business days of receipt of a petition. The non-petitioning party will have 10 days from the date of the petition to present its comprehensive explanation of the disagreement, as well as all relevant correspondence exchanged during negotiations and/or mediation. The Department's investigation will be streamlined and may or may not include hearings. The Department will issue an order no more than 60 days following the opening of the investigation.

E. Regulatory Safeguards

1. Introduction

In IntraLATA Competition, D.P.U. 1731, the Department stated that "as competitive forces begin to take hold in a market, the Department should begin to reduce the degree of regulation in the market, so that the benefits of competition may be enjoyed by the public. Such a reduction of regulation is consistent with our goal of economic efficiency, since we have found ... that competitive markets provide economic incentives without traditional regulatory review." Id.

at 55. In D.P.U. 1731, the Department found that NYNEX possessed substantial market power in the intraLATA market, and accordingly, we adopted a dominant/non-dominant regulatory framework, classifying NYNEX as a dominant carrier for the intraLATA market.

In Entry Regulation, D.P.U. 93-98 (1994), the Department eliminated the certification requirement for telecommunications providers that want to do business in the state, requiring instead that carriers register with the Department. The Department found that "current market forces, statutory requirements, and the Department's tariff regulations, notice requirements, and consumer complaint resolution process, are sufficient to ensure not only that rates are just and reasonable but that there is adequate consumer protection for interexchange, competitive access, and AOS services, absent the regulation of entry into these markets."[20] Id. at 12.

This section addresses regulatory safeguards that are appropriate for competitors in the local exchange market.

2. Positions of the Parties

a. NYNEX

NYNEX recommends that CLECs be subjected to the same regulatory requirements as NYNEX (NYNEX Initial Brief at 138). More specifically, NYNEX recommends that CLECs file tariffs; comply with the Department's consumer protection rules and regulations as set forth in D.P.U. 18448; have common standards for implementing price changes and pricing flexibility;

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[20] Consumer protections established by the Department include, among other things, residential customer billing and collection regulations (see NET, D.P.U. 18448 (1977)), operator service notice requirements (see ITI, D.P.U. 87-77/88-72 (1988)), and pay-telephone service requirements (see M.G., D.P.U. 90-143 (1991)).

maintain wholesale/retail price relationships; file annual reports, including reports related to the number of business, residence, and lifeline customers; adhere to the same accounting standards; and comply with other statutory requirements (id.). NYNEX argues that, while market forces are more effective in promoting consumer welfare than government regulation, competition works best when all carriers compete for customers solely on their relative efficiency in providing services (id.). NYNEX claims that its proposal is intended to establish a level playing field so that regulation acts in a competitively neutral manner (id.).

NYNEX argues that it is not requesting (1) that the Department depart from its dominant/non-dominant regulatory framework; (2) that CLECs be treated as dominant carriers; (3) that price cap regulation be imposed on CLECs; (4) that CLECs be required to file cost support data with tariffs; or (5) reinstitution of the certification process (NYNEX Reply Brief at 47-48). However, NYNEX maintains that CLECs that intend to charge higher terminating access rates than NYNEX should be required to support the need for higher charges (id. at 48). Moreover, contrary to the claims of MFS and other carriers that other states do not impose any regulatory oversight on CLECs, NYNEX maintains that other state commissions and specifically, the Maryland Commission, impose regulatory requirements on CLECs, such as certification, unbundling of network elements, a prohibition against packaging intraLATA and interLATA toll, and a prohibition against bundling of cable television and telephone services (id.).

NYNEX contends that its recommendations are neither onerous nor unfair to new entrants; they are intended to achieve a neutral regulatory environment and to ensure that all

carriers comply with the Department's regulations, such as billing and collection regulations, which are intended to preserve important public policies (id.).

b. Attorney General

Because NYNEX has bottleneck control over the majority of facilities needed for CLECs to compete, the Attorney General recommends that the Department adopt asymmetrical regulation of NYNEX and CLECs during the development of a competitive local exchange market in the state (Attorney General Initial Brief at 104).

c. AT&T

AT&T requests that the Department reject NYNEX's proposal that regulatory restrictions and requirements be applied to all market participants, because only NYNEX possesses market power and the incentives to abuse that market power (AT&T Reply Brief at 2). According to AT&T, imposing regulatory requirements on new entrants will not only be costly but will create artificial barriers which interfere with customer satisfaction and, therefore, will frustrate competition (id.).

d. Sprint

Sprint argues that NYNEX's recommendation that CLECs be regulated the same way as NYNEX should be rejected because it fails to take into consideration the fact that NYNEX has a dominant market share, controls essential facilities, and has market power in the local telecommunications market (Sprint Initial Brief at 11). Sprint maintains that, because CLECs lack market power, they must set prices and offer services in response to customer demand and satisfaction in order to retain customers (id.). Sprint argues that CLECs' charges to end users

should not be regulated beyond the requirement to file tariffs (id. at 12). According to Sprint, a competitive market offers consumers protection from pricing abuses of non-dominant carriers because consumers will always have the option of buying from another carrier (id. at 11-12). Because NYNEX has almost 100 percent of the market share and exclusive control of bottleneck facilities needed by CLECs, Sprint urges the Department to adopt regulatory safeguards that protect CLECs against NYNEX pricing abuses (Sprint Reply Brief at 3).

e. LDDS

While it does not believe that CLECs should be regulated the same way as NYNEX, LDDS maintains that the Department should adopt several minimum requirements, such as setting switched access rates of CLECs at NYNEX's rates; prohibiting CLECs from restricting resale of services; requiring them to provide both inter- and intraLATA equal access and presubscription and to file tariffs; and prohibiting them from engaging in discriminatory practices (LDDS Initial Brief at 28-29).

f. MFS

MFS notes that the Department, in D.P.U. 1731, adopted a dominant/non-dominant regulatory framework in order to promote intraLATA competition (MFS Initial Brief at 115). Because NYNEX still controls essential facilities, MFS claims that there is no reason for the Department to abandon the dominant/non-dominant regulatory framework (id.). MFS argues that, because it is highly unlikely that a new entrant can retain customers by charging more or providing worse quality of service than NYNEX, the Department's regulation of CLECs must be streamlined and CLECs should not be required to file service quality reports and cost support data

with their tariff filings (id. at 116). Moreover, MFS requests that the Department adopt a one-day notice period for CLECs for filing tariffs rather than the present thirty-day notice period (id. at 117). Furthermore, MFS indicates that the Act makes it clear that Congress does not agree with NYNEX's advocacy of regulatory symmetry between CLECs and LECs (MFS Reply Brief at 1). According to MFS, § 251 of the Act distinguishes the duties that must be imposed on all carriers, all LECs, and incumbent LECs (id. at 2). MFS, therefore, urges the Department to continue to oversee NYNEX's operations until effective intraLATA competition is realized, making the dominant/non-dominant form of regulation unnecessary (id. at 121).

g. TCG

TCG argues that a certification requirement for CLECs is not necessary because the Department could get all the information it needs from a review of a carrier's tariff (TCG Initial Brief at 44). In arguing against the adoption of service quality standards for CLECs, TCG contends that CLECs recognize the importance of maintaining industry parity in order to compete successfully in the market (id. at 44-45). TCG claims that the Department can implement a streamlined reporting requirement and still be able to maintain oversight of the CLECs through the Department's complaint process (id. at 45). TCG argues that CLECs should be allowed to file rates and charges without cost justification and to file changes on short notice (TCG Reply Brief at 7-8). TCG maintains that, while no carrier should be prevented from contracting with customers or responding to competitive bids, the Department should consider regulatory safeguards, such as a "fresh look" requirement that would be applicable only to NYNEX's offering of discounted rates in return for long-term commitments from customers (id. at 8). TCG

indicates that it supports the application of the Department's billing and termination rules to CLECs since they are intended to protect consumers (TCG Initial Brief at 45).

h. NECTA

NECTA recommends that the Department regulate the market entry of CLECs in accordance with the policies adopted in Entry Regulation, D.P.U. 93-98 (NECTA Initial Brief at 24). According to NECTA, the Department's requirement that carriers submit a Statement of Business Operations is a reasonable entry requirement and the filing of tariffs is consistent with G.L. c. 159 (id.). NECTA indicates that the imposition of additional entry requirements, such as the quality of service reporting requirements, would impede the development of local competition (id.). NECTA argues that CLECs should be able to limit their service to specific geographic areas and to provide services on a "phased basis" (id.). NECTA also recommends that the Department maintain its dominant/non-dominant regulatory framework and treat CLECs as non-dominant carriers (id. at 25-26). Furthermore, NECTA requests that the Department endorse the formation of an industry committee, working under the Department's supervision, that will address a "working set of cooperative engineering, operations and maintenance practices and procedures" (id.).

i. CLI

CLI recommends that the Department retain the dominant/non-dominant regulatory structure and that non-dominant carriers should not be burdened with the tasks of filing quality of service standards/reporting and the submission of cost support data with tariff filings (CLI Initial Brief at 110). CLI argues that pricing flexibility for non-dominant carriers is essential for

competition to develop (id. at 111). CLI also recommends that the 30-day notice period for reviewing tariff filings be reduced to a one-day notice (id.). Moreover, CLI maintains that the Department should continue to ensure that all carriers in the intraLATA market observe their common carrier responsibilities and provide service on a non-discriminatory basis (id.).

j. Cellular One

Cellular One recommends that the Department reduce its supervision of telecommunications carriers to the extent possible, without changing its authority to set regulatory guidelines for competition (Cellular One Initial Brief at 20).

k. DOD

DOD argues that regulatory safeguards are required to ensure that customers enjoy the potential benefits of competitive local services (DOD Reply Brief at 6). In order for effective local exchange competition to develop, DOD specifically identifies the need for: (1) a neutral body to administer number assignment; (2) number portability; (3) intraLATA presubscription; (4) network unbundling; (5) equal access to support systems and billing information maintained by NYNEX; (6) comprehensive interconnection agreements; (7) elimination of resale and use of restrictions; (8) open technical standards; and (9) cost-based rates (id. at 6-7).

3. Analysis and Findings

As we noted in Section II.E.1., the Department maintains a dominant/non-dominant regulatory framework, in which NYNEX and AT&T, because of their market power, are classified as dominant carriers in the intraLATA market and all other intraLATA competitors are

classified as non-dominant carriers.[21] All parties to this case, including NYNEX, support the continuation of the dominant/non-dominant regulatory framework for the local exchange market, and the classification of CLECs as non-dominant carriers. Moreover, the evidence overwhelmingly justifies the use of this regulatory framework in the local exchange market, in that NYNEX will retain market power and control of essential facilities for some time while competition develops. Accordingly, the Department will continue to employ a dominant/non-dominant regulatory structure in the local exchange market, with NYNEX classified as a dominant carrier and CLECs classified as non-dominant carriers.

Under this form of regulation, CLECs must register with the Department, in accordance with our registration requirements, and must comply with Massachusetts statutes and regulations on tariff filings. However, unlike NYNEX, CLECs may file tariff revisions for existing and new service offerings with minimal cost-support documentation. Lacking market power, CLECs will have to set prices and offer services in response to customer demand and satisfaction in order to acquire and retain customers.

NYNEX argues that in addition to the present Department registration and tariff filing requirements, CLECs that intend to charge higher terminating access rates should be required to (1) support the need for higher charges; (2) comply with certain reporting requirements that include, among other things, reports related to the number of business, residence, and lifeline

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[21] AT&T is classified as a dominant carrier in the interLATA and intraLATA toll markets in Massachusetts. On December 29, 1995, AT&T filed a petition with the Department to be reclassified as a non-dominant carrier. That petition was docketed as D.P.U. 95-131 and is currently under investigation.

customers; (3) adhere to the same accounting standards; and (4) comply with statutory requirements that apply to common carriers. In its comments on the FCC's Interconnection Notice of Proposed Rulemaking, the Department stated that "[r]eciprocal compensation rates should be symmetrical and based on the incumbent's rate, unless the new entrant proves to the state's satisfaction that its transport and termination costs are higher than the incumbent LEC's rate." Massachusetts Department of Public Utilities' Interconnection Comments, CC Docket No. 96-98, at 13 (May 15, 1996). CLECs that intend to charge higher terminating access rates must file supporting documentation showing that their costs actually are higher than NYNEX's costs. Absent such a showing, a CLEC cannot charge terminating access rates higher than what NYNEX charges the CLEC. We do not think that the other requirements proposed by NYNEX are necessary to protect consumers. Therefore, the Department finds that CLECS do not need to comply with the reporting and accounting standards to which NYNEX is subject. In addition, CLECs are exempted from the service quality reporting requirements imposed on NYNEX.

However, even though customers will have choices and will be able to switch local exchange carriers if they are not satisfied with their carrier's prices and services, the record does not support a finding to eliminate the unique protections afforded residential customers under the Department's billing and termination regulations. Residential customers have relied on the protections of the Department's billing and termination regulations, and we think that those safeguards should be continued, at least until we see robust competition in the local exchange market.[22] We recognize that the Department's billing and termination regulations, established in

(continued...)

1977 in D.P.U. 18448, may be outdated and inappropriate for certain carriers. Therefore, the Department intends to open a rulemaking proceeding to establish new billing and termination regulations.

Finally, certain CLECs requested that the Department shorten the tariff review period from 30 days to a one-day notice. The 30-day notice provision for tariffs is a statutory requirement, and the Department has only limited authority to shorten it.[23] While the Department has been in favor of shortening the 30-day tariff review period, our efforts over the past several years to obtain legislative change have been unsuccessful. We will continue to seek legislative change, but until the statutory requirement is amended, carriers must comply with the 30-day notice provision. Of course, carriers can continue to ask for expedited review where good cause necessitates.

(...continued)

[22] Ironically, exemption from complying with the Department's billing and termination regulations could actually work against CLECs since there is some anecdotal evidence to suggest that some residential consumers are unwilling to switch carriers unless they are assured of the same billing and termination protections.

[23] G.L. c. 159, § 19, requires that "... no change shall be made in any rate, except after thirty days from the date of filing ...." For "good cause shown," the Department may allow changes in tariffs to take effect upon less than 30 days notice. G.L. c. 159, § 19.

III. ORDER

Accordingly, after due notice, hearing and consideration, it is

ORDERED: That all carriers comply with the directives contained herein.

By Order of the Department,

John B. Howe, Chairman

Janet Gail Besser, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).