COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND CABLE

Petition for Investigation under Chapter 159, Section 14 of the Intrastate Switched Access Rates of Competitive Local Exchange Carriers	Docket No. 07-9

RESPONSE OF AT&T CORP. TO CLEC MOTION FOR RECONSIDERATION AND/OR CLARIFICATION

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TABLE OF CONTENTS

Introduction

In a last ditch effort to maintain their excessive access rates, the CLECs argue that the Department is trying to stick them with Verizon's burden of proof to make up for shortcomings in the case they put on. In fact, all Verizon had to demonstrate was that the "market" for switched access services is not sufficiently competitive to permit pricing flexibility for CLECs. Verizon did so. If the CLECs wanted the Department to set CLEC access rates on the basis of their costs after the Department found the CLECs' current rates unjust and unreasonable, it was their responsibility to make this argument and present supporting cost evidence. It was not the Department's responsibility to instruct them to present this evidence or direct them as to how to put on their case as they mistakenly assert on reconsideration.

In addition, the CLECs request for "clarification" of the exemption process is nothing more than a transparent attempt to try to delay, at a minimum, or avoid all together, the implementation of the rate reductions required by the Department's June 22, 2009, Order ("Order"). Such gamesmanship should not be condoned; the CLECs should be required to file any requests for an exemption within three (3) months of the date of the Order to provide sufficient time for the Department and all interested parties to review and, if appropriate, take action on, the exemption request(s) prior to the end of the one (1) year transition period.

Argument

I. VERIZON MET ITS BURDEN.

The CLECs essentially argue that Verizon failed to meet its burden because it failed to show that CLECs rates (and thus rate differences with Verizon rates)

are unrelated to their costs (and thus cost differences with Verizon's costs). The CLEC argument relies on a misapprehension of law. Verizon's burden is not to show that CLEC rates are not cost related. The presumption of reasonableness of CLEC access rates was never based on cost; it was based on the presumption that CLECs do not have market power in the retail and access markets in which they operate. Verizon's burden was met, when it, Comcast and AT&T showed that, contrary to the Department's presumption, CLECs indeed have market power in the unique market for switched access services.

A. VERIZON'S BURDEN WAS TO DEMONSTRATE THAT THE MARKET FOR SWITCHED ACCESS SERVICES IS NOT SUFFICIENTLY COMPETITIVE TO PERMIT PRICING FLEXIBILITY FOR CLECS.

In its June 22nd Order, the Department got it just right. It reviewed the basis for current regulation of access prices and found that that basis has been the presumption that "rates charged by non-dominant carriers for all services and by dominant carriers for ***sufficiently competitive services*** are presumed to be just and reasonable due to the disciplining effects of competitive forces." Order at 8 (emphasis in original), citing D.T.E. 01-31 Phase I, Order at 19, and *IntraLATA Order*, D.P.U. 1731, Order at 64-70. The Department then stated Verizon's burden, which is the issue in this case:

> Therefore, the Department must address whether CLEC access rates are subject to competitive forces. If the switched access market is sufficiently competitive, then continued market-based pricing is appropriate. If the market is not sufficiently competitive, however, then the Department must explore alternative methods of rate regulation to ensure just and reasonable rates.

Id., at 9, citing D.P.U. 87-72/88-72, Order, at 17 (Oct. 11, 1988).

It was not Verizon's burden to show that CLEC access rates exceeded CLEC costs, because cost had never been the basis for the Department's earlier finding that

CLEC rates were just and reasonable. As noted above, the basis had been a presumption that market-determined rates are "just and reasonable due to the disciplining effects of competitive forces." *Id.* at 8. On the issue of "burden," costs were simply irrelevant. For highly efficient CLECs with operations that could outperform the market, their access rates in a competitive market might have far exceeded their own costs; this margin would be their competitive reward, while the competitive market simultaneously protected consumers. The market price in a competitive market would be determined by the relatively less efficient, incremental provider, *e.g.*, a CLEC with higher costs. A carrier's cost would be irrelevant if the Department could rely on the disciplining effects of a competitive market to ensure just and reasonable rates. Verizon's burden, therefore, was not to prove that CLEC rates exceed their costs; it was to prove that the market for switched access services is not sufficiently competitive to permit market-based pricing flexibility.

B. THE EVIDENCE OVERWHELMINGLY SUPPORTS THE DEPARTMENT'S DETERMINATION THAT THE "MARKET" FOR SWITCHED ACCESS RATES IS DYSFUNCTIONAL AND DOES NOT PRODUCE JUST AND REASONABLE RATES.

In their motion for reconsideration, the CLECs reargue the novel theory of their witness that IXCs have "alternatives" to paying extortionate switched access rates on calls originated from or terminated to the CLECs' customers. Reconsideration Motion, at 13-15. The CLECs reargue in their motion that vertically integrated IXCs could avoid paying CLECs the extortionately high switched access rates by acquiring the retail customer whose line is used to generate such revenues. *Id.* Somehow, according to Dr. Ankum, this will put downward pressure on switched access rates.

The Department clearly and explicitly addressed and rejected that argument:

> The CLECs argue that they face competition in the switched access market because the "RBOCs [Regional Bell Operating Companies]/IXCs like Verizon own and operate the last mile loop facilities" and face no barrier "from entering the switched access market and competing away any alleged supernormal profits." . . . CLECs contend that "[i]f Verizon Long Distance believes CLEC's [sic] switched access rates are too high, its affiliate Verizon Massachusetts (the ILEC and owner of the loop over which a CLEC's end users are served) could attempt to win those customers away from the CLEC so that its long distance affiliate can avoid paying the CLEC access charges." . . . The Department is not persuaded by this argument because, even if price signals were received by the called party, the market structure would prevent any competitive pressure from forcing a reduction in rates.

Id. at 12. In short, the Department clearly accepted the evidence of AT&T, Verizon and Comcast that the structure of the switched access market – where the retail customer who chooses the LEC does not pay the price the LEC then charges IXC for access to the retail customer – precludes the normal disciplining effects of competition. Indeed, as AT&T explained,[1] and as the Department recognized, that structure creates a perverse dynamic, where LECs have an incentive to ***increase*** *switched access rates* to subsidize their retail offerings to make it harder for any other LEC to win the customer. *See*, Order, at 12. ("As the LEC charging higher access charges receives that additional revenue, it could use those funds to subsidize its retail offerings, making it harder for Verizon, or any other LEC, to win away customers.").

II. CONTRARY TO THE IMPLICATION OF THE CLECS' ARGUMENT, THE DEPARTMENT HAS NO OBLIGATION TO INSTRUCT CLECS ON HOW TO DEFEND THEIR POSITION.

The CLECs complain that "the lack of company specific cost data should not cut against the Joint CLECs[.]" Reconsideration Motion, at 6. They go on to state that

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[1] *See*, Initial Post Hearing Brief of AT&T Corp., October 30, 2008, at 26-30.

"[t]here was no indication that the Joint CLECs had the burden of proving that their access charges were not unreasonable by means of company-specific cost studies." *Id.* The CLECs misunderstand the role of "costs" in this case.

As noted above, the issue presented at the outset of this case had nothing to do with costs. The issue presented was whether the Department could rely on a competitive market to ensure that CLEC switched access rates are just and reasonable. While CLECs could and did seek to show that the switched access market is competitive (a task that proved impossible), it was always open to them to argue in the alternative that their rates were just and reasonable because they were in line with their costs, and seek to prove it.

Indeed, it was apparent that, if the Department were to find – as it eventually did – that "market"-based switched access rates cannot be presumed just and reasonable because there is no functioning market for switched access, the Department would be under an obligation to establish just and reasonable switched access rates for CLECs. *See*, G.L. c. 159, § 14.[2] Given the very real possibility of a Department finding that there is no basis for believing that the existing "market"-based CLEC rates are just and reasonable *and* a statutory requirement for the Department to fix the CLEC rates at just and reasonable levels, the CLECs had fair warning that an alternative basis for CLEC switched access rates would be "on the table" in this case. If the CLECs wanted the Department to set CLEC access rates on the basis of their costs, it was incumbent upon them to present such costs. It certainly was not the Department's responsibility to ask

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[2] "Whenever the department shall be of opinion, after a hearing had . . . upon complaint that any of the rates . . . of such common carrier . . . are unjust, unreasonable . . . the department shall determine just and reasonable rates . . . and shall fix the same by order[.]" Moreover, the Department explicitly acknowledged its obligation to establish just and reasonable rates in its decision. *See*, Order, at 26 ("Having determined that CLEC rates area unjust and unreasonable, the Department is obligated to institute a rate cap as quickly as possible[.]")

them to do so, especially in light of the fact that there is no statutory requirement that rates be set based on costs. *See*, D.P.U. 94-50 (Feb. 2, 1995 Interlocutory Order) ("Nothing in G.L. c. 159 indicates that the legislature intended to limit the Department to a specific regulatory scheme, such as cost-of-service, rate of return ratemaking.").[3] *See also, id.*, ("the Court has held that in some circumstances the Department is not even bound to adhere to cost-based standards").[4]

III. USE OF VERIZON'S ACCESS RATE AS A PROXY IS WELL ESTABLISHED DEPARTMENT PRECEDENT AND GOOD PUBLIC POLICY.

The CLECs argue that use of Verizon's access rates as a cap for CLEC access rates is in error. Their argument flies in the face of well established Department practice as well as the practice of Commissions in other states and of the FCC and – most importantly – would justify the imposition of unreasonable and unnecessary costs on ratepayers.

A. THE CLECS PROVIDE NO REASON TO DEVIATE FROM THE WELL ACCEPTED PRACTICE OF USING THE INCUMBENT'S RATE AS A PROXY.

CLECs have been operating under rates capped at the incumbent's level in the federal jurisdiction since at least 2001.[5] Moreover, CLECs have continued to operate in every state whose Commission has capped the intrastate rates – all states whose Commissions have addressed this issue. Yet, the CLECs want special treatment in Massachusetts.

The CLECs acknowledge that, in Massachusetts, use of the incumbent's rate as a proxy is a reasonable and well accepted practice when cost data for the CLEC are not

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3 160 PUR 4th 95, 1995 WL 125590 (Mass D.P.U.), at *108.

4 160 PUR 4th 95, 1995 WL 125590 (Mass D.P.U.), at *111, citing *American Hoechest Corp. v. Department of Pub. Utils.*, 379 Mass. 408, 411-412 (1980), citing *Monsanto Co. v. Department of Pub. Utils.*, 379 Mass. 317, 320 (1979).

5 The CLECs' interstate switched access rates have long been capped at the incumbent's interstate switched access rates pursuant to 47 CFR § 61.26(b), which further buttresses the reasonableness of the Department decision.

available. Reconsideration Motion, at 11. They claim that in this case, however, Verizon's switched access rates are not a reasonable proxy, because they are not based on Verizon's costs. Secondly, they claim that, even if they are based on Verizon's costs, CLEC costs are different from Verizon's. On their first claim, the CLECs are wrong as a matter of well documented Department case history. Their second claim fails, because – as the Department has already found in this case – they presented no evidence of their actual costs.

1. Movement Of Verizon's Intrastate Switched Access Rates To Their Interstate Level Is A Continuation Of A Long Department Endorsed Process To Move Them Toward Their Cost.

The CLECs' claim that Verizon's access rates established in D.T.E. 01-31 are not based on Verizon's actual costs, while technically true, does not help the CLECs' case. In fact, a review of the long history of Department decision making regarding the establishment of switched access rates demonstrates that they are above Verizon's cost.

In its June 29, 1990 Order in D.P.U. 89-300 ("D.P.U. 89-300 Order"), the Department established for each rate class "target rates" to which it expected Verizon (then, New England Telephone and Telegraph Company) to move its rates in a series of transitional filings. The Department's target rates were intended to be economically efficient, marginal cost based rates for usage elements, such as switched access. *See*, D.P.U. 89-300 Order, at 21. Verizon at the time opposed reduction of switched access rates to cost based levels because it would force intrastate retail long distance rates down as well. D.P.U. 89-300 Order, at 213. With the contribution to joint and common costs received from switched access and long distance service reduced, local exchange

residential rates would then have to be raised. The Department acknowledged that the Verizon proposed switched access rates still far exceeded the cost of switched access:

> There is no dispute that the proposed rate levels are still far in excess of marginal cost and would generate earnings for the class at a level several times higher than the Company's overall authorized rate of return.

D.P.U. 89-300 Order, at 216. The Department nevertheless accepted Verizon's proposal, stating:

> Moreover, this method does not prevent switched access rates from being lowered to target levels; it simply affects the timing of the appropriate rate reductions in the interest of preserving continuity for other rate classes.

D.P.U. 89-300 Order, at 217.

Subsequent history, however, shows that the transition to the cost-based target rates was terminated by the Department's May 12, 1995, decision in D.P.U. 94-50 ("D.P.U. 94-50 Order"). In that case, the Department acknowledged that

> [T]he intent of the transitional rate-rebalancing process has been to make [Verizon's] rates more cost-based and thus improve the allocative efficiency of telephone service.

D.P.U. 94-50 Order, at 128. The Department further acknowledged that the three rates not at target levels were (1) switched access rates, (2) toll rates and (3) residence exchange rates. *Id.* at 129. Nevertheless, the Department found:

> [I]f [Verizon] implements a price cap as discussed, *infra.*, then the Company's proposal to end the transitional rate-rebalancing process is reasonable and is so approved, even though not all target rates will be achieved under the price cap plan.

Id.

The Department's reduction of switched access rates in D.T.E 01-31 can be properly understood only when seen in light of the foregoing history. The Department in

D.T.E. 01-31 was merely seeking to resume the transition process to move switched access rates toward their cost-based levels. The Department was very explicit about that:

> With respect to AT&T's argument that above-cost switched access charges limit competition in the local exchange market, the Department notes that Verizon is not seeking a finding of sufficient competition for switched access service in this phase. Nevertheless, we agree with AT&T, *so the Department will reduce switched access charges to their economically efficient levels in Phase II of this proceeding to promote economic efficiency and competition for intrastate toll, as we did in the past through the rate-rebalancing process.*

D.T.E. 01-31 – Phase I (May 8, 2002), at 62-63. *See also*, D.T.E. 01-31 – Phase II (April 11, 2003), at 43, n. 38. Indeed, even the reduced access rates eventually established in Phase II of D.T.E. 01-31 still far exceeded TELRIC pricing, a result sought by AT&T and WorldCom at the time, but rejected by the Department. *See*, D.T.E. 01-31 – Phase II (April 11, 2003), at 64 ("AT&T therefore recommends that the Department devote its attention to pricing inputs at economically efficient levels (*i.e.*, TELRIC pricing for switched access)."); *see also, id.*, at 59 ("WorldCom argues that the Department should require Verizon to further reduce its intrastate switched access charges from the current level of interstate rates (as mandated in the Phase I Order) to TELRIC over a three year period[.]").

A comparison to the Department established TELRIC rate for reciprocal compensation – a service that constitutes exactly the same functionality and uses the same equipment as switched access – shows that Verizon's switched access rate is substantially above the cost of more efficient recent entrants, like the ones moving for reconsideration in this docket. As AT&T witness, Chris Nurse, stated:

> The CLECs' costs should look a lot like the TELRIC costs for reciprocal compensation. If you're building a forward-looking,

> most-efficient network, presumably the guy who just built the network has the forward-looking technology because he just built it, and presumably he built it efficiently, which was his business plan to enter the market. So if you think of the reciprocal-compensation cost that drives the Verizon reciprocal-compensation rate, it's in the nature of .0007, or 7/100 of a cent. That's very, very low. And then the Verizon rate is substantially above that. So there's a big gap between the reciprocal-compensation cost and the Verizon access rate, and that's plenty of room for a CLEC's access cost to get in between the Verizon access cost, if it isn't below the Verizon access cost, and the Verizon access rate.

9/24/08 Transcript, at 228-229.

In short, the rate established for Verizon's switched access service in D.T.E. 01-31 is a very generous cap for companies, like the CLECs, entering the market with the latest technologies whose costs should look much more like the costs estimated for reciprocal compensation in Massachusetts.

2. The Department Has Already Rejected The CLECs' Reliance On Non-Specific Assertions Of Cost Unrelated To The Massachusetts Cost Of The Individual CLECs Operating Here.

After the Department determined that the switched access rates of CLEC could not be presumed just and reasonable because of the presence of their market power in the relevant market, the Department had a responsibility under G.L. c. 159, § 14, to "determine the just and reasonable rates . . . for the service to be performed, and [to] fix the same by order[.]" The Department correctly concluded that the average and aggregated cost and price information randomly selected by the CLECs from various states around the country did not provide a basis for establishing the CLEC rates based on their own actual costs.

Indeed, the Department could not have been more clear that the "evidence" of costs presented by Dr. Ankum "is insufficient because it is not representative of

Massachusetts CLEC costs." Order, at 19. Moreover, the Department rejected as unproven the assumption necessary to accept Dr. Ankum's recommendation to use the switched access prices of small to mid-sized ILECs as the proxy or cap for Massachusetts CLEC access rates:

> Moreover, Dr. Ankum's underlying assumption—that CLECs are comparable to small and mid-sized ILECs—is entirely unsupported. The CLECs have presented no evidence of the costs of small and mid-sized ILECs to justify this comparison. As Verizon notes in its brief, "given the nature of the markets that CLECs have entered (typically large urban areas) and the types of customers targeted (typically business customers), there is no reason to presume that CLECs look more like small and mid-sized ILECs than they look like RBOCs." Verizon Brief at 28. The Department also notes that small and mid-sized ILECs operate under numerous different conditions and regulatory obligations than do CLECs that would tend to differentiate their underlying costs from that of the CLECs. See Pelcovits Testimony at 5-6. Therefore, the Department finds the QSI data is not a reliable indicator of CLECs' costs and cannot be used to determine, on a cost basis, the reasonableness of CLEC switched access rates in Massachusetts.

Order, at 20.

In their Reconsideration motion, the CLECs have simply reargued what the Department has already decided. The CLECs may not like the Department's decision, but that does not make it a mistake subject to a reconsideration motion. The CLECs reargument of this issue can be denied outright.

B. IT IS BAD PUBLIC POLICY AND UNLAWFUL TO REQUIRE CAPTIVE CUSTOMERS TO PAY MORE FOR A SERVICE THAN IS NECESSARY.

Even if it were true, the CLECs' argument that they lack the economies of scale of a Verizon and, therefore, have higher per-unit costs does not justify their entitlement to

recover these higher costs from those who cannot avoid them.[6] Clearly in a competitive world, a firm cannot charge higher prices simply because its costs are higher. In a competitive world, a prudent firm will find ways to bring its costs down to a level that permits it to compete at current market prices, or it will be forced to exit the market. A prudent CLEC therefore would do what Comcast and Richmond NetWorx did; they would share facilities to better utilize capacity and achieve comparable economies of scale.[7]

Indeed, if the Department were to allow CLECs to charge whatever costs they incur for their facilities, there would be no incentive for CLECs to defray their supposed higher per unit costs through prudent sharing arrangements. Any Department rule that would require Massachusetts consumers to pay the higher per unit costs caused by a CLEC that inefficiently builds additional capacity would be an invitation to build unnecessary capacity with the assurance that Massachusetts consumers would fund it, no matter the cost. It would encourage higher costs and higher rates.

Such a rule is bad for Massachusetts consumers, makes no public policy sense and results in unjust and unreasonable rates. It essentially creates a risk-free opportunity for business to earn profits from inefficient excess capacity funded by the public. Propping

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[6] Of course, the CLEC reconsideration motion is silent as to the off-setting cost *advantages* that CLECs enjoy, such as lower-wage non-union labor, lower pension and health care costs.

[7] AT&T witness Nurse stated:

> I've seen other instances where other carriers will buy switching capacity from another one. They'll buy a piece of a switch if they don't need a whole switch. If you don't need a whole switch, you shouldn't buy a whole switch. If you only need a part or you only need it for a while, you're going to enter a market, you need some capacity for two years, then when you grow bigger you'll do your own -- that's your classic kind of lease/buy analysis. I've seen that sort of switch leasing multiple times.

See Tr. 9/24/08, at 233. *See also*, Tr. 9/25/08, at 441 (Richmond NetWorx witness Dullaghan describing switch leasing arrangements).

up inefficient companies to build excess capacity is not a justification for imposing the burden on the public. As a matter of law, rates that recover the cost of imprudently constructed capacity not necessary for service to end users are unjust and unreasonable.

IV. THE CLECS' REQUEST FOR CLARIFICATION OF THE EXEMPTION PROCESS IS A TRANSPARENT ATTEMPT TO EXTEND THE RIGHT TO CHARGE UNJUST AND UNREASONABLE RATES INDEFINITELY.

The CLECs request, in the alternative, that the Department "clarify" its ordered process for obtaining an exemption from the cap it imposes on CLEC switched access rates. There is, however, nothing to clarify. The Department's order is clear on its face: On June 22, 2009, the Department stated that its ordered cap will go into effect in 12 months, that is, on June 22, 2010. A CLEC, however, may obtain an exemption by obtaining a Department finding that its actual costs of providing switched access in Massachusetts are higher than Verizon's and are prudently incurred.[8]

The CLEC's request for clarification of the process for exemption from the cap on CLEC switched access rates is a transparent attempt to extend the collection of revenue from excessive access rates indefinitely. They want the right to continue charging rates above the cap indefinitely so long as just before the June, 2010 implementation deadline they have filed what they contend is a cost study showing justifiable costs. They seek such a right on the basis of a mere filing, without any adjudication, that (a) their costs are higher than Verizon's and (b) they have been prudently incurred.

The very language of the CLECs' request reveals their intention:

> Therefore, CLECs also seek clarification that, if the CLEC submits its cost justification prior to the effective date of the rate cap, the

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[8] It is unlikely that any CLEC will be able to clear this bar, because they will have to show that it is prudent to incur higher, uncompetitive costs for switching capacity that the FCC has determined is competitively available.

> CLEC's rates will not be subject to the cap while the Department completes its review of the cost justification.

Reconsideration Motion, at 16. This is a request for a right to game the system. The CLECs want the right to continue charging extortionate rates after they have waited until the day before the cap goes into effect to file information that they unilaterally claim satisfies their burden. And they want the right to continue to delay the day of reckoning with the inevitable requests for more time to complete what will turn out to have been inadequate cost studies that were initially filed. Such a rule would be an invitation to abuse.

Instead, in order to avoid a situation where a CLEC submits a request for an exemption at the eleventh hour in an attempt to delay or avoid the ordered access rate reductions, the Department should require that all requests for an exemption be filed within three (3) months of the Department's Order. That will provide sufficient time for the Department and all interested parties to review and, if appropriate, take action on, the exemption request(s) prior to the end of the one (1) year transition period. This will prevent the CLECs from abusing the exemption process by using it as a mechanism for delay or avoidance of the ordered access rate reductions.

The Department has found that, in the absence of competition in the delivery of switched access services for each toll call, existing CLEC switched access rates cannot be presumed just and reasonable. Given that existing CLEC switched access rates higher than Verizon's are now unjust and unreasonable, and that captive customers will continue to pay them until they are reduced, the Department is providing the CLECs a generous transition period. There is certainly no need to extend it further – indeed, indefinitely –

by granting the CLECs a unilateral right to stop the clock just before the expiration of the transition period. The Department should deny the CLEC request for "clarification."

Conclusion

The CLECs' motion for reconsideration should be denied. The evidence put forth in this matter overwhelmingly supports the Department's finding that the "market" for CLEC switched access rates is dysfunctional and does not produce just and reasonable rates. As a result, the Department had a statutory duty to fix such rates at a just and reasonable level. The CLECs, having failed to introduce any cost or other justification for their existing rates, left the Department no choice but to cap CLEC rates at the incumbent's level – a level that is in accordance with a long history and carefully considered set of Department rulings and with the FCC's clear rule, codified at 47 CFR § 61.26(b).

The CLECs' request for clarification should also be denied. The CLECs' request for a right to wait until a day before the cap will go into effect before filing papers that will unilaterally and without any Department action stop the cap from going into effect is an invitation to abuse. Indeed, the Department should act to prevent any such possibility by requiring now that any CLEC that wishes to obtain an exemption prior to the

June 22, 2010 effective date of the cap must file a request for such within three months of the Department's Order.

Respectfully submitted,

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