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

INITIAL POST-HEARING BRIEF OF AT&T CORP.

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Introduction

Some Massachusetts CLECs have been exploiting the Department's rules to perpetuate intrastate access charges that in some cases are more than a thousand percent above Verizon's rates. This exploitation is harming Massachusetts consumers by causing in-state long distance prices to be higher than they need to be. Left unchecked, the problem will only grow worse as CLECs find new ways to leverage their excessive (and unregulated) rates, such as with the seedy sex lines and other traffic pumping schemes brought to light in this case. Fortunately, there is an easy way to cure the problem. Massachusetts, like a large number of other states, already has ordered that CLEC access rates be capped at the ILEC level. All that is required in this proceeding is for the Department to apply its long standing precedent to cap CLEC rates at the ILEC level where competition is not sufficient to discipline them.

None of the arguments that the coalition of CLECs in this docket put forward to defend their excessive access rates is persuasive. The CLECs argue that their switched access rates are cost-based; yet, they fail to submit any credible evidence that CLECs' access rates relate in any manner to their actual costs. Given that the CLECs' rates vary by an indefensible range of 12:1, it is not surprising they could not. Likewise, the CLECs argue that, as profit-seeking enterprises, they knowingly and purposefully executed a business model to enter a market where they would suffer from permanent, inescapable diseconomies of scale. Such an argument is not credible on its face, and certainly ignores the cost advantages CLECs expected to glean from newer technologies, cheaper labor costs, and the ability to enter only the most profitable geographic areas and market segments. Even where they seek to prove their operations are less efficient, they fail to

explain why it wasn't simply imprudent that they did not to achieve comparable economies of scale from the leasing and sharing of facilities – a strategy that interveners Comcast and Richmond Networx employed to their competitive success.

Even worse, the CLECs ask the Department to permit them to impose their excessive access charges on Massachusetts interexchange service and thus foist their claimed inefficiency onto Massachusetts toll service consumers. The imposition of unnecessary costs on Massachusetts residents and businesses is bad enough in normal times; it is worse in a period of economic uncertainty in which both residents and businesses are sensitive to increases in normal living and business costs. Resources are limited in normal times; they are scarce today.

Adding insult to injury, the CLECs also ask the Department to ignore clear evidence that their high access rates reflect the negative impact of unlimited market power over captive IXCs and their toll customers and to accept instead a flawed theory that the very conditions that incent carriers to increase access rates will – somehow, mysteriously – push them down in the future.

Indeed, the CLECs turn well understood regulatory theory on its head. They ask the Department to ignore decades of economic understanding regarding the incentives of multi-product firms that use a common network to offer both competitive and non-competitive services. As the Department has found in years of precedent, such firms will inevitably seek to shift their costs to their captive customers and reduce their prices to the customers with competitive alternatives. The Department can take little comfort in the present case that the captive customers are IXCs. As the evidence in this case demonstrates, the IXCs are forced not only to pay for inefficiently provided access

services; they are forced to underwrite non-telecom service providers as well, such as operators of adult-chat-lines. And, because IXCs compete in a fiercely competitive toll market, Massachusetts toll consumers are ultimately subsidizing adult-chat-line services through the high access rates paid to Massachusetts CLECs. This is hardly the type of "economic development" that Massachusetts needs.

The bottom line is this: CLEC access rates range up to 1,200 percent higher than Verizon's. Such rates are either a result of CLEC inefficiencies or, as is more likely the case, reflect CLEC exploitation of an environment where their access rates are uncontrolled by either regulation or market forces. As the Department has already ruled, and as a number of states also have done, it should cap CLEC access rates at Verizon's rates. This will leave the CLECs free to present their retail services to the competitive interstate, local and data markets and Massachusetts consumers free to choose the most efficient providers.

Argument

I. STANDARD OF REVIEW: RATES MUST BE JUST AND REASONABLE.

Under Massachusetts G.L. c. 159, § 14, it is the Department's duty to ensure that the rates of telecommunications services subject to its jurisdiction are just and reasonable. *See,* D.P.U. 94-50*, Petition of New England Telephone and Telegraph Company dba NYNEX for an Alternative Regulatory Plan for the Company's Massachusetts Intrastate Telecommunications Services*, Interlocutory Order On Motion To Dismiss Of The New England Cable Television Association, Inc. (February 2, 1995).

While the Department has never established a single criterion for determining when rates are just and reasonable and when they are not, it has a long history of decision making on the subject which provides strong guidance. Department precedent

demonstrates that rates are not just and reasonable if they recover unnecessary or imprudent costs or if they produce excess profits.

A. RATES THAT RECOVER IMPRUDENT COSTS ARE NOT JUST AND REASONABLE.

Just because costs are incurred does not mean that they can be recovered in rates. Under long established Department precedent, not all costs can be recovered from ratepayers. For costs to be recovered in rates, the expenditures must be prudently incurred. *See,* D.T.E. 05-27, *Investigation by the Department of Telecommunications and Energy on its own motion pursuant to General Laws c. 164 § 94, and 220 C.M.R. §§ 5.00 et seq. as to the proprietary of the rates and charges set forth in the following tariffs: M.D.T.E. Nos. 34 through 68, filed with the Department on April 27, 2005 by Bay State Gas Company*, Order, at 74 (November 30, 2005).Such a prudence determination is not a "hand wave." The Department must consider the costs incurred in light of the circumstances at the time. *Id.* Where costs have been imprudently incurred, their inclusion in rates would not be just and reasonable. *See, Attorney General v. Department of Public Utilities*, 390 Mass. 208, 220 (1983) (Department denied recovery of project costs incurred beyond the date at which it was imprudent to continue). The prudence requirement permeates all rate regulation. It is also, for example, reflected in rules recently adopted for the determination of E911 surcharges.[1]

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[1] 220 CMR § 16.03(4) states in part (emphasis added):

> The surcharge must be sufficient to recover not only *prudently incurred costs* associated with the provision of enhanced 911 service, dual party TDD/TTY message relay service, and wireline adaptive equipment services in Massachusetts, but also *prudent capital improvements* to be made to the wireline enhanced 911 system.

In the present case, the Department is called upon to determine whether the current system of regulation – or in this case, reliance on putative competitive forces – is permitting CLECs to assess access rates that far exceed any prudent measure of costs. If it does, as AT&T contends, then the Department must adopt an approach to controlling CLEC access rates that does not endorse rates far exceeding prudently incurred costs. As we explain in more detail below, the proposal under review in this case will accomplish that result.

B. RATES THAT RESULT FROM UNCONTROLLED MARKET POWER IN THE ACCESS MARKET ARE NOT JUST AND REASONABLE.

The purpose of rate regulation has been to prevent common carriers from exploiting their captive customers, protecting those who lack alternatives. The Department rightly relies on competition to produce just and reasonable rates where markets are competitive, and depends on regulation where they are not.

Massachusetts has been in the forefront of state commissions turning to competition to discipline the rates of telecommunication carriers. *See* D.P.U. 1731, *New England Telephone and Telegraph Company*, Order (1985) ("*IntraLATA Competition*"). But even in that seminal competition order, the Department also recognized the need for government intervention where markets do not work, or do not work fully. *IntraLATA Competition*, at 45 ("the degree of regulation that should apply to a particular market should reflect the degree of competition present"). Since that landmark case, the Department has balanced the degree of competition with the need for regulation in a long history of cases.[2] "The Department has traditionally taken the absence of market power,

[2] *See*, e.g., NET, D.P.U. 86-124-D (1986); NET, D.P.U. 89-300 (1990); NET, D.P.U. 91-30 (1991); Collocation, D.P.U. 90-206/91-66 (1991) and D.P.U. 90-206-A/91-66-A (1991) and D.P.U. 90-

or equivalently, the presence of sufficient competition, to be the necessary condition for the approval of pricing flexibility for a previously regulated service." *See,* D.T.E. 01-31 – Phase I, *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' Intrastate Retail Telecommunications Services in the Commonwealth of Massachusetts*, Opinion, 2002 Mass. PUC LEXIS 10, *, (2002) at *64-*65.

In this case, therefore, the Department must decide whether there is sufficient competition to control CLEC switched access prices under the current practice of unlimited pricing flexibility for CLEC access rates. If there is not, as is abundantly clear from the evidence, the Department must regulate CLEC ***wholesale*** access rates ***directly*** to ensure just and reasonable rates.

Adoption of Verizon's proposal is a "light touch" approach that presents the most administratively efficient means of accomplishing that result. *Every* CLEC in this case, and in this state, has operated under an access rate cap at the ILEC's rates for years pursuant to FCC rules.[3] CLECs exist and operate successfully in a large number of states which cap CLEC rates at the ILEC level—including many of the CLEC parties in this case. There is no need to require Massachusetts businesses and residents to pay more for their services than the incumbent provider charges.

206-B/91-66-B (1993); AT&T, D.P.U. 91-79 (1992); NET, D.P.U. 92-100 (1992); Common Carrier Entry Deregulation, D.P.U. 93-98 (1994), and NET, D.P.U 93-125 (1994).

[3] *See* 47 CFR §61.26, and the rural exception noted for 61.26(e).

II. THE DEPARTMENT MUST APPLY ITS WELL ESTABLISHED PRINCIPLE THAT REQUIRES CLEC ACCESS RATES TO BE CAPPED AT THE ILEC LEVEL.

In D.P.U. 94-185, the Department imposed a requirement that CLEC access rates be capped at Verizon's access rate levels in the absence of a showing of greater costs. The Department stated:

> 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.

See D.P.U. 94-185, *IntraLATA and Local Exchange Competition*, Order, at 66 (August 29, 1996)("*1996 CLEC Access Capping Order*"). If the Department indeed intended its ruling to apply to switched access, this case has already been decided, and AT&T requests that the Department enforce its precedent. If, however, the Department intended to refer to reciprocal compensation, the principle underlying its *1996 CLEC Access Capping Order* still requires that the Department adopt proposal under review in this case.

In subsequent cases, the Department has cited its *1996 CLEC Access Capping Order* for the proposition that, when a CLEC provides a service requiring work that is similar in purpose and scope to the work performed by the incumbent for a comparable service, the CLEC must either use the incumbent's rate as a proxy, or file supporting cost information. See D.T.E. 05-4, *Complaint of Verizon New England, Inc. d/b/a Verizon Massachusetts concerning customer transfer charges imposed by Broadview Networks, Inc.*, Order (April 26, 2006). Moreover, during the intervening ten years (1996 to 2006), the Department has cited to, and relied on, this principle frequently. In December, 2000, and again in May, 2001, for example, the Department cited to the *1996 CLEC Access Capping Order* with approval when it found that CLECs must use Verizon's

interconnection rate or submit supporting cost information for a different rate. *See,* D.T.E. 00-54-A, *Petition of Sprint Communications Company L.P., pursuant to Section 252(b) of the Telecommunications Act of 1996, for arbitration of an interconnection agreement between Sprint and Verizon New England, Inc. d/b/a Verizon-Massachusetts*, Order, 2001 Mass. PUC LEXIS 4 (May 3, 2001). *See also*, D.T.E. 0054, *Petition of Sprint Communications Company L.P., pursuant to Section 252(b) of the Telecommunications Act of 1996, for arbitration of an interconnection agreement between Sprint and Verizon-Massachusetts*, Order, 2000 Mass. PUC LEXIS 37 (December 11, 2000).

Certainly if the Department somehow decided it would not apply its longstanding rule here, it first would be required to support such a change with hard evidence or clear reasoning as to why that rule should no longer apply. In *Boston Gas Company v. Department of Public Utilities*, 367 Mass. 92 (1975), the Massachusetts Supreme Judicial Court stated:

> A party to a proceeding before a regulatory agency such as the Department has a right to expect and obtain reasoned consistency in the agency's decisions. This does not mean that every decision of the Department in a particular proceeding becomes irreversible in the manner of judicial decisions constituting res judicata, but neither does it mean that the same issue arising as to the same party is subject to decision according to the whim or caprice of the Department every time it is presented.

Here the Department should adhere to its longstanding rule. There is no public policy justification for permitting CLECs to impose excessive access rates on IXCs and the toll consumers of Massachusetts. As the record in this case demonstrates, requiring companies and consumers to purchase services at prices far higher than would occur if

they had the opportunity to choose imposes a dead-weight loss on the consumers of Massachusetts. *See* Section V. It simply makes no sense to pursue a policy of competition to reduce costs and prices by forcing Massachusetts consumers to pay more than they should to subsidize CLECs who are either inefficient producers or opportunistic price gougers.

The Department should enforce the longstanding rule established in its *1996 CLEC Access Capping Order* to cap CLEC access rates at Verizon's level. To do otherwise would be to ignore the Department's well established principle reiterated as recently as its April 26, 2006 decision in D.T.E. 05-4, that CLECs must use the incumbent's rate when a CLEC provides a non-competitive service comparable to the incumbent's, in the absence of cost justification.

III. ADOPTION OF VERIZON'S PROPOSAL WILL NOT DRIVE CLECS OUT OF BUSINESS IN MASSACHUSETTS.

A. DESPITE AMPLE OPPORTUNITY, CLECS PRESENTED NO EVIDENCE OF ANY PROBLEMS THEY THEMSELVES HAVE SUFFERED IN THE MANY JURISDICTIONS IN WHICH THEY OPERATE WHERE CLEC SWITCHED ACCESS RATES HAVE BEEN CAPPED.

The CLECs through their witness have offered much hand-wringing and gloomy speculation of what might happen if the Department were to cap CLEC access rates in accordance with its long-standing precedent. The CLECs' dire assertions, however, were backed up by absolutely no support. AT&T presented evidence that *twenty-five states* have adopted some form of constraint on CLEC access pricing flexibility (for the very same reasons addressed herein).[4] Yet, the CLECs offered no evidence and not even an

[4] *See*, ATT-Exh.-1 att. (Exhibit A to Pre-filed Testimony of Dr. Ola Oyefusi and E. Christopher Nurse).

argument to explain why the (supposedly inefficient) CLEC activity in those states did not decline or disappear when similar access rate caps were adopted in other states.

Indeed, the CLECs were in a unique position to provide such evidence if it existed. The very CLECs in this docket operate in many of the states that have adopted constraints. For example, One Communications operates in Maine, which has had a cap on CLEC switched access rates since 2003. *See* Tr. 9/25/08, at 559. The CLECs, however, provide the Department with no information regarding the impact on One Communications of that cap. *Id.* at 560. Similarly, One Communications, as well as XO and PAETEC, operate in Maryland which has a cap codified in its regulations. Again, the CLECs offer nothing to suggest that such a cap presents a problem for them. *Id.* One Communications and PAETEC both operate in New Hampshire which has a cap codified in its regulations; yet the CLECs provide no evidence that New Hampshire's cap has created a problem. The CLECs also admitted through Dr. Ankum that they provided no information regarding the impact of Virginia's cap on access rates implemented a year ago on XO and PAETEC, which operate there. This is no mere clerical oversight in a research effort. This is a wholesale failure to bring relevant evidence to the Department to settle this question.

The Department can rest assured that, if constraints in Maine, Maryland, New Hampshire and Virginia – to name a few of the many states that have implemented such constraints – on the access rates of the very CLECs appearing in this docket had had an adverse impact, the CLECs would have presented that evidence. They did not because they could not. CLECs will not go out of business if they are prevented from charging

exorbitant access rates on captive customers. If these CLECs can succeed in nearby states they can succeed here as well.

B. CLEC S WOULD NOT HAVE ENTERED THE MARKET IF THEIR COSTS WERE HIGHER THAN VERIZON'S.

It defies credulity to believe that CLECs developed a business plan to go into an economy-of-scale business based on the calculation that, even though their costs would be higher than their competitors, they could count on state public service commissions to require that residential and business consumers bear those inefficiently incurred higher costs. There isn't a shred of evidence that this is the business plan that the CLECs disclosed to their investors, the public, or the Department. To the contrary, as Mr. Nurse testified at the hearings,

> I thought it was just absurd. I mean, the notion that TCG [for whom Mr. Nurse previously worked] built a network that was less efficient than Verizon's network and then went out to compete for business customers like Fidelity and Merrill Lynch and very large customers on the basis that we built a less efficient network and we were going to somehow enter the market, be less efficient, and take customers away from Verizon, was just ridiculous.

See Tr. 9/24/08, at 221. Mr. Nurse went on to describe a number of the countervailing cost advantages that CLECs have over a legacy competitor like Verizon. First, they are able to choose both the geographic and the product markets to compete in, so they will of course choose the lowest cost, highest margin customers and geography to serve. Second, they are unburdened by legacy costs or constraints such as software, billing systems, and operating support systems that require backwards compatible "solutions" to the countless issues that have arisen from the onset of multi-product local exchange competition, combined with long-distance and data services. Third, they necessarily begin with the newest and most efficient transport and switching technologies and

network architecture without the burden of migrating in-place customers from older generation systems, networks and equipment to newer generation systems and facilities. *See* Tr. 9/24/08, at 222-224. Fourth, many pay lower wages and benefits than those paid by a unionized company like Verizon, and certainly none of them have the residual burden of pensions and health care of retirees to the extent that Verizon does.

Indeed, given that CLECs selectively entered the market with newer, less expensive, more efficient facilities, it is reasonable to conclude that a CLEC's long run incremental costs of providing switched access service is likely much closer to the "forward-looking, most efficient network" TELRIC calculations for reciprocal compensation (in the range of seven one-hundredths of a cent per minute) than to the inflated access rates charged by CLECs today (in the range of 3.5 to 5.5 cents per minute). *See* Tr. 9/24/08, at 228-229.[5] Moreover, as demonstrated by Comcast and Richmond NetWorx, carriers can solve economy of scale issues that arise when they first begin offering service by employing leasing and joint venturing opportunities while they build scale and scope. Stated another way, the actual cost to a CLEC of providing switched access service should be less than, certainly not more than, Verizon's switched access rate, which is in the range of four tenths of a cent.

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[5] Mr. 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[.]

IV. CLECS HAVE ABUSED THE DEPARTMENT'S RULES TO ESTABLISH UNJUST AND UNREASONABLE ACCESS RATES TO THE DETRIMENT OF MASSACHUETTS CONSUMERS.

A. THERE IS NO EFFECTIVE COMPETITION TO DISCIPLINE ACCESS RATES, BECAUSE THE IXC THAT PAYS THE SWITCHED ACCESS RATE HAS NO OPPORTUNITY TO CHOOSE OR ACCEPT THE ACCESS PROVIDER.

1. The Three-Way Structure Of The Access "Purchase" Transaction Hides The Price Signal Necessary To Discipline Access Rates.

Competition disciplines rates for the very simple reason that a consumer with a choice will choose the lower priced provider when a service or product is indistinguishable across providers. *See* Tr. 9/24/08, at 256, lines 5-14; at 312, lines 9-18; and at 334, lines 6-10. This fundamental condition, however, is absent from the switched access "market." The IXC, the consumer paying for the access service, does not choose, and does not accept, the access service provider which completes the call. Moreover, the long-distance end user, who does choose the access provider, does not pay the access provider. It is this separation of the economic actor who chooses from the economic actor who pays that prevents the normal price disciplining forces of competition from working.

If a long-distance call carried by an IXC is placed to a customer served by a CLEC, the IXC carrying the call has no alternative but to pay the terminating access charges of the CLEC whose customer is receiving the call. *See* Tr. 9/24/08, at 277, line 22; at 278, line 1; at 587, line 3; and at 589, line 8. Indeed, not only does the IXC lack the ability to choose an alternative access provider, the IXC even lacks the choice to decline to terminate the call.[6] An IXC has an obligation under federal law to deliver calls

[6] That is, not only is the IXC forced to pay the access monopolist's price if it wants to consume the access service, but worse, the IXC is forced to consume the access service, even when the IXC would refuse to willingly do so, such as when the access rate is higher than the toll rate.

to any end user its customers wish to call.[7] Thus, an IXC must pay terminating switched access charges to the called party's local exchange carrier, *i.e.*, the entity which controls the network facilities to which the called party is connected regardless of how much it is. At the same time, the called party who, in practical effect, "chooses" the CLEC as the terminating access provider when she chooses her local service provider does not take the high access charge into account because she never pays it; indeed, it is unlikely that she is aware of the intra-carrier mechanics of intrastate switched access; nor should she.

Under these circumstances, market forces do not and cannot constrain the CLEC's pricing behavior. *See* Tr. 9/24/08, at 258, line 17 and at 259, line 3. The CLEC providing the terminating access has no incentive to lower its access rates in order to induce the purchaser (the IXC) to buy its service, because the purchaser is not the payer, and the payer is divorced from the purchaser.[8] Indeed, as we explain below (*see* Section IV.B.3), the CLEC's incentives are just the opposite. That is, the CLEC actually has an incentive to *increase* its terminating access rates so as to reduce the rates paid by the party choosing the carrier.

Although the discussion above relates to terminating switched access, the circumstances, under which IXCs purchase ***originating*** access services from the calling party's CLEC carrier also prevent market forces from disciplining access rates on the

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[7] Specifically, the FCC states that "no carriers, including interexchange carriers, may block, choke, reduce, or restrict traffic in any way …. These decisions evidence the Commission's general prohibition on call blocking. *See* WC Docket No. 07-135, *In the Matter of Establishing Just and Reasonable Rates for Local Exchange Carriers and Call Blocking by Carriers*, Declaratory Ruling and Order, ¶6 (June 28, 2007) (DA 07-2863).

[8] When Dr. Ankum described possible signs of competition in the retail market, he described the possibility of Verizon sales representatives taking retail end users out to lunch. Interestingly, the CLECs present no evidence of sales lunches, promotions or advertising to IXCs for purchase of their access service. The absence of advertising, promotion or sales efforts is usually a good sign that a firm is not worried about a competing provider taking its customer.

originating side, although the details of the mechanism differ somewhat from terminating access. *See* ATT-Exh-1 (8/20/08 Oyefusi/Nurse Pre-filed Testimony) at 10-11. IXCs are required by federal law to geographically average their interstate toll rates,[9] and generally do the same with intrastate toll rates as well, especially with regard to CLECs operating in an ILEC territory. Even if the law allowed an IXC to de-average its (switched) intrastate long distance prices, it would be extremely difficult to implement mass-market price schedules which vary according to the LEC used by the calling party. Forty different access tariffs would require 40 different toll schedules leading to insurmountable complexity and confusion.[10] This means, as a practical matter, that an IXC's recovery of all LEC access rates – CLEC and ILEC alike – is averaged across all of the IXC's end users in the state. *Id.* at 11.

CLECs are aware of this and exploit it. They understand that if an IXC cannot selectively impose higher toll rates on its customers who take CLEC local exchange service, they are able to charge the highest access rates they can without affecting their own customers' prices for toll service. In fact a CLEC's terminating access rate may easily exceed the IXC customer's toll price. Those access rates will unavoidably be averaged into the IXC's statewide toll prices. In short, market forces cannot and do not discipline CLEC originating access rates either.

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9 *See* § 254(g) of the Federal Telecommunications Act of 1996.

10 Recently, AT&T has made a very limited effort in the large business enterprise market to distinguish long distance pricing for its "on-net" customers (*i.e.*, customers who are directly connected to the AT&T network) versus customers who connect to AT&T's long distance network through another local exchange provider. This effort, considerable as it is, does not begin to distinguish between the dozens of different local exchange providers other than AT&T. In any event, it is a reaction to inefficient access pricing and is not practical to implement in mass-market customer processes.

2. The Empirical Evidence Confirms That Access Prices Are Not Constrained by Competition.

On one fact, there is no dispute. CLEC access prices vary from one carrier to another over an extraordinary range. According to Verizon witness Paul Vasington, about forty CLECs have switched access rates that are effectively above Verizon's and at least three are effectively at or near 15 times that of Verizon's. *See* VZ-Exh-2 (July 7, 2008, Vasington Testimony), at 14-15. A calculation of CLEC access rates using reasonable assumptions regarding traffic patterns unchallenged by any party showed CLEC access rates ranging from within a few percentage points of Verizon's levels (*e.g.*, Cleartel Telecommunications, Charter Fiberlink; Freedom Ring Communications) to rates 370 percent above Verizon's (*e.g.*, Choice One) to rates in the range of 600 to 700 percent above Verizon's (*e.g.*, PAETEC) to rates ***more than 1,270 percent higher*** (Conversent).[11] The CLECs were unable to explain both why their rates are so high, and they were equally unable to explain why their high rates were so varied from each other, especially since they all have a similar CLEC network architecture. The CLECs presented over a hundred pages of rambling testimony asserting – without evidence – that CLECs are less efficient than Verizon. But there was zero evidence and zero argument as to why one CLEC was 12 time more inefficient that another in the same metropolitan area.

One additional fact is not in dispute. This extreme and sustained variation in access rates is absolutely inconsistent with a competitive commodity market. On this, all who testified at the hearings agreed, including three economists – AT&T's Dr. Oyefusi,

[11] Mr. Vasington's 15-to-1 factor differs from AT&T's 1,270 percent difference (which is equivalent mathematically to a factor of 13.7-to-1), because they use different methods for normalizing the rate designs of the different carriers. Mr. Vasington compares average revenue per minute. AT&T calculates the average price per minute based on tariffed rates and stated assumptions regarding traffic patterns in DTC-ATT 1-15. The result is nonetheless very close: a 15-to-1 factor for Mr. Vasington, and an almost 14-to-1 factor for AT&T.

Comcast's Dr. Pelcovits, and the CLEC's Dr. Ankum. *See,* Tr. 9/24/08, at 334, lines 6-17 (Oyefusi); at 353-354 (Pelcovits); *see also,* Tr. 9/25/08, at 498-499 (Ankum). Indeed, Dr. Ankum – in a remarkably clear and direct response to cross examination – readily accepted an example of this fundamental principle. He agreed that the price of a commodity in a competitive market tends to converge toward a single price and that each supplier of that commodity is a "taker" of the single price without regard to its costs or method of production. *See* Tr. 9/25/08., at 464-465. Dr. Ankum accepted that, when the world oil price is $100 per barrel, an oil company with production costs of $150 per barrel will not be able to sell a barrel of its oil for $150 just because that is what it costs to produce. And Dr. Ankum also agreed that a company that can produce oil for $30 per barrel will not agree to sell its oil for less than $100 per barrel when that is the world price. *Id.*

Because observed, sustained, and indisputable rate variation of such extreme magnitude is inconsistent with a competitive commodity market, Drs. Oyefusi and Pelcovits reach the common sense conclusion that the access market is not competitive. *See* Tr. 9/24/08, at 267, lines 9-15 (Oyefusi) and at 353, lines 13-15 (Pelcovits) Unable to deny the existence of extraordinary rate variation and unable to dispute the basic economic principles of converging prices in competitive commodity markets, Dr. Ankum's only way out was to assert that switched access is somehow *not* a commodity.

The Department can easily dismiss the incredible assertion of the CLECs' witness. A commodity is defined by how it is perceived and experienced by the buyer, not what it cost the supplier or how it is produced by the supplier. Switched access service is simply an indistinguishable commodity. It is just the temporary use of a circuit

that connects the long-distance network of the toll provider to the originating end-user and terminating end-user only for the duration of the long distance call. *See* ATT-Exh-1 (8/20/08 Oyefusi/Nurse Pre-filed Testimony), at 7. The parties to the toll call experience cannot discern and are completely indifferent to which local exchange carrier provides the access service. And certainly the IXC experiences no meaningful qualitative difference in the originating or terminating access from one local exchange carrier to another. Nor do the parties to the call or the IXC experience any difference in calls that are originated or terminated over different network materials, for example, coaxial cable, fiber or copper wire.

Since there is no difference in quality, features or function, neither IXCs nor end-users have any incentive to pay a different price. For example, AT&T does not pay Verizon more, or less, for a switched access minute produced from Verizon's new all-fiber Fios network versus from it legacy copper network. In fact, AT&T and AT&T's customer do not even know when a Verizon end user migrates from the one network to the other. In short, a minute of access service is just as much a commodity as a barrel of oil, an ounce of gold, or a bushel of grain.

In the hearings, the CLECs' witness was asked to defend his assertion that switched access service is not a commodity. He was unable to give a direct response. The following transcript excerpt from the beginning of four pages on the issue gives the flavor of the convoluted attempt of the CLECs' witness to avoid the basic, common-sense observation succinctly stated by Mr. Mael in emphasized text below:

> Q. Unlike the Mercedes and Honda Prelude example, is **in fact the access -- it's no different regardless of who provides it to you.**
>
> A. Oh, it's very different, it's hugely different. When a call gets terminated in South Dakota to an ILEC that serves a very sparsely

> populated area, with very long loops and long transport links and a largely underutilized switch, the cost to the ILEC in South Dakota is tremendously different than when a call is terminated to a Verizon office in Manhattan, where they have a huge switch that is fully loaded, with very short transport links, with all the efficiencies of economies of scale. These two calls, which are called access calls, could not be more different, and it will never be that the costs of production for these calls are going to be the same; and unless regulators force these down, with all the harm thereof, access prices for these radically different products will just never be the same, because the costs are not the same.

See Tr. 9/25/08, at 600-601. As Mr. Mael readily understood, however, the issue is not the obfuscation of South Dakota, but whether an end-user in Massachusetts experiences a difference in the access service underlying his long distance call depending upon which of two competing local exchange carrier he uses *at his location*. *See* Tr. 9/25/08, at 602, line 12 ("From the end-user perspective --").

In order to avoid acknowledging the obvious, the CLECs' witness tried to defend his claim that access service is not a commodity by focusing on the network architecture and cost of providing the access service. He stated that access is not a commodity, because "[w]hen the call terminates to the CLEC, as opposed to Verizon, it gets terminated over an entirely different architecture, and it terminates on a customer base that is relatively sparse." *See* Tr. 9/25/08, at 601-602. But differing techniques or costs of production are irrelevant to the determination of whether something is not a commodity. As the CLECs' witness had already acknowledged, commodities are frequently produced by different firms with significantly different costs and techniques.[12] Thus, the CLECs' argument that switched access is somehow not a commodity is based

[12] Recall that a barrel of oil sells for the same price whether it is produced by the Saudi Prince from oil bubbling out of his backyard at the low cost of $30 per barrel or by West Texas Petro having to use much more expensive extraction techniques to reach the oil in West Texas. *See* Tr. 9/25/08, at 464-465.

on a unsubstantiated premise that their own witness acknowledges is not correct (that production costs and functions determine whether something is a commodity). Indeed this "access-is-not-a-commodity" argument seems as novel as it is far fetched. The argument, now apparently a keystone of the CLEC argument, appears no where in the pre-filed testimony, but emerged spontaneously under cross examination.

The evidence is thus incontrovertible. Access is a commodity, but its price varies enormously from one local exchange carrier to another. Market forces, therefore, are not constraining access prices, because prices in competitive commodity markets tend to converge around a single market price, as Dr. Ankum concedes. *See* Tr. 9/25/08, at 465, lines 17-19.

B. UNDER THE CURRENT REGULATORY RULES, NOTHING CONSTRAINS CLECS FROM SETTING ACCESS RATES AT SUPRACOMPETITIVE LEVELS THAT, *INTER ALIA*, SUBSIDIZE NON-TELECOMMUNICATION SERVICES OR OTHER JURISDICTIONS.

It is thus clear that the current market mechanisms and regulations impose no regulatory or competitive constraints on access prices. Current CLEC access rates that range up to more than 1,200 percent higher than Verizon's can be explained in only two ways: either they are based on the inflated cost of a grossly inefficient service provider, or they reflect the price-gouging of captive customers to generate revenues great enough to be shared with non-telecommunications providers or – as explained in Section V.B., below – other jurisdictions. Either Massachusetts consumers are asked to subsidize the inefficient provision of their telecommunications services or they are asked to pay rates that allow CLECs to share access revenues with customers that include racy chat lines, voyeuristic "dating" services and purveyors of pornography. As we show below, whichever is the case, the resulting rates are not just and reasonable.

1. The Claimed But Unproven Economic Inefficiency of CLECs, Even If True, Would Be No Basis For Concluding That The Current Unconstrained CLEC Access Rates Are Just and Reasonable.

As set forth in Section I, above, companies regulated by the Department do not have an automatic right to recover any cost they may incur. Certainly, a claim of inefficiency is not usually made to justify higher prices—and certainly not one that captive consumers are compelled to pay. There is a certain irony, if not paradox, in a utility arguing that it should be allowed to charge higher rates ***because*** it is *less efficient* than alternative providers. Just imagine where this would lead in the long-run.

Such a position violates the "prudently-incurred cost" regulatory doctrine; it also reduces "consumer welfare" for Massachusetts consumers. It is, in the jargon of economics, a "dead-weight loss" to society. Even Dr. Ankum agrees that where the government forces a buyer to purchase higher cost goods or services than are available elsewhere, the transaction produces a dead-weight loss to society; it uses up more of our resources to get the same benefit that fewer resources could provide. *See* Tr. 9/25/08, at 466, lines 16-19. Dr. Pelcovits agreed, testifying that it makes no sense to maintain a regime that permits higher cost CLECs to enter the market to replace a lower cost Verizon (or lower cost CLECs) and then to impose their higher costs on other carriers' ratepayers. *See* Tr. 9/24/08, at 390, lines 8-15. In short, even if *arguendo* CLEC rates are cost based, their rates are not just and reasonable if they are being imposed on IXCs (and their customers) who cannot avoid them.

Moreover, the claim of inefficiency that the CLECs make as a justification for their higher rates runs afoul of the well established regulatory doctrine that costs must be prudently incurred. *Boston Gas Co. v. Department of Telecommunications and Energy*,

436 Mass. 233 (2002) (utility rates can only reflect costs found by the Department to be reasonably and prudently incurred). It is difficult to argue that it is prudent for an enterprise to enter a market and offer a service with costs that require prices higher than the incumbent's to recover, especially when the incumbent is already satisfying market demand, and the new enterprise must under-price the incumbent to obtain new customers. Indeed, there are well known strategies for new entrants to overcome the economy of scale problems from which it is claimed they suffer. As Mr. Nurse testified, carriers can aggregate lines over a larger geographic area to equal the incumbent or carriers that enter the market and without sufficient customers initially to fill a switch do not need to buy a whole switch. *See* Tr. 9/24/08, at 231. They can lease switch capacity from another carrier which also doesn't have enough customers to fill an entire switch. *See* Tr. 9/24/08, at 233, lines 2-10. Mr. Nurse also gave the example of Comcast. Comcast had planned to use packet-switching, but needed circuit switching capacity in the short term. Comcast did not buy a circuit switch; it leased circuit switching capacity from AT&T. *See* Tr. 9/24/08, at 232-233.

Entering a market with higher costs that require higher prices than the incumbent for the same good or service is imprudent *per se*. It is contrary to well established Department precedent to permit utilities to foist such costs on Massachusetts consumers with no ability to avoid them.[13]

[13] The logical implications of such as policy lead to absurd outcomes. If a utility becomes more inefficient, the CLECs' proposal would lead to still higher access rates. This would simply lead to imprudent and enormous risk taking by the CLECs since they would pocket the profits if successful, and fall back on a ratepayer bailout if the risky investment turns out unprofitable.

2. If CLECs Are Rational, Profit-Maximizing Operations That Enter Markets Where They Believe They Will Be Sufficiently Efficient To Be Competitive and Profitable, The High Access Rates Reflect Price Gouging of Captive Customers, Not Recovery of Higher Costs.

Prudent businesses do not enter markets where they have cost disadvantages that require higher prices than the existing firms are charging to satisfy all of existing demand. Although the CLECs claim that they have higher costs due to economy of scale problems, the offsetting cost advantages of the CLECs are conspicuously absent from his testimony. Indeed, Dr. Ankum focuses only on one cost component of a local exchange carrier's cost structure[14] and fails to consider potential cost advantages associated with newer technologies, cheaper labor costs, and the absence of constraints from legacy operating systems. *See* Tr. 9/24/08, at 222-223. This is akin to a "single issue rate case," *i.e.*, asking for a rate increase because one cost component has increased, without taking into account reductions of other cost components. There is long Department precedent against such practices. *See* D.P.U. 07-89, *Re Bay State Gas Company*, Order (April 30, 2008).

Indeed, even with respect to the one cost item on which the CLECs' case focuses (lack of economies of scale), the CLECs offer no serious proof. First, as their witness, Dr. Ankum, acknowledged, he didn't review the financial books of even one of his CLEC clients for even a cursory review of actual CLEC costs. *See* Tr. 9/25/08, at 509, line 11; at 510, line 5. Second, Dr. Ankum studiously avoided testing his own hypothesis that CLEC access rates are driven in large part by costs. He admitted that the combination of

[14] Even with respect to this one cost component, Dr. Ankum presents no hard evidence of the cost that any CLEC in Massachusetts actually incurs. Apparently, the CLECs did not believe that Massachusetts cost data would help them.

four smaller companies into one larger company (such as the merger that produced One Communications, one of his clients) should have produced improved economies of scale, but he did not even look to see whether those improved economies of scale resulted in a reduction in CLEC access rates. *See* Tr. 9/25/08, at 488. (They did not. *See* Exh. VZ-CLEC 1-11) Moreover, the variation in access rates among the various CLECs presented ideal data to test the hypothesis that such variation is correlated with variations in cost. Surely, if Dr. Ankum believed that such evidence would support his position, it would be in the record today. It is not.

Perhaps most telling is Dr. Ankum's failure to explain why CLEC switched access rates are so much higher than Verizon's, while their local exchange rates are competitive. After all, both services are provided over the same network. Indeed, Dr. Ankum has made much of the fact that CLECs are firms that produce multiple products with significant joint and common costs. *See* Tr. 9/25/08, at 461, line 17; at 462, line 10; and at 512, lines 1-7. Somehow, CLECs are able to price – at rates competitive with Verizon's – local exchange service that is provided over the same network as their access service.[15] If CLECs can provide local exchange service at prices competitive with Verizon's, there is no reason that cannot use the same network to provide access services at rates comparable to Verizon's.

Given (a) the conspicuous absence of hard evidence of actual switched access costs in the CLECs' case, (b) Dr. Ankum's omission entirely of any discussion of other

[15] *See,* Comcast-CLEC 1-6 ("Joint CLECs, as all firms that operate under competitive conditions, are generally price takers. This means that Joint CLECs set their retail prices relative to market conditions."); *see also*, Comcast-CLEC 1-9 ("CLECs are price takers in retail markets and lack the ability to mark up retail rates for internal cost considerations."). *See also*, Tr. 9/25/08 at 499, line 20, and 511, lines 1-8.

costs and cost advantages of CLECs, and (c) the CLEC pricing of other services at competitive rates even though they use the same network, the Department cannot rule out the very likely possibility that, under current regulatory rules, switched access rates up to 15 times (almost 1,400%) that of Verizon's reflect the CLECs' unconstrained market power over captive customers. Indeed, there is affirmative evidence before the Department that access rates are priced so high that some CLECs can actually afford to pay end users with high terminating traffic to become their customers. More than one CLEC in Massachusetts have been able to profit handsomely from the switched access revenues generated by its end-users who are operators of adult chat-lines. AT&T presented evidence of 17 such chat-lines that AT&T found when investigating other issues. They represent an unknown fraction of chat-line customers of CLECs. *See* Exh. DTC-ATT 1-5 (10/03/08 Supplemental Response and Exhibit E to Supplemental Response).[16]

One chat-line telephone number alone had over 60,000 intrastate terminating minutes from AT&T alone during the month of September. *Id.* The local exchange carrier of this customer therefore (whose terminating access rate is roughly $0.04) earned more than $2,400 from AT&T terminating traffic. *Id.* If AT&T's percentage of the terminating traffic is 25%, *the CLEC is earning almost* ***$10,000 in a single month*** *from access on this one customer in switched access alone.* It defies credulity to believe that the cost of providing access service over this one telephone number to this one customer

[16] AT&T understands that its supplemental response filed on October 3 is in the record. At the hearings, Mr. Chattopadhyay requested that AT&T provide any additional evidence of traffic-pumping it may have. *See* Tr. 9/24/08, at 338-340. He further indicated that the supplementation would be entered into the record assuming that the original response is entered into the record. *Id.* The original response was marked and entered into the record. AT&T filed its supplemental response on October 3, 2008, in accordance with the deadline for filing record requests and the Department's rules. *See* 220 CMR §1.11(7) (Department may permit the filing of any evidentiary document after completion of hearing).

is $10,000 per month. There can be no question the CLECs are exploiting their unconstrained market power.

High rates produced by market power are not just and reasonable regardless of who benefits. Nevertheless, it is instructive to consider the incentives created by the present system of uneven rules and competition. There is a huge incentive to seek out (and use the revenues from captive IXCs and their toll customers to pay) end-users who generate high volumes of terminating traffic. And, as we have seen, end-users who generate such levels of terminating traffic often provide services normally associated with the pornography industry. Certainly, the websites associated with the chat-lines that generate large revenues for certain CLECs in Massachusetts do. *See* Exh. DTC-ATT 1-5 (10/03/08 Supplemental Response and Exhibit F to Supplemental Response). Because the revenues that may be shared with such operations are produced by unavoidable access charges imposed upon IXCs and their customers, Massachusetts toll service consumers may end up subsidizing the provision of adult chat-lines. Such access charges are surely not just and reasonable.

3. High Access Rates Are Not Constrained By The "Competition" Described By the CLECs' Witness, But Instead Are An Incentive To Increase Access Rates Even Higher.

The CLECs' witness, Dr. Ankum, argues that CLECs are not sustaining profits in excess of normal profits. *See* Tr. 9/25/08, at 507, lines 22-23. Dr. Ankum's theory is a novel one. He essentially argues that a vertically integrated carrier offering both local and interexchange service, like Verizon, has an incentive to "acquire" an end-user whose service is generating high levels of access charges. *See* Tr. 9/25/08, at 510, lines 16-22. According to Dr. Ankum, the incentive is created by a desire to either obtain the high revenues for itself, or at least to eliminate the payout of high access charges to another

carrier. *See* Tr. 9/25/08, at 495-497. Somehow, the threat of a Verizon trying to take the *retail* customer will mitigate price increases in the *wholesale* market. *See* Tr. 9/25/08, at 500, lines 3-21.

Dr. Ankum agreed that the threat of Verizon trying to take the retail customer would put downward pressure on *retail* rates. *See* Tr. 9/25/08, at 500, lines 6-12; *see also, id.*, at 511, lines 6-14. Unfortunately for the CLECs, Dr. Ankum was never able to describe why competition for the *retail* customer creates an incentive to decrease *wholesale* prices.[17] Strikingly, Dr. Ankum failed to explain why this effect has not played out in the real world after so many years.

In fact, Dr. Ankum was unable to refute the proposition that the competition he identifies will have precisely the opposite effect from the one he claims, that is, that competition for the *retail* customer, who responds to *retail* prices, will create an incentive to *reduce retail* prices *and to increase access* prices to recover the joint and common costs that support both services. *See* Tr. 9/25/08 at 510, line 23, through 511, line 8; *see also*, Tr. 9/25/08 at 511, lines 16-20. Indeed, when asked to refute that possibility, his answer stated the economic facts which show that the possibility he seeks to refute is actually the probability. He stated:

> As I explained earlier, you're in a multiproduct situation, ***where the considerations about individual prices are made jointly with the prices of all these other products that these companies offer*** -- and they may offer 30, 40 different products, ***with a fair amount of shared and common costs***.

[17] Likewise, the CLECs were unable to establish when this phenomenon would begin to take effect, and why it has not already had its claimed effect after so many years of competitive entry. The empirical evidence does not rescue the CLECs theory from its illogical foundations.

See Tr. 9/25/08, at 512. The reference to 30 or 40 different products is a red-herring. While it is true that there may be many different retail products, all but one product are purchased by the retail customer. Thus the relevant consideration in this case is the relative pricing of access services versus retail services as a bundle.

Since these two services, which are produced by a common network with common costs, are paid for by different economic actors, the CLEC's pricing decision boils down to how much of its joint and common costs does it want to recover from retail services purchased by retail customers and how much from access services purchased by IXCs and their customers. The answer obviously depends upon which economic actor makes the economic choice. Any economist should know that the economic incentive is to lower the price faced by the consumer making the choice – in this case, the retail customer. If fewer joint and common costs are recovered by the retail customer, then more of those costs must be recovered from the IXC and its customers – an easy option since the IXCs cannot avoid price increases. This is a classic cost shifting strategy employed by firms that produce products that share joint and common costs for both competitive and non-competitive markets. *See,* ATTACHMENT 1 to this brief for an illustration of this cost-shifting strategy, how it works, and how it should be controlled.

The Department long ago established safeguards to protect against the practice by firms in this situation of shifting disproportionate amounts of common costs to customers without alternatives. In the early days of deregulation in Massachusetts, for example, the Department described a regulatory mechanism by which AT&T could obtain relief from rate regulation for services deemed sufficiently competitive while remaining subject to rate regulation for services not subject to sufficient competition. That mechanism was

designed to ensure that AT&T did not seek to shift recovery of an undue proportion of common costs to the services offered to captive customers in non-competitive markets. *See* D.P.U. 90-133, *AT&T Communications of New England, Inc.* (January 2, 1991), at 32-33 ("AT&T would not be permitted to shift unrecovered costs to other [noncompetitive] service categories."). *See also,* D.P.U. 94-50, *New England Telephone & Telegraph Company dba NYNEX*, Order (May 12, 1995) (regulated utility's incentive to shift costs from its competitive to other operations).[18]

The irony here is that Dr. Ankum has in fact identified precisely the facts that create an incentive for CLECs to *increase* the price of switched access in order to reduce retail rates below market levels. Indeed, in the present situation that incentive is even stronger than in the classic situations that the Department has historically addressed. In the present situation, there is a direct connection between acquiring the retail customer and acquiring the wholesale customer that does not exist in the classic situation. In the classic situation, firms have an incentive to price down to the customer with alternatives while increasing prices to captive customers, but acquisition of the customer in the competitive market does not itself bring with it revenues from the higher priced services in the noncompetitive market. In the unusual situation of switched access, CLECs realize an immediate gain of the high priced access services when the retail customer responds to reduced retail prices. The cost shifting incentive is too strong to resist – a fact confirmed by the extraordinary levels of CLEC access charges.

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[18] Concerns regarding cost shifting of firms producing products for both competitive and non-competitive markets from a common set of costs are not limited to the telecommunications industry. *See, e.g.*, D.T.E./D.P.U. 06-36, *Petition of Bay State Gas Company, pursuant to 220 C.M.R. § 1.04(5), for approval of a proposal to implement an incremental capacity planning standard for grandfathered customers and approval of tariffs M.D.T.E. No. 35, Distribution and Default Service Terms and Conditions, and M.D.T.E. No. 36, Cost of Gas Adjustment Clause*, Order (June 29, 2007).

In any event, the Department should be wary of seeking to implement the CLECs' theory that inordinately high access rates will attract the attention of vertically integrated firms to acquire the customer, thus keeping downward pressure on high access rates. First, there is no evidence that it works. The CLECs presented no evidence of access rate reductions, and their witness did not dispute that the only access rate changes in recent years have been rate increases. *See* Tr. 9/24/08, at 247, line 12; at 248, line 5; at 291, lines 8-14; at 296, lines 9-22. *See also* Exh. RNK-ATT-1-4; Exh. VZ-CLEC 1-11 and all CLEC attachments to VZ-CLEC 1-11. Second, the dynamic that the CLECs' witness identifies is not the efficient competitive response seen in competitive markets. The dynamic Dr. Ankum identifies does not "squeeze" inefficient costs out of the telecommunications market; it merely shifts them to Massachusetts consumers of toll services. Even where Verizon, the vertically integrated firm in Dr. Ankum's example, acquires a retail customer from a CLEC simply to avoid a CLEC's extortionate access rates on its toll services,[19] Verizon must do so by lowering its retail rates below those of the CLEC retail rates that have been cross subsidized with high access rates. Verizon can only do that by shifting its own costs to the toll market. If the CLEC is actually subsidizing its retail rates with revenues from access services, Verizon will have to pay the retail customer the benefit of the subsidy it had been enjoying from the CLEC – a cost that Verizon must recover from other customers. *See* Tr. 9/25/08, at 522-523. The net result is a few lucky, and sometimes not so savory (*see* Exh. DTC-ATT 1-5, 10/03/08

[19] Apart from avoiding the high access rates of the former carrier, the new carrier does not benefit from the high access rates associated with the former carrier, unless – of course – the new carrier also raises its access rates generally.

Supplemental Response), business customers and a "tax" on most Massachusetts consumers to pay for the transfer. *Id.*

* *

In sum, under the current regulatory regime, CLECs are setting access rates that either (a) recover unnecessary and even imprudent costs or (b) produce excess profits that generate a revenue stream so substantial that it can be shared with end-users who produce inordinately high levels of terminating access traffic, such as adult chat-lines. Moreover, the CLECs' witness could not explain any means by which the market would auto-correct, or push down excessive access rates. Indeed, the only dynamic that the CLECs described is one which pushes access rates up, not down. It is a dynamic under which CLECs will seek to retain or acquire profitable retail customers by lowering retail rates to retain the customer and increasing switched access rates to recover the total costs of serving the customer. There is even an incentive to increase the switched access rates to levels that will generate revenues great enough to be shared with the end-user customer.

V. THE PROPOSAL THAT MASSACHUSETTS CAP CLEC RATES AT THE ILEC'S LEVEL IN THE SAME WAY OTHER STATES HAVE DONE IS A REASONABLE METHOD FOR ENSURING THAT CLEC ACCESS RATES ARE JUST AND REASONABLE.

A. THE DEPARTMENT HAS HISTORICALLY USED THE INCUMBENT'S RATE AS A BENCHMARK FOR OTHER CARRIERS PROVIDING SERVICE NOT SUBJECT TO COMPETITION

As noted in Section I, above, Massachusetts has been in the forefront of state commissions turning to competition to discipline the rates of telecommunication carriers. *IntraLATA Competition* But even in that order, the Department also recognized the need for government regulation where markets do not work. *IntraLATA Competition*, at 45.

A history of the Department's decision-making since 1985 is a history of its application of the important principle established in *IntraLATA Competition.* Where market forces are not sufficient to discipline rates for particular services of even non-dominant carriers, the Department has regulated the rates for such services. In 1988, for example, the Department determined that dominant carrier regulation is necessary where a company provides a service to captive customers, even when the company is an otherwise non-dominant carrier. *See* D.P.U. 87-72/88-72, *International Telecharge, Inc.* (1988), at 11-18. The Department found that it was the inability to of customers to access alternative providers at the time they wanted to make the call that made them "captive customers" even though alternative providers existed at other locations. *Id.* As a result, the Department required that alternative operator services providers either provide cost justification or base their rates on New England Telephone's intraLATA rates or AT&T's interLATA rates for similar services. The Department based its determination on the fact that those rates had been found to be just and reasonable based on traditional ratemaking principles. *Id.* To mention just one other, the Department applied dominant carrier regulation to outbound calling by inmates in penal institutions and established a cap based on the usage rates of Verizon Massachusetts. The reason, again: consumers – in that case, inmates – do not have a choice of long-distance provider at a prison payphone. *See* DPU/DTE 97-88/97-18 (Phase II) at 8-10.

B. ADOPTION OF THE PROPOSAL WILL BENEFIT MASSACHUSETTS CONSUMERS.

Under existing competitive conditions in the toll market, CLEC switched access rate reductions will flow through to Massachusetts toll consumers without regulatory intervention. The reason relates not only to the fact that the toll market is "competitive."

It is, indeed, that. But a deeper analysis shows why the competition in the instant case will ensure that the price of wireline toll services, on which access costs are incurred, will go down. The reason is simple: switched access is a cost that must be recovered in wireline toll service, but it is not a cost that must be recovered in the price of the competitive service offered by wireless competitors in the toll market. This creates a constant tension on wireline providers trying to keep their prices down close to those of their wireless competitors. Access is always a cost that will require wireline toll providers to charge more than wireless providers, all else equal. And this differential has created a steady loss of business for wireline toll providers. *See* Tr. 9/24/08, at 309-310. Wireline providers, therefore, will face market pressure to pass through to consumers any reduction in access prices so as to bring their toll rates down closer to those of their wireless competitors. That is the only way that wireline toll providers will be able to stem the loss of toll business. *See* Exh. DTC-ATT 1-3. *See also*, Tr. 9/25/08, at 308-15. *See, especially, id*, at 314 (access is a cost floor below which the price of wireline toll service cannot go when competing with wireless providers who do not pay access).

Moreover, one thing is clear. Under the current regulatory regime, Massachusetts consumers are being forced to pay, through their long distance rates, the unconstrained access charges being imposed by Massachusetts CLECs. Furthermore, as we have seen in only the limited examples above regarding PAETEC, One Communications, and XO, the CLECs in Massachusetts also operate across a very wide footprint. They are not limited to Massachusetts. As a result, there is a strong likelihood that the inflated payments Massachusetts consumers are being forced to pay to the CLECs are not staying in Massachusetts. On the other hand, competition in the toll market, where consumers

have the ability to choose lower cost providers, creates a strong incentive for toll providers to pass on the access rate savings to Massachusetts consumers. In short, access rate reductions are more likely to stay in the pockets of Massachusetts consumers than are unavoidable payments of inflated access charges to CLECs.

Conclusion

CLEC access rates under the current regulatory rules reflect either imprudent costs, or market power over captive customers, or both. Rates that recover imprudent costs and rates produced by the exercise of market power over captive customers are not just and reasonable. Because the Department has a duty to ensure just and reasonable rates, the Department must adopt a new method for ensuring CLEC access rates meet the statutory standard. Verizon's proposal to cap CLEC access rates at Verizon's level is a reasonable, administratively efficient method for ensuring just and reasonable CLEC

access rates. AT&T, therefore, strongly urges the Department to adopt the proposal in this docket.

Respectfully submitted,

AT&T CORP.

By their attorney,

_____/s_____

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