COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND CABLE

D.T.C. 10-2 January 5, 2011

In re Petition of Choice One Communications of Massachusetts Inc., Conversent Communications of Massachusetts Inc., CTC Communications Corp., and Lightship Telecom, LLC for Exemption from Price Cap on Intrastate Switched Access Rates as Established in D.T.C. 07-9.

FINAL ORDER

APPEARNACES: Eric J. Krathwohl, Esq.
Rich May, a Professional Corporation
176 Federal Street
Boston, MA 02110-2223

Paula Foley, Esq.
5 Wall Street
Burlington, MA 01803

FOR: Choice One Communications of Massachusetts Inc., Conversent Communications of Massachusetts Inc., CTC Communications Corp., and Lightship Telecom, LLC
<u>PETITIONER</u>

J. Tyson Covey, Esq.
Mayer Brown LLP
71 S. Wacker Drive
Chicago, IL 60606

Mary E. Burgess, Esq.
111 Washington Ave.
Albany, NY 12210

FOR: AT&T Corp.
<u>INTERVENOR</u>

David W. Bogan, Esq.
Robinson & Cole LLP
280 Trumbull Street
Hartford, CT 06103

John A. Poakeart, Esq.
Robinson & Cole LLP
1055 Washington Blvd.
Stamford, CT 06901

FOR: Comcast Phone of Massachusetts
INTERVENOR

Alan D. Mandl, Esq.
Smith & Duggan LLP
Lincoln North
55 Old Bedford Rd.
Lincoln, MA 01773

Adam L. Sherr, Esq.
1600 7th Ave. Room 1506
Seattle, WA 98191

FOR: Qwest Communication Company LLC
INTERVENOR

Michael Tenore, Esq.
333 Elm Street, Suite 310
Dedham, MA 02026

FOR: RNK Communications
INTERVENOR

Alexander W. Moore, Esq.
125 High Street, Oliver Tower, 7th Floor
Boston, MA 02110-1585

Richard C. Fipphen, Esq.
140 West Street, 27th Floor
New York, NY 10007

FOR: Verizon New England Inc. d/b/a Verizon Massachusetts, MCI Metro Access Transmission Services of Massachusetts Inc. d/b/a Verizon Access Transmission Services, MCI Communication Services Inc. d/b/a Verizon Business Services, Verizon Long Distance LLC, and Verizon Select Services Inc.
INTERVENOR

I. INTRODUCTION

In this Order, the Department of Telecommunications and Cable ("Department") denies the petition of Choice One Communications of Massachusetts Inc., Conversent Communications of Massachusetts Inc., CTC Communications Corp., and Lightship Telecom, LLC (collectively, "One Communications") seeking an exemption from the price cap on intrastate switched access rates as established in D.T.C. 07-9.[1] *See In re Petition of Choice One Communications of Mass. Inc., Conversent Communications of Mass. Inc., CTC Communications Corp. and Lightship Telecom LLC for Exemption from Price Cap on Intrastate Switched Access Rates as Established in D.T.C. 07-9*, D.T.C. 10-2 ("D.T.C. 10-2"), Petition (June 21, 2010). For the reasons discussed below, the Department finds that One Communications' proposed cost analysis model does not comply with industry standards, and therefore the company has not provided adequate cost justification to warrant an exemption from the price cap in accordance with the requirements established in D.T.C. 07-9.

II. PROCEDURAL HISTORY

On June 21, 2010, One Communications filed a petition with the Department seeking an exemption from the Department's established ceiling on the intrastate switched access charges of competitive local exchange carriers ("CLECs"). Petition at 1. As the petition itself was not supported by affidavits or documentary evidence, One Communications explained it would "support this petition by a cost study to be filed in conjunction with One Communications' pre-filed testimony." *Id.* at 1. The Petition additionally requested "that the Department conduct an expedited review of One Communications' cost justification." *Id.* On July 2, 2010, the

[1] *In re Petition of Verizon New England, Inc., MCImetro Access Transmission Services of Mass., Inc., d/b/a Verizon Access Transmission Services, MCI Communications Services, Inc., d/b/a Verizon Business Services, Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance and Verizon Select Services, Inc. for Investigation into the Intrastate Access Rates of Competitive Local Exchange Carriers*, D.T.C. 07-9, *Order* (June 22, 2009) ("D.T.C. 07-9").

Department docketed the matter as D.T.C. 10-2, and requested that One Communications submit its cost study at its earliest possible convenience. *See* D.T.C. 10-2, Letter from Lindsay E. DeRoche, Hearing Officer, Dep't of Telecomms. and Cable, to Eric J. Krathwohl and Paula Foley, Counsel for One Communications at 2 (July 2, 2010). On July 9, 2010, One Communications filed the Cost Study in support of its Petition. *See* D.T.C. 10-2, OneComm Cost Study (July 9, 2010) ("Cost Study"). Contemporaneously with its Cost Study, One Communications filed a motion for confidential treatment[2] pursuant to G. L. c. 25C, § 5. *See* D.T.C. 10-2, Motion of One Communications for Confidential Treatment (July 9, 2010) ("Confidential Motion").

On July 20, 2010, the Department held a public hearing and procedural conference at which it established a discovery and briefing schedule. *See* D.T.C. 10-2, Transcript of Procedural Conference at 40 (July 20, 2010) ("July 20, 2010 Tr."). At the July 20, 2010 procedural conference, the Department also granted the motions for leave to intervene filed by RNK Inc. d/b/a RNK Communications ("RNK"); Verizon New England Inc. d/b/a Verizon Massachusetts, MCI Metro Access Transmission Services of Massachusetts, Inc. d/b/a Verizon Access Transmission Services, MCI Communication Services, Inc. d/b/a Verizon Business Services, Verizon Long Distance LLC, and Verizon Select Services, Inc. (collectively "Verizon"); Comcast Phone of Massachusetts ("Comcast"); Qwest Communication Company LLC ("Qwest"); and AT&T Corp. ("AT&T"). *See* July 20, 2010 Tr. at 12-13.

On August 13, 2010, One Communications submitted pre-filed testimony in support of its petition. *See* D.T.C. 10-2, Docket Sheet at 2 ("Docket"). On September 14, 2010, the

[2] In its motion, One Communications asked the Department to protect from public disclosure the Cost Study and "related testimony and . . . materials (responses and attachments thereto) filed in response to discovery issued by the Department and other parties to [the] proceeding, as may be designated by One Communications as Confidential Materials". *See* Confidential Motion at 1. The Department granted in part and denied in part the Confidential Motion see D.T.C. 10-2, Hearing Officer Ruling Regarding Motion for Confidential Treatment (May 23, 2011).

Department held a technical session attended by the parties, where One Communications presented the mechanics of its Cost Study, conducted using QSI Consulting's Network Usage Cost Analysis ("NUCA") tool, and made available One Communications' technical experts for informal questioning. *See* D.T.C. 10-2, One Communications Technical Presentation on Network Usage Cost Assessment and Cost-Based Access Rates (September 14, 2010). Discovery on One Communications' pre-filed testimony began on August 13, 2010, and ended on September 30, 2010. *See* D.T.C. 10-2, Docket Timeline (July 27, 2010) ("Timeline of July 27, 2010"). On November 1, 2010, AT&T, Comcast, and Verizon filed intervener testimony. Docket at 3. The discovery period on Intervenor testimony ended on November 23, 2010. *See* Timeline of July 27, 2010. On December 15, 2010, One Communications filed a rebuttal to Intervenor pre-filed testimony. Docket at 3. On December 21, 2010, discovery on One Communications' pre-filed rebuttal testimony ended. *See* Timeline of July 27, 2010. On December 22, 2010, all parties submitted witness and exhibit lists to the Department. *Id.*

On December 27, 2010, AT&T filed a motion with the Department for leave to respond to One Communications' rebuttal testimony alleging One Communications' rebuttal improperly addressed new matters outside the scope of proper rebuttal testimony. *See* D.T.C. 10-2, AT&T Communications' Motion for Leave to Respond to New, Improper Material in OneComm Rebuttal Testimony at 1 (December 27, 2010). On December 28, 2010, Verizon also filed a motion seeking leave to respond to One Communications' rebuttal testimony. *See* D.T.C. 10-2, Letter from Richard C. Fipphen, Assistant General Counsel, Verizon, to Lindsay DeRoche, Hearing Officer, Dep't of Telecomms. and Cable at 1 (Dec. 28, 2010). Finding the need for further development of the evidentiary record prior to the evidentiary hearing, the Department granted the right for all parties to file responses to One Communications' rebuttal testimony on

December 30, 2010, and delayed the evidentiary hearing to accommodate the change in procedural schedule. *See* D.T.C. 10-2, Hearing Officer's Ruling Regarding Motions for Leave to Respond to Rebuttal Testimony at 2 (Dec. 30, 2010) ("December 30, 2010 Hearing Officer Ruling"). On January 4, 2011, One Communications filed an appeal of the December 30, 2010 Hearing Officer Ruling.[3] *See* D.T.C. 10-2, One Communications Appeal to the Commissioner Regarding Hearing Officer's December 30, 2010 Ruling on AT&T's and Verizon's Motions for Leave to Respond to One Communications' Rebuttal Testimony, January 4, 2011. On January 7, 2011 the Department adopted a revised procedural schedule. *See* D.T.C. 10-2, Docket Timeline Update (January 7, 2011) ("Timeline Update of January 7, 2011"). On January 10, 2011, parties filed responses to One Communications' rebuttal testimony. *Id.* On January 14, 2011, One Communications' filed a sur-response. Docket at 4. The Department held the evidentiary hearing on January 24, and 25, 2011. *See* January 24, and 25, 2011 Hearing Transcripts.[4] The parties then filed Initial briefs on February 18, 2011, and reply briefs on March 11, 2011.[5] *Id.*

III. <u>ANALYSIS AND FINDINGS</u>

A. Introduction

After careful consideration, the Department finds that the NUCA methodology is not in accordance with the industry standard principles of a Total-Service Long-Run Incremental Cost

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3 In its ruling, the Department denied the appeal of One Communications and affirmed the *Hearing Officer Ruling* of December 30, 2010 granting leave for parties to respond to the Rebuttal Testimony. The Department found that One Communications failed to meet the burden of showing that the *H.O. Ruling* was made in error or that the Hearing Officer abused his discretion in delaying the evidentiary hearing and allowing additional discovery. See D.T.C. 10-2, *Interlocutory Order on Appeal of Hearing Officer's Rulings Regarding Motions for Leave to Respond to Rebuttal Testimony* (March 21, 2011).

4 Citations to hearing transcripts are denoted as "Tr. at page."

5 On March 23, 2011, One Communications filed a Motion to Strike Extra-Record Evidence in the Reply Brief Filed by AT&T ("Motion to Strike"). *See* Docket at 2. Specifically, One Communications objected to AT&T's inclusion of certain arguments and evidence related to the Cost Study's modeling of One Communications' trunk ports, asserting that AT&T is improperly introducing evidence after the record has closed. Motion to Strike at 2. The Department has not relied on any of the material identified in One Communications' Motion to Strike for any aspect of its findings in this Order. Accordingly, the Department does not reach the merits of the Motion to Strike.

("TSLRIC") study, and therefore, the Department denies One Communications' request for exemption from the intrastate switched access rate cap. The Department reaffirms its position that the pricing of monopoly services, such as switched access, must be based on the average incremental cost of the entire service in question. *See* IntraLATA, D.P.U. 94-185, at 14 (1996). As the Department explains, One Communications' Cost Study is neither incremental nor forward looking, and therefore is not an accurate measure of One Communications' actual cost of providing switched access service.

B. The Department's Rate Cap

In D.T.C. 07-9, the Department established its ceiling on the intrastate switched access rates of CLECs after finding that competitive forces failed to discipline prices. *Id*. Given the determination that market power existed, the Department explained that tariffed switched access rates remained *prima face* lawful, but the presumption that they were just and reasonable was removed. *Id.* at 18. Therefore, given the pending Verizon complaint, the Department was obligated to investigate the reasonableness of CLEC intrastate switched access rates. *Id.*

The Department noted that it "has generally evaluated the reasonableness of rates as they relate to 'prudently incurred costs.' " *Id.* at 18 *quoting Town of Hingham v. D.T.E.*, 433 Mass 198, 203 (2001). Specifically, the Department stated that "[c]apping the CLEC's intrastate rate at the LRIC[6] may be appropriate *if* it would more accurately reflect their costs than the Verizon rate." D.T.C. 07-9 at 28 (emphasis added). However, as the Department went on to explain, "the lack of CLEC-specific cost data prevents the Department from making any finding about the reasonableness of CLEC rates based on cost." *Id.* at 20.

While the Department ultimately settled upon the use of Verizon's switched access rate as a proxy for CLEC rates, the Department did state that "[o]n a going-forward basis…to the

6 Long Run Incremental Cost

extent a CLEC is able to demonstrate justifiable costs in excess of the proposed rate cap with cost-specific data, the CLEC shall be granted an exemption." *Id.* at 27. Upon reconsideration, the Department clarified that it "will not issue an exemptive order until it has had the opportunity to make findings of fact on whether the [cost] study is 'in accordance with industry standards' and whether the results warrant an exemption." D.T.C. 07-9, *Order on Motion for Reconsideration and Clarification* at 20 (December 7, 2009) ("Recon Order"). Thus, the burden is on the petitioner in this case to establish that their cost study represents "justifiable costs" and is calculated "in accordance with industry standards". Before evaluating whether One Communications has met this burden, the Department first determines what precisely is the "industry standard." To answer that question, the Department next looks to the history of access charge reform and the guiding standard of cost causation pricing, before reaffirming the adoption of TSLRIC as the standard model of access charge pricing in Massachusetts.

C. Principles of Access Charge Reform

The Federal Communications Commission ("FCC") has long recognized that, "to the extent possible, costs of interstate access should be recovered in the same way that they are incurred, consistent with principles of cost-causation" and that "the cost of traffic-sensitive access services should be recovered through corresponding per-minute access rates" and non-traffic sensitive ("NTS") costs "should be recovered through fixed, flat-rated fees." *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, *First Report and Order* at ¶ 24 (rel. May 16, 1997) ("*First Report and Order*").[7] The FCC's interstate access charge reform orders have consistently sought to bring

[7] *See also In re Access Charge Reform, Price Cap Performance Review of LECs, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249,

the rate structure more in line with these principles. *See In the Matter of Access Charge Reform, Price Cap Performance Review for LECs, Low-Volume Long-Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, *Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45* at ¶ 75 (rel. May 31, 2000) ("*CALLS Order*"); *Cost Review Order* at ¶ 12; *First Report and Order* at ¶ 36.

While the FCC has consistently recognized the importance of these principles, its interstate access charge rules were not always consistent, due to affordability concerns. *See Order on Remand* at ¶ 2; *First Report and Order* at ¶ 24. Specifically, the FCC historically limited the subscriber line charge ("SLC"), a flat monthly charge associated with the interstate costs of the local loop, because of concerns that rates above a certain level would result in customers disconnecting their lines. *First Report and Order* at ¶ 24. This meant that any interstate costs of the loop not recovered through the SLC were recovered through a per-minute rate, the carrier common line ("CCL") charge, charged to interexchange carriers ("IXCs"). *See Order on Remand* at ¶ 2; *Cost Review Order* at ¶ 10; *First Report and Order* at ¶ 24.

In its *First Report and Order*,[8] the FCC examined its existing interstate access charge rate structure, and began reforming its rules to conform with the objectives of the 1996 Act, including removing "implicit subsidies in favor of explicit subsidies where possible."[9] *See Cost Review Order* at ¶ 11-12. The FCC found that the current rate structure, recovering non-traffic sensitive

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96-45, *Order On Remand* at ¶ 2 (rel. July 10, 2003) ("*Order on Remand*"); *In re Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket 96-262, 94-1, *Order* at ¶ 2 (rel. June 5, 2002) ("*Cost Review Order*") (noting that the purpose of recovering costs in the manner in which they are incurred is "[t]o promote economically efficient competition and to avoid cross-subsidization").

8 Reforming access charge rules for price cap carriers.

9 "In light of Congress's command to create secure and explicit mechanisms to achieve universal service goals, we conclude that implicit subsidies embodied in the existing system of interstate access charges cannot be indefinitely maintained in their current form." *First Report and Order* at ¶ 35.

costs through per-minute charges (the CCL) created "an incentive for customers to underutilize the loop by requiring them to pay usage rates that significantly exceed the incremental cost of using the loop." *First Report and Order* at ¶ 69 ("Because common line and other NTS costs do not increase with each additional minute of use transmitted over the loop, the current per-minute CCL charge that recovers loop costs represents an economically inefficient cost-recovery mechanism and implicit subsidy"). Consequently, allowing carriers to recover non-traffic sensitive costs through traffic sensitive rates resulted in high-volume users shouldering a larger share of the non-traffic sensitive costs than low-volume users. *See CALLS Order* at ¶ 23. The result was that "low-volume customers pay rates that are less than the cost of the dedicated equipment." *Id.* at ¶ 129. The FCC found that to the extent that its rules prescribed rates that did "not reflect the underlying cost of providing access service, they could be said to embody an implicit subsidy." *First Report and Order* at ¶ 28.

Accordingly, the FCC sought to align "the access charge rate structure more closely with the manner in which the costs are incurred"[10] and thus "ensure that costs are recovered in the same way that they are incurred."[11] The FCC stated that, "[i]n general, [non-traffic sensitive] costs incurred to serve a particular customer should be recovered through flat fees, while traffic-sensitive costs should be recovered through usage-based rates." *First Report and Order* at ¶ 36. In particular, the FCC found that "the costs of the common line or loop that connects an end user to a LEC's central office should be recovered from the end user through a flat charge, because loop costs do not vary with usage." *Order on Remand* at ¶ 2 (citing *First Report and Order* at ¶ 77). Focusing on maintaining consistency with principles of cost-causation and economic

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10 *Cost Review Order* at ¶ 12.
11 *First Report and Order* at ¶ 36.

efficiency,[12] the FCC also found that "[non-traffic sensitive] costs associated with local switching should be recovered on a flat-rate, rather than usage sensitive basis." *First Report and Order* at ¶ 125.[13]

In the *First Report and Order*, the FCC reformed its rules in line with these principles by creating the presubscribed interexchange carrier charge ("PICC"), which was a flat per-line charge imposed on IXCs to recover any costs beyond those a carrier could recover due to the SLC cap. *See First Report and Order* at ¶ 6. The PICC was subject to a cap as well, and any remaining costs above the PICC cap could be recovered through a CCL charge. *See Order on Remand* at ¶ 6. Even though it did not entirely eliminate the CCL charge, the FCC found that the addition of PICCs in the rate structure "markedly reduced the inefficient per-minute recovery of local loop costs through the CCL charge, and increased the portion of loop costs recovered through flat charges." *Order on Remand* at ¶ 6.

In 2000, the FCC issued the *CALLS Order*, further reforming the interstate access rate structure for price cap carriers[[14]] by setting out a five-year transitional interstate access and universal service reform plan." *Order on Remand* at ¶ 8. In that *Order*, the FCC modified the interstate access rate structure, removing implicit subsidies and creating an explicit interstate access universal service support mechanism to provide support to ILECs and competitive

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12 "Economic efficiency does require that NTS costs, regardless of how they are separated, be recovered in each jurisdiction through flat charges." *First Report and Order* at ¶ 133.

13 "The record before us indicates clearly that the costs of the line side port (including the line card, protector, and main distribution frame) are NTS." *First Report and Order* at ¶ 125. The FCC, thus, reassigned those costs to the common line for price cap carriers, for recovery through the SLC and PICC. *See First Report and Order* at ¶ 125.

14 In 2001, the FCC reformed access charge rules for rate-of-return carriers, consistent with the *CALLS Order* reforms for price cap carriers. *In re Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket Nos. 00-256, 96-45, 98-77,98-166, *Second Report and order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166* at ¶ 11 (rel. Nov. 8, 2001).

providers. *Cost Review Order* at ¶ 14. These reforms included increasing SLC caps to "enable carriers to recover the costs of the loops in a more cost-causative manner, while removing inefficient implicit subsidies"[15] as well as eliminating the PICC for residential and single-line business customers, and capping multi-line business PICCs. *Order on Remand* at ¶ 9. The FCC noted that the rate structure adopted in the *CALLS Order* "furthers the Commission's efforts over the past two decades to eliminate per-minute recovery of common line costs." *CALLS Order* at ¶ 75.

In 2001 the FCC issued the *CLEC Access Reform Order* to ensure that CLEC access charges[16] are just and reasonable, and eliminate the regulatory arbitrage opportunity related to tariffed CLEC access services. *In re Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, *Seventh Report and Order and Further Notice of Proposed Rulemaking* at ¶ 2-3 (rel. Apr. 27, 2001) ("*CLEC Access Reform Order*"). In that *Order*, the FCC found that the structure of the access service market effectively prevented competition from disciplining CLECs' access charges. *See id.* at ¶ 32. Without competition to control those rates, the FCC expressed concern that:

> [I]n this environment, permitting CLECs to tariff any rate that they choose may allow some CLECs inappropriately to shift onto the long distance market in general a substantial portion of the CLECs' start-up and network build-out costs. Such cost shifting is inconsistent with the competitive market that we seek to encourage for access service. Rather, it may promote economically inefficient entry into the local markets and may distort the long distance market. While we seek to promote competition among local-service providers, we also seek to eliminate from our rules

15 *Cost Review Order* at ¶ 40.

16 "Switched access service typically entails: (1) a connection between the caller and the local switch, (2) a connection between the LEC switch and the service wire center (often referred to as 'interoffice transport'), and (3) an entrance facility which connects the serving wire center and the long distance company's point of presence. Using traditional ILEC nomenclature, it appears that most CLECs seek compensation for the same basic elements, however precisely named: (1) common line charges; (2) local switching; and (3) transport." *CLEC Access Reform Order* at ¶ 55.

> opportunities for arbitrage and incentives for inefficient market entry.

Id. at ¶ 33 (citation omitted).

In addressing CLECs' access charges, the FCC reiterated its ongoing goals to make access charges "more economically rational," to align "access rate structures more closely with the manner in which costs are incurred," and to remove "subsidies from access rates." *Id.* at ¶ 8. The FCC also noted that, in addressing CLEC access charge issues, it was necessary to recognize that carriers serve separate groups of customers, in two separate markets. *Id.* at ¶ 38. Specifically, IXCs, who are "subject to the monopoly power that CLECs wield over access to their end users" and those end users "who benefit from the ability, provided by access service, to place and receive long distance calls.[[17]]" *Id*. The FCC recognized that these end users have at least one competitive alternative to CLEC access services, unlike the IXCs, who are subject to the CLECs' monopoly power over their end users. *CLEC Access Reform Order* at ¶ 38.

Accordingly, in the *CLEC Access Reform Order*, the FCC revised its tariffing rules to prevent CLECs from imposing excessive interstate access charges on IXCs through their tariffs through a benchmark approach. *Id.* at ¶ 2. Specifically, CLECs' interstate access charges at or below the benchmark rate, are presumed to be just and reasonable, and, accordingly, may be tariffed. *Id.* at ¶ 40. Interstate access charges above the benchmark are mandatorily detariffed, and may only be charged outside of the regulated tariff process, under agreement with the IXC. *Id*. The order set a schedule transitioning the benchmark rate, over a three year period, to the rate of the competing ILEC. *Id.* at ¶¶ 52-54. The FCC set the ultimate benchmark at this rate to permit CLECs to "receive revenues equivalent to those the ILECs receive *from IXCs*, whether they are expressed as per-minute or flat-rate charges." *CLEC Access Reform Order* at ¶ 54

[17] The FCC found that the benefit end users receive from access service justifies the SLC that ILECs impose on such users. *CLEC Access Reform Order* at ¶ 38.

(emphasis added). The FCC explicitly noted that "[t]his does not entitle CLECs to build into their tariffed per-minute access rates a component representing the subscriber line charge (SLC) that ILECs impose on their end users, or any other charges that ILECs recover from parties other than the IXCs to which they provide access service." *Id.*

The FCC acknowledged that if CLECs' "per-unit costs are higher than those of the ILECs, we will not stand in the way of their recovering those costs" but concluded that it was "necessary to constrain the extent to which CLECs can exercise their monopoly power and recover an excessive share of their costs from their IXC access customers – and, through them, the long distance market generally." *Id.* at ¶ 39. The FCC noted that under this approach, "CLECs will be restricted only in the manner that they recover their costs from those access-service consumers that have no competitive alternative"[18] and that because the end user access service market is unregulated, "CLECs remain free to recover from their end users any greater costs that they incur in providing either originating or terminating access services." *CLEC Access Reform Order* at ¶ 39. As a result, these end users will receive "correct price signals" and have the option to switch to another carrier for access (and likely local exchange) service. *Id.*

D. The TSLRIC Model

When evaluating the reasonableness of prices for a given service in an inefficient market, the Department's concern is that the result resemble as closely as possible that price level which would be seen in a normal competitive market. *See* AT&T Communications of New England, D.P.U. 91-79, at 32 (1992) (finding the goal of rate regulation is to simulate the results of an actual competitive market.) The Department has long established that "properly defined incremental costs should be used as the primary basis for pricing all services, including local exchange service." *See* IntraLATA Competition, D.P.U. 1731, at 38 (1985). This methodology

18 *CLEC Access Reform Order* at ¶ 40.

is widely accepted. *See* D.P.U. 94-185, *Local Comp. Order* at ¶ 675, 4 Colo. Code Regs. 723-2:2463, Conn. Gen. Stat. 283 § 16-247b, 220 Ill. Comp. Stat. 5/13-507. In fact, the FCC has observed that "in competitive markets, the price of a good or service will tend towards its long-run incremental cost." *Local Comp. Order* ¶ 675. The FCC also observed that, "economists generally agree that prices based on forward-looking long-run incremental costs (LRIC) give appropriate signals to producers and consumers and ensure efficient entry and utilization of the telecommunications infrastructure." *Id.* at ¶ 630.

In the past the Department has used different methods to arrive at long-run incremental cost, but in the case of costing services, the Department has endorsed the TSLRIC method. *See* D.P.U. 94-185 at 14. In its order endorsing this method, the Department explained:

> TSLRIC is determined by taking the long-run incremental cost of an entire service and dividing it by the expected output. As a result, TSLRIC is referred to as the average incremental cost of the entire service. It includes all forward-looking costs that are variable with the offering of a service as well as forward-looking, service-specific fixed costs, which are recovered equally from each unit sold. In contrast, LRIC represents the volume-sensitive costs that a firm incurs in producing an additional increment of output. LRIC does not include forward-looking service-specific fixed costs (i.e., costs that do not change as output changes but nevertheless are incurred to produce the service). Thus, TSLRIC is more consistent than LRIC with the principles of common carriage in G. L. c. 159, § 19, which require that monopoly services and essential elements be priced on a nondiscriminatory basis for similarly-situated customers.

See D.P.U. 94-185 at 14, G. L. c. 159, § 19.[19]

[19] Twenty seven states have endorsed, by statute or regulation, the use of TSLRIC/TELRIC. They are: Arizona, Ariz. Admin. Code R14-2; Colorado, 4 Colo. Code Regs. 723; Connecticut, Conn. Gen. Stat. 283 § 16-247b; Delaware, 26 Del. Admin. Code § 4005; Florida, Fla. Stat. Ann. § 364.051; Hawaii, Haw. Admin. Rules § 6-80-42; Illinois, 220 Ill. Comp. Stat. Ann. 5/13-507; Iowa, Iowa Code Ann. § 476.97; Kansas, Kan. Stat. Ann. § 66-2005; Michigan, 2011 Mich. Pub. Acts 58 § 202; Minnesota, Minn. Stat. Ann. § 237.772; Missouri, Mo. Ann. Stat. § 386.020; Nebraska, Neb. Admin. Code Ch. 5, § 002; Nevada, Nev. Admin. Code § 704.7592; New Mexico, N.M. Admin. Code tit. 17, § 11.3.12; North Carolina, N.C. Admin. Code tit. 4, r. 9.7; Ohio, Ohio Rev. Code Ann. § 4901; Oklahoma, Okla. Admin. Code § 165:55-1-4; Oregon, Or. Rev. Stat. § 759.050; South Carolina, S.C. Code Ann. § 58-9-576; Tennessee, Tenn. Code Ann. § 65-5-108; Texas, Tx. Util. Code Ann. § 60.064; Utah, Utah Code Ann. § 54-8b-3.3; Virginia, 20

That TSLRIC is the preferred method for calculating the costs of switched access service is clear. Indeed, One Communications expert witness Dr. Ankum testified "[i]n terms of the cost methodology, we have followed TSLRIC." Jan. 24, 2011 Tr. at 91. The Department thus examines the NUCA model as it relates to the settled principles of a TSLRIC study.

1. The Minute-of-Use Increment is Not Compatible With TSLRIC

Despite One Communications' assertion that NUCA is a total-service study, the scope of the NUCA study is not consistent with the generally accepted understanding of total service. In a TSLRIC study the traditional increment or "S" portion of the study is a distinct service. *See* D.P.U. 94-185 at 29-30. Specifically, "the Department concludes that the term 'service' should be used to identify services which: 1) are available for purchase by consumers or carriers, and 2) have a specific tariffed rate filed with the Department." *Id.* Defining "service" is critical to TSLRIC studies because, as later discussed, the purpose of an incremental cost study is to measure the difference in costs between producing a service and not producing that service in the long run. Jan. 24, 2011 Tr. at 139-141 (agreeing to definition with the proviso that it holds only in the long run.)

The Cost Study, however, does not in fact measure the difference in producing or not producing intrastate switched access service. One Communications testified that its Cost Study increment is "the total volume of use on the network, and that volume reflects the use of access, toll, any kind of uses, voice traffic, that rides over the network." Jan. 24, 2011 Tr. at 141-142. Thus, One Communications' analysis yields a single cost for all of One Communications' voice services which it expresses on a per-minute-of-use basis. As Verizon points out, "[t]he use of a proxy measure, such as minutes, to allocate costs is a tool of FAC [Fully Allocated Cost] studies

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Va. Admin. Code § 5-417-60; Washington, Wash. Admin. Code § 480-80-142; Wisconsin, Wis. Stat. Ann. § 196.015; and Wyoming, Wyo. Stat. Ann. § 37-15-203.

and has no place in a properly conducted incremental cost study for a particular service." *See* Verizon pre-filed panel testimony at 26. The Department agrees.

One Communications states, "[t]he reason we do that is because a minute truly is a minute." Jan. 24, 2011 Tr. at 142. One Communications continues, "[t]he switch, the technology, does not know whether a call is access or local or what have you." *Id.* Therefore, One Communications argues, "[g]iven a minute is a minute, the fair way and the more transparent way is to just say all of these minutes are the same." *Id.* at 145. However, the purpose of a cost study accompanying a petition for exemption from the rate cap is to ensure the actual costs of a tariffed service (here, intrastate switched access) do in fact exceed the Department established cap for that service. *See* D.T.C. 07-9 at 27 (ruling "to the extent a CLEC is able to demonstrate justifiable costs in excess of the proposed rate cap with cost-specific data, the CLEC shall be granted an exemption). One Communications has provided a calculation of its total network costs as allocated by use across all services. This calculation is specific neither to switched access service nor to any tariffed service One Communications offers. As such, the Department finds One Communications' minute-of-use increment incompatible with the established definition of "service" as it relates to TSLRIC studies.

The failure of the Cost Study to measure a distinct service is not the only deviation from the TSLRIC standard made by the NUCA model. The Department next examines the long-run characteristics of One Communications' Cost Study as it relates to the established TSLRIC methodology.

2. NUCA is Not a Long-Run Incremental Model

As previously discussed, the Department uses TSLRIC cost analysis to closely approximate price in a competitive market. *See infra* at 15. As the FCC established, "in competitive markets, the price of a good or service will tend towards its long-run incremental cost." *Local Comp. Order* at ¶ 675. The FCC further explained, "[t]he term 'long-run,' in the context of 'long-run incremental cost,' refers to a period long enough so that all of a firm's costs become variable or avoidable." *Id.* at ¶ 677. In other words:

> Only those costs that are incurred in the provision of the network elements in the long run shall be directly attributable to those elements. Costs must be attributed on a cost-causative basis. Costs are causally-related to the network element being provided if the costs are incurred as a direct result of providing the network elements, or can be avoided, in the long run, when the company ceases to provide them.

Id. at ¶ 691.

One Communications testified to the importance of long-run analysis, stating "[i]f you, however, use the L in TSLRIC, the long-run, that allows you to then to appropriately recognize all these large capital-intensive costs, these fixed costs that don't vary with an individual customer coming or going." Jan. 24, 2011 Tr. at 141. While the Department agrees with One Communications' position with respect to the importance of a long-run study, the Cost Study here fails to appropriately recognize which costs are, in the long-run, causally-related to the provision of switched access service, or any other service.

One Communications argues that under NUCA "all network based costs are considered against the backdrop of all usage." Webber Pre-Filed Testimony at 17. One Communications further contends that "[i]n this way, NUCA's per-minute of use output captures the totality of the demand placed upon the network." *Id.* at 18. However, as discussed above, "[t]he term 'long-run,' in the context of 'long-run incremental cost,' refers to a period long enough so that all of a firm's costs become variable or avoidable." *Local Comp. Order* at ¶ 677. Because NUCA allocates all network based costs equally across units of use, it is impossible to distinguish which costs are variable or avoidable in the long-run. If One Communications were to cease offering switched access service, in the long run, its network based costs under NUCA would remain fixed. The election to allocate total cost across total usage in the NUCA model forecloses on any possibility of identifying service specific incremental costs. Therefore, the Department finds that One Communications' Cost Study is not a long-run incremental cost study.

3. NUCA Fails to Isolate Incremental Costs

The FCC has determined that, "[c]osts are causally-related to the network element being provided if the costs are incurred as a direct result of providing the network elements, or can be avoided, in the long run, when the company ceases to provide them." *Local Comp. Order* at ¶ 691. For a cost to be incremental to a particular service it must be caused by that service or, alternatively, avoided as a result of not providing that service. *Id.* Because multiple telecommunications services are frequently provided over shared network facilities, it is necessary to isolate and apportion the cost of those shared network facilities on a causative basis in order to calculate incremental costs. *Id.* at ¶ 678. One Communications' Cost Study attempts to do this by dividing total network cost by network usage. Jan. 24, 2011 Tr. at 141. As One Communications explains, "[t]he minute-is-a-minute approach recognizes that most of a telecommunications network is constructed to accommodate usage." Ankum Pre-Filed Testimony at 25.

One Communications elaborates, "[t]o the extent that various types of call[s] (e.g., local, toll, access) use the same network functionalities, their respective per minute of use costs are very much the same, hence NUCA's 'a-minute-is-a-minute' approach." *Id.* at 26. One Communications argues that "[t]his approach is more reasonable, because it avoids endless discussion about which calls cause the network to be constructed." *Id.* One Communications contends that "[b]y recognizing all usage on the network, and spreading the costs of shared network facilities over all usage, all services pick up a proportionate share of the costs of shared facilities." *Id.* at 27.

The Department disagrees with One Communications' contentions. As discussed extensively in D.T.C. 07-9, the intrastate switched access market is not competitive. *Id.* at 18. Given the monopolistic characteristics of switched access, there is a strong "incentive to shift costs to those more monopolistic services and attempt to use revenues from those markets to cross-subsidize more competitive service offerings." *See* D.P.U. 1731 at 28, *Local Comp. Order* at ¶ 696. To avoid cross-subsidization, "[t]he Department has found that, even in a noncompetitive market, services should be priced to reflect their incremental costs." *Id.* at 33. In other words, noncompetitive services should be priced to reflect those costs caused by the provision of that specific service.

The Department has found that when identifying cost causation, a key concern is the distinction between traffic-sensitive and non-traffic-sensitive costs. *See* Investigation by the Department of Telecommunications and Energy on its Own Motion in the Appropriate Pricing, D.T.E. 01-20, at 311 (released July 11, 2002). Specifically, the Department is concerned that the inclusion of non-traffic-sensitive costs in traffic sensitive rates could lead to over-recovery and improper subsidization. *Id.* at 309. In the context of determining cost causation for loop costs, the Department has stated, "because an increase in [minutes of use] does not cause an increase in getting started costs (unless Verizon needs to deploy another switch), it is inappropriate to assign these costs to the traffic-sensitive category." *Id.* at 311. Indeed, the Department has on more than one occasion ruled that "the local loop is demanded in its own right, and that the cost of the loop is incurred and easily identifiable when it is provisioned…." *See* Investigation by the

Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation, D.T.E. 01-31-Phase II, at 77 (2002), *See also* New England Telephone and Telegraph Company, D.P.U. 86-33-G at 455 (1989).
For this reason the Department has found that assigning loop costs to non-traffic-sensitive unbundled network elements is methodologically superior to allowing traffic-sensitive recovery. D.T.E. 01-20 at 311.

In seeking to avoid identifying specific causative costs, One Communications' NUCA model treats all costs as being caused by usage in general, and therefore apportions all cost across minutes of use. Ankum Pre-Filed Testimony at 35. This approach ignores longstanding Department precedent by including loop costs and additional fixed costs for recovery in NUCA's traffic-sensitive minute-of-use measurement. *See generally* D.P.U. 1731, D.P.U. 86-33-C, D.P.U. 86-33-G, D.P.U. 94-185, D.T.E. 01-20, D.T.E. 01-31 Phase II. One Communications argues:

> The record in this case does support the Department's revising its 22 year old conclusion regarding loop costs as it pertains to OneComm. Unlike Verizon's residential customers which the Department was considering in its 1989 and 2003 orders, here, OneComm's customers, who are all small and medium sized business customers, do not obtain telephone service solely to receive local service and instead purchase bundles of services, of which but one of many is local service.

One Communications' Reply Brief at 15.

While the Department recognizes that One Communications' customers may purchase bundled packages of services as opposed to local service on its own, the Department does not find One Communications' argument sufficiently compelling to overturn the Department's longstanding conclusion on treatment of loop costs. Ultimately, One Communications' customers are, like the Department found New England Telephone customers to be in D.P.U. 86-

33-G, paying for access. As the Department stated, "[a]ccess is customer-related because it is the demand for lines connecting the customer's premises with the central office that causes these costs to be incurred." D.P.U. 86-33-G at 455. Access is easily assignable because it is clearly the customer initiating service, or any bundle of services, that causes the charge to be incurred. *Id.* at 463-64. Indeed One Communications' acknowledges that its bundled services have monthly recurring portions on their bills regardless of whether the customer has voice traffic on their line. Jan. 24, 2011 Tr. at 183.

The Department reaffirms its finding that customers, bundled or not, are first purchasing access, whether to stand-alone local traffic or bundled voice services. Furthermore, while the Department agrees with One Communications that IXCs are responsible for causing some portion of network costs, the Department rejects the notion that the proper way to account for such costs is to apportion all network costs by minute-of-use. *See* One Communications Reply Brief at 15. Indeed, to paraphrase One Communications' analogy, if a telemarketer calls a customer, the telemarketer has caused a cost to be incurred, and the telemarketer's IXC ought to bear that cost. However, the customer has also caused a cost by requesting access so as to be available to telemarketers, and all others, through One Communications' network. Therefore, the Department finds that NUCA does not measure those costs incremental to intrastate switched access services, and as a result is incompatible with the TSLRIC standard.

4. Recent FCC Developments

In finding that One Communications' Cost Study is incompatible with the TSLRIC standard, the Department has relied entirely on the evidence submitted by One Communications and admitted parties to this case. However, the Department notes recent developments from the FCC which will likely impact CLEC intrastate access rates. On November 18, 2011, the FCC announced that it would be changing its Universal Service and Intercarrier Compensation rules and would move all switched access rates to a bill and keep methodology. In the Matter of Connect America Fund, Docket Nos. 10-90, 09-51, 05-337, 01-92, 96-45, 03-109, 10-208, FCC 11-161, Report and Order and Further Notice of Proposed Rulemaking (rel. November 18, 2011). While it is likely the order will face significant legal challenges, to the extent the order is upheld, the entire issue of CLEC cost justifications of switched access rates may become moot. *Id.* at ¶ 34.

IV. ORDER

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

ORDERED: That One Communications' petition for exemption from the Price Cap on intrastate switched access rates as established by the Department in D.T.C. 07-9 is denied.

By Order of the Department

/s/*Geoffrey G. Why*___________
Geoffrey G. Why, Commissioner

RIGHT OF APPEAL

Appeals of any final decision, order or ruling of the Department of Telecommunications and Cable may be brought pursuant to applicable federal and state laws.