COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND CABLE

D.T.C. 06-61 January 5, 2012

Investigation by the Department of Telecommunications and Energy on its own motion as to the propriety of the rates and charges set forth in the following tariff: M.D.T.E. No. 14, filed with the Department on June 16, 2006, to become effective July 16, 2006, by Verizon New England, Inc. d/b/a Verizon Massachusetts.

ORDER ON RECONSIDERATION

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I. INTRODUCTION

On June 16, 2006, Verizon New England, Inc. d/b/a Verizon Massachusetts ("Verizon") filed proposed revisions to its resale tariff, M.D.T.E. No. 14 ("resale tariff"), with the Department of Telecommunications and Energy[1] ("Department"). *Investigation by the Dep't of Telecomms. and Energy on its own motion as to the propriety of the rates and charges set forth in the following tariff: M.D.T.E. No. 14, filed with the Dep't on June 16, 2006, to become effective July 16, 2006, by Verizon New England, Inc. d/b/a Verizon Mass.*, D.T.E. 06-61, Docket at 1 (June 16, 2007) ("Docket"). The revisions proposed reduced the wholesale discounts for resold services. *Investigation by the Dept. of Telecomms. and Energy on its own motion as to the propriety of the rates and charges set forth in the following tariff: M.D.T.E. No. 14, filed with the Dep't on June 16, 2006, to become effective July 16, 2006, by Verizon New England, Inc. d/b/a Verizon Mass.*, D.T.E. 06-61, *Order* at 1 (Jan. 30, 2007) ("*Order*"). The revisions relevant to this reconsideration included the treatment of indirect expenses[2] in setting the wholesale rate for resold services. *Id.* at 60-71. Verizon argued that these indirect costs are not avoided under the "actually avoided" standard. *Id.* at 61-63. The CLEC Coalition[3] asserted that some level of these expenses are avoided and must be treated as avoided in determining the wholesale discount. *Id.* at 63-66. The Department issued an *Order*, concluding that although avoided indirect expenses may very well exist, the record contained insufficient evidence to calculate

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1 Pursuant to Governor Patrick's Reorganization Plan, Chapter 19 of the Acts of 2007, the Department of Telecommunications and Energy ceased to exist, and the Department of Telecommunications and Cable was created, effective April 11, 2007. For administrative ease "Department" shall refer to both agencies.

2 Indirect expenses are costs not directly attributable to any specific service or function but rather common to many different activities. Examples of indirect expenses include corporate overhead, such as executive salaries, furniture, and computers.

3 CLEC Coalition refers to these six intervening companies collectively: Metropolitan Telecommunications of Massachusetts, Inc. d/b/a MetTel; One Communications; Broadview Networks, Inc.; DSCI Corp.; Eureka Telecom, Inc. d/b/a InfoHighway Communications; and New Horizon Communications. *Order* at 2 n.1.

these costs, and additionally, that *Iowa Utilities Board v. FCC* ("*Iowa II*")[4] prohibited the Department from using a cost-apportioning methodology to calculate the avoided indirect costs for the purpose of setting the wholesale discount. *Order* at 70-71.

This matter comes to the Department for reconsideration of the limited issue of the treatment of indirect costs in setting the wholesale discount. On reconsideration, the Department finds that Verizon failed to satisfy its burden to show that indirect costs are not avoided, and that the record contained substantial evidence of avoided indirect costs that the Department previously ignored based on its mistaken view that *Iowa II* prohibited state commissions from applying a cost-apportioning methodology to determine the avoided indirect costs that must be excluded from the wholesale rate pursuant to 47 U.S.C. § 252(d)(3).

II. PROCEDURAL HISTORY

In June 2006, Verizon filed proposed revisions to its resale tariff[5] along with the direct testimony of Joseph S. Williams, an avoided cost study, and a description of the methodology used in that study. *Order* at 1. The Department opened an investigation into these proposed revisions and, on August 9, 2006, held a public hearing and procedural conference. Docket at 1. The Attorney General filed a notice of intent to participate and several telecommunications companies were granted intervenor status as well.[6] Docket at 1.

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4 *Iowa Utils. Bd. v. F.C.C.*, 219 F.3d 744, 755-756 (8th Cir. 2000), *aff'd in part and rev'd in part on other grounds, Verizon Commc'ns. Inc. v. F.C.C.*, 535 U.S. 467 (2002).

5 On July 7, 2006, the Department suspended the operation of the proposed revisions to the resale tariff pending an investigation. Docket at 1. Verizon withdrew its proposed revisions and resubmitted them with an effective date of December 6, 2006. *Order* at 1. The Department suspended the re-filed revisions until January 31, 2007, pending completion of the investigation. *Id.*

6 AT&T Communications of New England, Inc.; SBC Long Distance, LLC d/b/a AT&T Long Distance; Metropolitan Telecommunications of Massachusetts, Inc. d/b/a MetTel; One Communications; Broadview Networks, Inc.; DSCI Corp.; Eureka Telecom, Inc. d/b/a InfoHighway Communications; New Horizon Communications; and RNK Inc. d/b/a RNK Telecom. Optimal Global Communications was granted limited participant status.

Discovery consisted of several rounds of information requests and responses. Both the CLEC Coalition and Verizon also submitted rebuttal panel testimony. Docket at 2. The parties jointly waived cross-examination and stipulated to the admission of all discovery materials and pre-filed testimony. *Order* at 2. The record in this proceeding consists of the direct testimony of Joseph S. Williams, an avoided cost study with a description of the methodology used in that study, rebuttal panel testimony from both Verizon and the CLEC Coalition, and all responses to discovery.[7] *Id.* at 2-3. Verizon and the CLEC Coalition filed briefs on November 22, 2006 and reply briefs on December 6, 2006. Docket at 3.

On January 30, 2007, the Department issued an *Order* where the Department reviewed Verizon's avoided cost study, which did not include any avoided indirect expenses.[8] *Id.* at 60-71. The Department found that, under the "actually avoided" standard, "there can be, and in fact may be, indirect costs that Verizon avoids as a result of resale activity." *Id.* at 68. However, the Department found that the record did not contain sufficient evidence of "the existence or level, if any, of those expenses" to conclude that such costs exist in Massachusetts. *Id.* at 70. The Department reached that conclusion because it interpreted *Iowa II* to prohibit the use of the cost-apportioning methodology proposed by the CLEC Coalition, and concluded that without the use of such methodology, there were no means of determining avoided indirect costs for the purposes of calculating the resale discount. *Id.* at 71.

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[7] As in the *Order*, and for convenience, discovery responses will be referred to by their information request reference number. Verizon's direct testimony of Joseph S. Williams, its avoided cost study, and a description of the methodology used in the cost study are referred to as Exh. VZ-1 and Verizon's rebuttal testimony is referred to as Exh. VZ-2. The CLEC Coalition's panel rebuttal testimony is referred to as Exh. CC-1.

[8] The indirect expenses at issue are included in the following accounts or sub-accounts: (1) 612300 – Office Equipment Expenses; (2) 612400 – General Purpose Computer Expenses; (3) 67110500 Executive Expenses – Marketing Operations-C; (4) 67111500 Executive Expenses – Customer Services-C; (5) 672300 – Human Resources; and (6) 672800 – General and Administrative.

On February 20, 2007, the CLEC Coalition filed a Motion for Reconsideration ("Motion"). Verizon filed its response on March 7, 2007. Response of Verizon Massachusetts to Motion for Reconsideration of the CLEC Coalition at 2-4 ("Response"). Additionally, the CLEC Coalition submitted a request to suspend Verizon's compliance tariff pending an order on its Motion for Reconsideration. Alternatively, the CLEC Coalition requested that should the Department decline to suspend the tariff, the resale rates be subject to a true-up as of the March 17, 2007 effective date of the resale tariff in the event the Department granted the CLEC Coalition's Motion for Reconsideration. Request to Suspend Verizon's Compliance Tariff at 1 n.2. Verizon submitted its Opposition to the Request to Suspend on March 12, 2007, urging the Department to allow the new rates to take effect on March 17, and suggesting a true-up back to that date, if tariff revisions were ordered upon reconsideration. Opposition of Verizon Massachusetts to Request to Suspend Compliance Tariff at 1. On March 16, 2007, the Department issued a *Letter Order*, declining to suspend the compliance tariff, but finding that a true-up to the March 17, 2007 effective date of the resale tariff would be appropriate should the Department grant the CLEC Coalition's Motion for Reconsideration. *Investigation by the Dep't of Telecomms. and Energy on its own motion as to the propriety of the rates and charges set forth in the following tariff: M.D.T.E. No. 14, filed with the Dep't on June 16, 2006, to become effective July 16, 2006, by Verizon New England, Inc. d/b/a Verizon Mass.*, D.T.E. 06-61-A, *Letter Order* at 2 (Mar. 16, 2007) ("*Letter Order*").

The CLEC Coalition sets forth four arguments on reconsideration. First, it argues that under G. L. c. 159, § 20, Verizon was responsible for showing that there were no avoided indirect costs, and that Verizon failed to meet that burden. Motion at 4-5. The CLEC Coalition also asserts that Verizon's position was unlawful in that it permitted it to incur wasteful and

imprudent expenditures. *Id.* at 6-7. Thirdly, the CLEC Coalition argues that the Department erred in not finding substantial evidence in the record to find that indirect costs will be avoided. *Id.* at 7-9. Lastly, the CLEC Coalition argues that the Department was mistaken in concluding that *Iowa II* prohibited state commissions from using a cost-apportioning methodology to determine avoided indirect costs. *Id.* at 9.

Verizon argues that the setting of wholesale rates is governed by federal law and that the burden placed on the carrier under G. L. c. 159, § 20, is not applicable in determining wholesale rates. Response at 2-4. Verizon further argues that the cited standard that evaluates waste and prudency is outdated and additionally not relevant to this matter. *Id.* at 4- 6. Verizon asserts that the Department was correct in determining that the record did not contain substantial evidence to justify a finding that indirect costs will be avoided, and that the argument that substantial evidence was present in the record is simply a rehashing of the CLEC Coalition's earlier arguments. *Id.* at 6-7. Lastly, Verizon concedes that the Department might have overstated the *Iowa II* holding, but asserts that that determination was simply an alternate basis for the holding in the *Order*, and not necessary to uphold the original *Order*. *Id.* at 8-9.

On September 26, 2011, the Department held a status conference at which it invited the parties to submit supplemental briefs regarding any legal developments that the parties wished the Department to consider prior to issuing this Order. Both the CLEC Coalition and Verizon declined this invitation. In light of the absence of additional briefing on the issues presented by the pending motion for reconsideration, the Department issues this decision.

III. ANALYSIS AND FINDINGS

The Department considers motions for reconsideration only when required to do so by extraordinary circumstances. *See Investigation by the Dep't, on its own motion, into the*

calculation and allocation of margins derived from the Gas Serv. Agreement between N. Attleboro Gas Co. and Metalor USA Ref. Corp, D.P.U., 94-130-B., *Order on Motion By N. Attleboro Gas Co. for Clarification and Reconsideration* at 2 (Sept. 15, 1995) ("*N. Attleboro Gas*"); *Investigation by the Dep't into the propriety of the cost studies filed by New England Tel. & Tel. Co. on Apr. 18, 1986, pursuant to the Dep't's Orders in D.P.U. 1731*, D.P.U. 86-33-J, *Order on Motions for Recalculation and Reconsideration* at 2 (June 23, 1989) ("*New England Tel. & Tel.*"). In those instances, the Department takes a "fresh look at the record for the express purpose of substantively modifying a decision reached after review and deliberation." *See N. Attleboro Gas* at 2; *New England Tel. & Tel.* at 2. A party may argue on reconsideration that the Department's treatment of an issue was the result of mistake or inadvertence. *See Investigation by the Dep't on its own motion as to the propriety of the recovery by Mass. Elec. Co. of additional Conservation and Load Mgmt. charges in 1991 through a new standard fuel clause, M.D.P.U. 797*, D.P.U 90-261-B at 7 (Feb. 7, 1991); *New England Tel. & Tel.* at 2.

Under the Telecommunications Act of 1996 ("1996 Act"), incumbent local exchange carriers ("ILECs") must "offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers." 47 U.S.C. § 251(c)(4)(a). The 1996 Act charges state commissions with determining the wholesale rate charged to competitive local exchange carriers ("CLECs") on the basis of the retail rate charged to subscribers, but "excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided." 47 U.S.C. § 252(d)(3).

In its *Local Competition Order*,[9] the Federal Communications Commission ("FCC") promulgated national rules for use by state commissions in establishing, arbitrating, and reviewing wholesale prices for telecommunications services. The *Local Competition Order* established a "reasonably avoidable" cost standard that required state commissions "to make an objective assessment of what costs are reasonably avoidable when a [local exchange carrier ("LEC")] sells its services wholesale." *Local Competition Order* at ¶¶ 911-912. That *Order* further determined that under the "reasonably avoidable" standard, state commissions must include indirect expenses in avoided cost studies. *Id.* at ¶ 912.

On July 18, 2000, the United States Court of Appeals for the Eighth Circuit vacated the FCC's "reasonably avoidable" cost standard in *Iowa II*. *Iowa II* at 755-56. The Eighth Circuit held that "[t]he plain meaning of the statute is that costs that are actually avoided, not those that could be or might be avoided, should be excluded from the wholesale rates." *Id.* at 755. The Eighth Circuit noted that the "statute recognizes that the ILEC will itself remain a retailer of telephone service with its own continuing costs of providing that retail telephone service" and that "[u]nder the statute as it is written, it is only those continuing costs of providing retail telephone service which will be avoided by selling to the competitor the services it requests which are to be excluded." *Id.*

In 2003, the FCC issued a Notice of Proposed Rulemaking, seeking comment on whether the FCC should adopt new rules on setting the wholesale discount in light of *Iowa II*. *In the Matter of Review of the Comm'n's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Serv. by Incumbent Local Exchange Carriers*, 18 F.C.C.R. 18,945, *Notice of Proposed Rulemaking* at ¶¶ 141-145 (Sept. 15, 2003). Since then, the FCC has not yet acted to

[9] *In the Matter of Implementation of the Local Competition Provisions in the Telecomms. Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Serv. Providers*, 11 F.C.C.R. 15499, *First Report and Order* (Aug. 8, 1996) ("*Local Competition Order*")

establish new wholesale discount rate regulations, and as such, the applicable standard is that of "actually avoided" costs as described in *Iowa II*. *See Iowa II* at 755.

A. <u>The Authority of State Commissions to Set Rates</u>

The Department concludes that its predecessor misinterpreted the Eighth Circuit's holding in *Iowa II* when it interpreted that decision to prohibit the Department from using a cost-apportioning methodology to calculate avoided indirect costs for the purposes of 47 U.S.C. §252. What the Court actually held was that "the FCC does not have jurisdiction to set the actual prices for the state commissions to use" because "[s]etting specific prices goes beyond the FCC's authority to design a pricing methodology and intrudes on the states' right to set the actual rates pursuant to § 252(c)(2)." *Iowa II* at 757. Moreover, the Court held that the state commission was entitled to "exercise its discretion in establishing rates." *Id.*

The Eighth Circuit did not rule that states were barred from using a cost-apportioning methodology to calculate the resale discount, only that the FCC had no jurisdiction to prescribe the proxy prices[10] at issue in that case. *Id.* That holding is consistent with the Supreme Court's recognition that, under the 1996 Act, Congress had constructed "a hybrid jurisdictional scheme with the FCC setting a basic, default methodology for use in setting rates when carriers fail to agree, but leaving it to state utility commissions to set the actual rates." *Verizon Commc'ns. Inc. v. F.C.C.*, 535 U.S. 467, 489 (2002). On reconsideration, the Department now finds that rather than prohibiting the use of cost-apportioning methodologies by state commissions, *Iowa II* stands

[10] The proxy prices at issue in *Iowa II* included a proxy for the wholesale rate. *Iowa II* at 756-57. That proxy set a range of acceptable interim wholesale rates at 17-25% less than the existing retail rate and permitted state commissions to select an interim wholesale discount rate within that range, while also requiring states to use such interim rates in certain circumstances. 47 C.F.R. § 51.611(b); *Local Competition Order* at ¶ 910. The Court also found those wholesale proxy prices to be "infirm because they rely …on the erroneous definition of 'avoided retail costs.'" *Iowa II* at 757.

for the proposition that rate setting is within the authority of state commissions. *See Iowa II* at 757.

B. <u>Verizon Fails to Present Evidence that Indirect Costs Are Not Avoided</u>

As a preliminary matter, the Department must consider the question of burden of proof. Under 220 C.M.R. § 1.06(6)(f), "in any hearing held upon the Department's own motion or upon petition, the person being investigated or the petitioner, as the case may be, shall open and close." This places the burden of presenting a direct case upon the petitioner or subject of the investigation. *See* 220 C.M.R. § 1.06(6)(f); *Investigation by the Dep't of Telecomms. and Energy, on its own motion, into Boston Edison Co.'s compliance with the Dep't's Order in D.P.U. 93-37*, D.T.E. 97-95, *Interlocutory Order on: (1) Motion for Order on Burden of Proof, (2) Proposed Nondisclosure Agreement, and (3) Requests for Protective Treatment* at 6-7 (July 2, 1998); *Adjudicatory hearing in the matter of complaint of Anne M. Pavilonis relative to rates and charges for services provided by New England Tel. and Tel. Co.*, D.P.U. 431, at 2 (Dec. 28, 1981) (noting that the burden of production and burden of persuasion are both borne by the moving party). *See also*, G. L. c. 159, § 20 ("the burden of proof to show that such increase is necessary to obtain a reasonable compensation for the service rendered shall be upon the common carrier"). Here, Verizon filed revisions to its resale tariff, proposing to change the discounts applicable to its resale services. Letter from John L. Conroy, Vice President, Regulatory MA, Verizon, to Mary L. Cottrell, Secretary, Department of Telecommunications and Energy (June 16, 2006) (on file with the Department). The Department reviewed Verizon's revisions and suspended the operation of those revisions, pending an investigation by the Department. *Investigation by the Dept. of Telecomms. and Energy on its own motion as to the propriety of the rates and charges set forth in the following tariff: M.D.T.E. No. 14, filed with the*

Dep't on June 16, 2006, to become effective July 16, 2006, by Verizon New England, Inc. d/b/a Verizon Mass., D.T.E. 06-61, Notice of Investigation and Public Hearing (July 17, 2006). Accordingly, as the wholesale rate revisions proposed by Verizon are the subject of the Department's investigation, Verizon had the burden of proof with respect to its contention that no indirect costs are avoided as a result of resale.

In an effort to show that no indirect costs are avoided, Verizon offered an analysis purporting to show a lack of causation between a decrease in switched access lines and revenues and changes in three indirect expense accounts[11] for each year from 2001-2005. Exh. DTE-VZ 2-7 & Attachment. In this analysis, Verizon provided correlation coefficients that measure the relationship between switched access lines and both local and total revenue and each of the three indirect expense accounts. *Id.* The analysis also included figures that reflect the extent of a linear relationship between access lines and revenues and expenses, and ones that reflect the proportion of the variance in revenues and expenses attributable to the variance in access lines. *Id.*

On its face, the Verizon analysis indicated a lack of correlation between the indirect expense accounts and changes in switched access lines. *See id.* However, as the CLEC Coalition pointed out, this analysis was flawed because "Verizon's use of correlation coefficients to support its statement that certain indirect expenses will not be avoided is invalid." Reply Brief of the CLEC Coalition at 15; Exh. DTE-CC 2-1 at 6-7. The Department agrees. Correlation does not equate to causation, and the correlation analysis presented here by Verizon does not constitute evidence of *causation*, and thus neither shows that indirect costs are avoided nor that such costs are not avoided. Verizon's approach assumed that any change in expense was caused

[11] At the Department's request, Verizon later provided the same analysis for several previously omitted indirect expense accounts. Exh. DTE-VZ 3-16.

only by a change in switched access lines, and thus failed to account for the impact of any other factors.[12] *See* Exh. DTE-CC 2-1 at 6-7. Verizon itself recognized the limitations of this analysis, noting that "[e]ven if a correlation were to be observed, it would be nearly impossible to isolate the effect of resale from other factors."[13] Exh. DTE-VZ 3-21. Additionally, Verizon's approach improperly assumed that indirect expenses could only be affected by changes in switched access lines occurring within that same year. *See id.*

The remainder of Verizon's evidence consisted of the conclusory statements of its expert witness. Exh. VZ-2 at 14, 18-21 ("The simple fact is that the indirect expenses cited by the CLEC Coalition are not actually avoided when Verizon MA provides services to resellers on a wholesale basis. Verizon MA does not avoid incurring any portion of its indirect expenses because of its wholesale efforts, the standard set forth by the Eighth Circuit.") As previously recognized by this Department, while "even un-corroborated expert testimony is some evidence", it alone does not fulfill the substantial evidence standard. *Order* at 58 (citing *Boston Gas Co. v. Dep't of Telecomm. and Energy*, 436 Mass. 233, 242 (2002); *Mass. Inst. of Tech. v. Dep't of Pub. Utils.*, 425 Mass. 856, 873 (1997). Accordingly, the Department finds that Verizon failed to provide evidence that indirect costs are not avoided and thus failed to satisfy its burden of supporting the proposed changes in its wholesale rates.

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12 For example, changes in special access lines and local private lines would have impacted expenses, but only changes in switched access lines, and not total lines were used in the analysis. *See* Exh. DTE-CC 2-1 at 7.

13 It appears that Verizon offers its analysis with the disclaimer that while any lack of correlation shown between the factors indicates a lack of causation, any correlation shown between them would not actually indicate causation. Exh. DTE-VZ 2-7; Exh. DTE-VZ 3-21. This sort of "heads I win, tails you lose" characterization of the analysis raises serious concerns about the credibility of this evidence.

C. **The Record Contains Substantial Evidence that Indirect Costs Will Be Avoided for the Purpose of Setting Wholesale Rates**

Even though Verizon failed to carry its burden of proof with respect to its claim that no indirect avoided costs exist, the Department must base its own findings as to such costs upon substantial evidence. *See New Boston Garden Corp. v. Bd. of Assessors of Boston*, 383 Mass. 456, 465 (1981). The standard of "substantial evidence" is not easy to define. *See id.* at 465-66. Earlier cases have found it to be "such evidence as a reasonable mind might accept as adequate to support a conclusion." *See id.* (citing *Boston Edison Co. v. Selectmen of Concord*, 355 Mass. 79, 92 (1968) (quoting G. L. c. 30A, § 1). In considering the entire record, the Department takes into account "whether experience permits the reasoning mind to make the finding; … [and] whether the finding could have been made by reference to the logic of experience." *Id.* Additionally, the Department must weigh the evidence and consider whatever in the record "fairly detracts from its weight." *Id.*

As an initial matter, Verizon declined to include indirect costs in its avoided cost calculation. It declined to do so, not based upon any empirical cost data,[14] but upon its interpretation of the Eighth Circuit decision to mean that because all indirect expense accounts "are continuing in nature," no indirect costs are avoided. Exh. DTE VZ 4-2. The Department found that under Verizon's interpretation, the entire cost category of indirect expenses would be categorically excluded from the avoided cost calculation. *Order* at 68. The Department now confirms its earlier holding that Verizon's reading of *Iowa II* is much too narrow, as it would lead to the automatic result of the categorical exclusion of indirect costs from the avoided cost calculation. This would violate of the statutory requirement that when determining wholesale

[14] "Verizon MA's expectation that indirect expenses are not avoided does not rely on empirical cost data as such." Exh. DTE VZ 2-7.

rates, state commissions must exclude the portion of the retail rate attributable to "costs that will be avoided." *Order* at 68. *See* 47 U.S.C. § 252(d)(3).

In the *Order*, the Department acknowledged the likely existence of indirect costs that would be avoided by Verizon, but concluded that the record contained insufficient evidence of the existence or level of such costs in Massachusetts. *Id.* at 68-71 (noting that "there can be, and in fact may be, indirect costs that Verizon avoids as a result of resale activity"). This conclusion by the Department was largely, if not exclusively, a product of the Department's misreading of *Iowa II*, namely, that it prohibited state commissions from using proxies, and thus prohibited the Department from calculating avoided indirect costs through the application of a cost-apportioning methodology. *See id.* at 71. It was because it considered itself prohibited from using such accounting methodologies to calculate the indirect costs that would be avoided that the Department concluded that the record could not support a finding as to the existence or level of avoided indirect costs. *See id.* Accordingly, by misreading *Iowa II*, the Department disregarded substantial support in the record for both the existence of, and a means to calculate, avoided indirect costs through the application of such a cost-apportioning methodology. Disabused of its prior, erroneous view of the holding of *Iowa II*, the Department now concludes that its earlier finding that the record did not contain sufficient evidence of the existence or level of avoided costs was in error.

As discussed above, the analysis and expert testimony presented by Verizon does not constitute substantial evidence that indirect costs will not be avoided. *See supra* Part III.B. While Verizon's evidence fails to support its position that there were no avoided indirect expenses in Massachusetts, the record did contain a cost-apportioning methodology proposed by the CLEC Coalition for determining indirect costs. *Order* at 68-69; DTE-CC 3-1; DTE-CC 3-2.

This type of methodology was previously proposed by Verizon itself in proceedings before the Wireline Competition Bureau of the FCC and the District of Columbia Public Service Commission, and both of those regulatory authorities found this methodology appropriate to identify avoided indirect costs under the "actually avoided" cost standard.[15] *See In the Matter of Petition of WorldCom, Inc. pursuant to Section 252(e)(5) of the Commc'ns Act for Preemption of the Jurisdiction of the Va. State Corp. Comm'n regarding Interconnection Disputes with Verizon Va. Inc. and for Expedited Arbitration*, 18 F.C.C.R. 17722, *Memorandum Opinion and Order* at 17982, 17989-91 (Aug. 29, 2003) ("*Va. Arbitration Order*")[16] (in dealing with the issue of whether indirect expenses would be avoided, the Wireline Competition Bureau applied the "actually avoided" cost standard and found that certain indirect costs were avoided and others were not); *In the Matter of the Implementation of the D.C. Telecomms. Competition Act of 1996 and Implementation of the Telecomms. Act of 1996*, Case No. 962, Order No. 12610, *Opinion and Order* at 28-30 (Dec. 6, 2002) ("*D.C. Order*") (applying same standard and likewise finding some indirect costs avoided and others not avoided).

Verizon cited to two more recent proceedings, in Pennsylvania and in Illinois, where it had submitted cost studies indicating that no indirect expenses were avoided, and it asserts that those studies were found to be consistent with the law. Exh. VZ-2 at 15-18. After review, the Department finds that in each of those cases, the calculation of avoided expenses was not a

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[15] In the *Virginia Arbitration Order* the Wireline Competition Bureau adopted an approach, then proposed by Verizon, for determining costs that it would avoid, with a couple of adjustments to the Office Equipment and Human Resources accounts. *See In the Matter of Petition of WorldCom, Inc. pursuant to Section 252(e)(5) of the Commc'ns Act for Preemption of the Jurisdiction of the Va. State Corp. Comm'n regarding Interconnection Disputes with Verizon Va. Inc. and for Expedited Arbitration*, 18 F.C.C.R. 17722, *Memorandum Opinion and Order* at 17986, 17990 (Aug. 29, 2003) ("*Va. Arbitration Order*").

[16] This *Order* was issued by the Wireline Competition Bureau of the FCC, acting in the place of the Virginia State Corporation Commission. *Va. Arbitration Order* at 17726, 17980. As a result it does not have the same precedential effect as an FCC order.

litigated issue and was instead the product of a negotiated resolution.[17] As the findings regarding indirect costs in the *Pennsylvania Order* and the *Illinois Order* were not the results of litigation of that issue, the Department acknowledges those *Orders*, but finds them not persuasive.

In addition to the cost-apportioning methodology, the CLEC Coalition pointed to $155 million[18] in direct avoided expenses as evidence that at least some associated indirect expenses must be avoided as well. Initial Brief of the CLEC Coalition at 25. The CLECs assert that "a reduction in direct expenses…will also lead to a reduction in related indirect expenses." Reply Brief of the CLEC Coalition at 13. The CLEC Coalition asserts that common sense demands that some indirect expenses must be avoided in light of the direct costs shown to be avoided. Reply Brief of the CLEC Coalition at 13-15.

On reconsideration, and in light of the Department's finding that *Iowa II* does not prohibit state commissions from using a cost-apportioning methodology, the Department considers the findings in the *Virginia Arbitration* and the *D.C. Order* persuasive that some amount of indirect costs are avoided in Massachusetts as well. *See Va. Arbitration Order* at 17989-91; *D.C. Order* at 28; *supra* Part III.A. Additionally, the Department agrees with the CLEC Coalition that common sense dictates that some indirect costs must be avoided when

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[17] In Pennsylvania, the state Public Utility Commission issued an *Order* approving a recommended decision on a negotiated settlement stipulation. *Wholesale Rate for Resale of Telecomms. Servs. Provided by Verizon Pa., Inc. and Verizon North Inc.*, R-00038516, *Order* (Pa. Pub. Util. Comm'n, Mar. 3, 2005) ("*Pa. Order*"). The recommended decision stated that "[i]t is understood and agreed among the Parties that this Settlement is the result of compromises and does not necessarily represent the position(s) that would be advanced by any Party if this proceeding were fully litigated." *Wholesale Rate for Resale of Telecomms. Servs. Provided by Verizon Pa., Inc. and Verizon North Inc.*, R-00038516, Recommended Decision at ¶ 11 (Pa. Pub. Util. Comm'n, Feb. 1, 2004)Verizon concedes that in the proceeding before the Illinois Commerce Commission ("ICC"), the wholesale discount recommended by the staff expert, and found reasonable by the ICC, was the result of negotiations between Verizon and ICC staff. *Verizon North Inc. and Verizon South Inc., Petition Seeking Approval of Cost Studies for Unbundled Network Elements, Avoided Costs and Intrastate Switched Access Services*, 00-0812, *Order* (Ill. Commerce Comm'n May 3, 2006) ("*Ill. Order*"); DTE-VZ 3-20 ("The Illinois avoided cost decision was based on a settlement with the Illinois Staff.").

[18] The total amount of avoided costs in Verizon's avoided cost study was $155 million. Verizon Reply Brief at 15.

direct costs are shown to be avoided in associated cost accounts, and in considering the entire record, "whether experience permits the reasoning mind to make the finding; … [and] whether the finding could have been made by reference to the *logic of experience*" is relevant to the substantial evidence standard. *Boston Edison Co*., 355 Mass. at 92 (emphasis added). The Department finds on reconsideration that substantial evidence exists in the record to find that some indirect costs will be avoided.

As the Department finds that some indirect costs will be avoided, the Department must identify the portion of indirect costs that will be avoided. As recognized in the *Order*, "it is the nature of indirect expenses that renders it difficult to determine their causality" and, accordingly, the Department will prescribe a methodology for determining these costs.[19] *Order* at 70.

In the *Order*, the Department found that because Verizon uses the Uniform System of Accounts ("USOA"), a common set of accounts used by telecommunications carriers, in every state, the accounts and sub-accounts are consistent between the states. *See Order* at 6 & n.8, 59-60. Thus, even though expenses differ from state to state, because the accounts and sub-accounts are uniform, the methodology adopted by the Department, and used in the *Virginia Arbitration*

[19] The Department notes that, in the *Order*, the Department rejected a proxy, proposed by Verizon, based on the mistaken belief that *Iowa II* prohibits the use of proxies, as well as because the avoided cost standard "requires the Department to rely on actual, as opposed to surmised, expenses." *Order* at 38. Verizon did not seek reconsideration of the Department's decision regarding that proxy. The Department declines to revisit that issue, but notes that this decision would not change the result in regards to that proxy. There, in arguing that the expenses corresponding to nine miscellaneous service accounts should be removed from the numerator of the resale discount calculation, when revenues from those service accounts were removed from the denominator, "Verizon proposed the use of a proxy, that determines the percentages of expenses that should be removed based on the percentage of revenue that was removed, the theory being that the revenue and expenses associated with the nine miscellaneous services are roughly equal." *Id.* at 34-38. That proposed proxy was based upon the assumption that a direct relationship exists between revenues generated by a particular service account and the expenses of providing that service. As discussed above, any relationship between revenues and expenses is not that straightforward and, accordingly, the Department cannot adopt a proxy based upon such a relationship. *See supra* Part III.B (discussing the analysis proffered by Verizon). In contrast, the methodology adopted here, which uses previously calculated avoided direct expenses to determine the resulting avoided indirect expenses in associated indirect expense accounts is based on a causal relationship between these expenses. *See D.C. Order* at 28.

Order and in the *D.C. Order*, to identify the extent of the avoided indirect costs, is equally applicable in Massachusetts. *See Order* at 59-60. *C.f. Va. Arbitration Order* at 17989-91; *D.C. Order* at 28. Accordingly, the Department adopts that methodology to determine the indirect costs avoided by Verizon in Massachusetts. *See Va. Arbitration Order* at 17989-91; *D.C. Order* at 28. The Department adopts the following methodology to determine the portion of each indirect expense account that will be avoided.[20]

1. Each function code in the indirect expense account is analyzed to determine if it directly supports an avoided direct function.

2. Indirect expenses are classified as fixed or variable relative to the level of retail output.

3. For expenses that vary with the retail output level, each function code is analyzed to determine the portion that is avoided.[21]

Consistent with the above methodology and the D.C. and Virginia conclusions, the Department finds that indirect expenses in Account 612300 (Office Equipment Expenses), Account 672300 (Human Resources), and Account 672800 (General and Administrative) vary directly with the number of employees and thus are avoided in the ratio of avoided intrastate direct expenses to total company intrastate direct expenses. *C.f. D.C. Order* at 28.

Additionally, the Department, like the D.C. Commission and the Wireline Competition Bureau, finds that some portion of Account 612400 (General Purpose Computer Expenses) is avoided when Verizon offers a part of its services on a wholesale basis. *C.f. Va. Arbitration* at 17989-90. The record in this docket does not contain an analysis on what portion of these costs will be avoided, and hence the Department directs Verizon to submit the calculation of this ratio

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[20] This methodology is consistent with standard cost allocation principles as illustrated by 47 C.F.R. § 64.901 (prescribing a method for assigning or allocating carriers' costs to regulated or nonregulated activities).

[21] *D.C. Order* at 28.

for Massachusetts following the same methodology as detailed in the *Virginia Arbitration*. *See id.* at 17989-90 (agreeing with Verizon's treatment of General Purpose Computer Expenses where Verizon treated as avoided computer expenses associated with a specific functional group when that function was avoided).

The Department also finds that some indirect expenses in Account 67110500 (Executive Expenses – Marketing Operations – C) will be avoided when Verizon offers a part of its services on a wholesale basis. The Department adopts the approach used in the cost study in both the *Virginia Arbitration* and *D.C. Order*, and will use the percentage of avoided cost in the Sales account (6612) for the portion of avoided executive expenses in Account 67110500. Exh. CC-1 at 48.

Similarly, the Department determines that a portion of Account 67111500 (Executive Expenses – Customer Services – C) will be avoided when Verizon offers a part of its services on a wholesale basis. The Department will use the percentage of avoided cost in the Customer Services account (6623), as utilized in the costs studies in both the *Virginia Arbitration* and the *D.C. Order*, for the portion of avoided executive expenses in Account 67111500. Exh. CC-1 at 48. The Department finds this to be a reasonable approach for determining the avoided expenses in Account 67111500 for Massachusetts.

IV. CONCLUSION

As the Department finds that it previously misinterpreted *Iowa II* and erred in concluding that the record contained insufficient evidence of avoided indirect costs, the Department grants the CLEC Coalition's motion for reconsideration and calculates the avoided indirect costs according to the above-described methodology. Verizon shall recalculate the wholesale discount based on the directives contained herein and shall submit such recalculation, with supporting

documentation and workpapers, along with a revised tariff, to the Department within 21 days of the date of this *Order*.

In the *Letter Order*, issued on March 16, 2007, the Department found that "should the CLEC Coalition prevail on its reconsideration request, a true-up would protect the interests of resellers without prejudicing Verizon, and would not be administratively burdensome." *Letter Order* at 2. The Department established a true-up date of March 17, 2007, the effective date of the tariff. *Id*. Thus, Verizon was on notice that it might have to reimburse CLECs pursuant to a true-up should the Department find in the CLEC's favor on reconsideration. Therefore, Verizon shall calculate refunds for those competitive local exchange carriers that purchased resale services during the true-up period, and shall submit such calculation to the Department within 21 days of the date of this *Order*.

V. ORDER

Accordingly, after consideration, it is

ORDERED: That the Motion for Reconsideration submitted by the CLEC Coalition on February 20, 2007 is GRANTED; and it is

FURTHER ORDERED: That Verizon shall recalculate the avoided cost discount rates based on the directives contained herein and shall submit such recalculation, with supporting documentation and workpapers, along with a revised tariff, to the Department within 21 days of the date of this *Order*; and it is

FURTHER ORDERED: That Verizon shall calculate refunds based on the wholesale discount rates established by this *Order* for the true-up period beginning March 17, 2007, the effective date of the tariff as provided for in the *Letter Order*, and submit such calculation to the Department within 21 days of the date of this *Order* and it is

FURTHER ORDERED: That Verizon shall comply with all other directives contained herein.

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.